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

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Credit Profile		
US$585.0 mil GO bnds ser 2015 F due 11/15/2034		
Long Term Rating	AA/Negative	New
US$65.0 mil GO bnds (Green Bnds) due 11/15/2036		
Long Term Rating	AA/Negative	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' rating and negative outlook to the State of Connecticut's $585 million general obligation (GO), 2015 series F bonds and $65 million GO green bonds 2015 series G.

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;
- Ongoing revenues and expenditures that are near alignment, following significant use of one-time budget balancing measures during the last recession;
- Active monitoring of revenues and expenditures to identify and correct mid-fiscal year budget gaps, as exemplified by small midyear budget adjustments made in fiscal years 2015 and 2016; 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, in our opinion, include a history of cyclical budget performance, which has led Connecticut to issue debt to cover operating deficits in recessionary periods, some of which remains outstanding from the last recession. The state's current level of reserves would provide only a modest cushion against an unexpected downturn in our opinion. 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.

Standard & Poor's understands that the series 2015F bonds will be used for various capital projects, while the series 2015G bonds will finance various wastewater treatment facilities, related energy efficiency upgrades, and storm and sanitary sewer separation projections.

A credit bright spot since fiscal 2012 has been the state's commitment to fully fund its actuarial annual required contribution (ARC) for its pension funds; however, the governor recently proposed reducing the state's pension contribution in fiscal years 2017-2044, instead of the current 16-year actuarial amortization of the unfunded pension liability. The goal is to level out projected increasing pension payments attributable to the state employees' oldest Tier 1 pension plan, which has been closed to new employees since 1984. Annual contributions to this tier are projected to increase gradually under the system's assumed 8.0% investment rate of return, but when projected under a lower 5.5% investment return assumption and the current amortization schedule, state contributions would spike sharply from approximately $2.0 billion to $3.1 billion by 2032. The governor's proposal would address the potential market risk of investment returns coming in below actuarial assumptions by instead paying Tier 1 retirement benefits on a pay-as-you-go basis, in effect stretching out Tier 1 payments beyond 2032 and levelling out overall state pension payments below what the state would have otherwise paid after 2018. The proposal would continue to fund the actuarial ARC for the state's remaining Tier 2, 2a, and 3 pension systems, as well as the separate teachers' pension system, although it would stretch out unfunded liability amortization to a rolling 15-year period, which could lower the pension ARC. This would be partially offset by a proposal to lower the current 8.0% assumed actuarial rate of return on the state employees system and the 8.5% assumed for the teachers' system, which would raise ARC payments, but value the pension fund in a more conservative manner. Overall, the proposal would reduce cumulative 2017-2032 state contributions roughly from $8 billion-$20 billion, depending on investment return assumptions, and lower the peak annual payment in 2032 to about $2.0 billion from about $3.1 billion, compared with a 2017 ARC of $1.6 billion.

In our opinion, the pension proposal would represent a significant deferral of unfunded pension liabilities after fiscal 2018, and if implemented in a way that led us to conclude that actuarial unfunded pension liabilities were likely to grow substantially over time, could prompt us to lower the state GO rating one notch. However, we believe there are hurdles to adoption of the proposal, including approval by labor unions and the state legislature, and it is unclear what the final form of any pension changes might look like or what effect on a future actuarial valuation might be. The size of a potential shortfall in annual funding against actuarial ARC is also unclear without an actuarial study--the ARC can be reduced simply by stretching out the unfunded liability amortization period to match the longer amortization periods of some other states. Although the governor has not proposed changes for the separate teachers' pension system at this time, we believe similar projected ARC growth for the teachers' system could also lead to a comparable proposal for that system.

Nevertheless, we believe the pension proposal is an indicator of budget stress because of high fixed costs and the potential difficulty of raising taxes further after recent rounds of increases. The state calculates combined debt service, pension, and OPEB expenses at about 26% of the fiscal 2016 general fund budget, a level we view as elevated.

The state comptroller estimates Connecticut ended fiscal 2015 with what we view as a small $113.2 million general fund balance drawdown, or 0.6% of projected expenditures, on an unaudited budgetary basis of accounting. The deficit was drawn from the state's budget stabilization fund (BSF), leaving it at $406.0 million, or an adequate, if modest, 2.2% of fiscal 2015 estimated general fund expenditures. However, to achieve this essentially break-even result in 2015, Connecticut had to enact multiple rounds of small 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, Connecticut had projected 25% personal income tax growth in April compared with the previous April, but achieved only 14% growth--a strong increase, but below budget.

The state adopted its 2016-2017 biennium budget after closing a projected general fund budget gap of $1.1 billion per year, or about 6% of projected current service expenditures. The gap was largely attributable to slow revenue growth and was closed with a combination of spending cuts and tax increases. The enacted 2016-2017 budget 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 governor has since proposed rolling back about $23 million more of business taxes in mid-2016. The enacted budget increases general fund appropriations in fiscal 2016 by 4.0% 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 gap-closing measures have left Connecticut at what we view as near structural balance under current economic conditions--the state estimates that only about 0.8% of budgeted fiscal 2016 general fund revenue consists of one-time revenue items. We note, however, that 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 the context of an $18 billion annual general fund budget. In our view, 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 2016-2017 budget did change state law to increase the level of reserves in future years, but we do not view this as relevant to our current rating on Connecticut, since it does not take effect until fiscal 2020. Since the change was made under statutory law, it could also potentially be modified before going into effect.

Since enactment of the 2016-2017 biennium budget, the state has identified an additional $221.2 million mid-fiscal 2016 deficit as a result of reduced income tax projections, or 1.2% of forecasted expenditures, which the governor has partially addressed with $102.8 million of midyear spending rescissions in September, leaving a remaining midyear shortfall of $118.4 million, or only 0.7% of appropriations. The governor has proposed minor state workforce reductions, deferred raises for managers, and efficiency improvements as further midyear adjustments, while consulting with the legislature regarding possible budget balancing actions.

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 IHS Global Insight Inc., 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 through September 2015 it has recovered approximately 84% of the jobs lost through the Great Recession. Its real gross state product growth was slightly negative in 2011, but growth 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 Nevertheless, IHS Global Insight estimates that Connecticut experienced modest total employment growth of 0.7% in calendar 2014, and projects 1.7% state employment growth in 2015, 1.1% in 2016, and 0.7% in 2017, led by the services industries, compared with 1.9%, 1.9%, 1.5%, and 1.4%, respectively in those years, for the nation. IHS Global Insight also notes that job growth for the state picked up somewhat in the first quarter of 2015, including in the construction sector, although it still expects annual growth to be below that of 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 September 2015 it was 5.2% on a preliminary basis, compared with 5.1% 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 at fiscal year-end 2015. The operating surplus exceeded an original budget surplus projection of only $4.4 million.

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. This improvement 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 $406 million at fiscal year-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 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. The state recently sold $500 million of GO bonds in August 2015 and $840 million of special tax bonds in October. 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 $3 billion since fiscal year-end 2014. We estimate tax-backed debt per capita at about $6,202 after this sale. Tax-backed debt to income at fiscal year-end 2014 was 8.7%. Our calculation of tax-backed debt service as a percent of total governmental fund expenditures, less federal revenues and restricted grant funds during fiscal 2014, is what we view as high at 12.2%. The governor has proposed a substantial increase in annual transportation capital spending to make up for perceived past underfunding of transportation infrastructure, with up to $6.6 billion of state bonding over five years, consisting mostly of transportation fund secured bonds. The potential exists for substantially more bonding after the initial five-year period under the contemplated program--the governor has proposed up to $100 billion of transportation-related bonds over 30 years. However, we expect additional transportation-related bonds to be contingent on additional transportation-related tax revenue being made available.

We also consider combined unfunded pension liabilities as high, at $52.2 billion at fiscal year-end 2014. Since fiscal 2012, Connecticut has been fully funding its retirement system ARC, including through the adopted 2016-2017 budget, which helps ameliorate what we view as currently low retirement systems' funded levels. 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 if continued. We view the fiscal 2014 pension funded ratio as a relatively low 50% on a combined actuarial basis. The state employees' retirement fund (SERF) 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, 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 2018. 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 negative outlook reflects our view of budget pressure caused by weak revenue growth. We believe evidence of this has occurred in the governor's recent proposal to defer a large portion of the state's pension liabilities through 2032, as well as the multiple rounds of midyear budget cuts in fiscal years 2015 and 2016, 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. Although 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, or adopt significant deferrals to its pension liabilities, 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 to stable.

Government Framework

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

A key feature of Connecticut's governmental framework is 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. As of July 1, 2015, authorized unissued GO debt stood at $3.1 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 28% 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 Nov. 10, 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. Currently, the budgetary reserve is at 2.2% of expenditures, and is not projected to grow in fiscal 2016 and only slightly in 2017.

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. Although 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 previous bienniums have 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 Connecticut's 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 2.9% from 2004-2014, compared with 8.9% 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 that of the nation at 59.8% in 2013.

The state's average unemployment rate in 2014 was 6.6% versus 6.2% for the U.S. The preliminary seasonally adjusted state unemployment rate in Sept. 2015 was 5.2%, again just slightly above the nation at 5.1%. We believe the state's economy exhibits some moderate cyclicality due to exposure to the financial sector. IHS Global Insight has reported that the important financial industry, with its well-paying jobs, has been shrinking in the state since 2008, including a decline of 1.6% in 2014. In 2014, financial activities comprised 7.7% of payroll employment, compared to 5.7% for the nation. Other major sectors include education and health services (19.5% for the state compared with 15.5% for the U.S.); trade, transportation, and utilities (18.1% of state employment, 18.9% of U.S.); government (14.3% of state, 16.0% of U.S.); professional and business services (12.7% of state, 13.7% of U.S.); and manufacturing (9.6% of state, 8.7% of U.S). Key employers include Sikorsky Aircraft (which has announced recent layoffs), Pratt & Whitney, Yale University, and Foxwoods Resort Casino, as well as insurance companies and financial sector firms. Jackson

Laboratories announced a new $1.1 billion project in a state health care center in 2011.

State income levels are strong in our opinion. State per capita income of $64,864 in 2014 was 141% of that of the U.S., and GDP per capita of $70,353 was 129% of that of the nation. However, GDP growth has been below that of the U.S. periodically In 2014, real state GDP rose 0.6% compared with 2.4% for the nation, and 1.0% in 2013 compared with 1.5% for the U.S. Connecticut also experienced greater decline in GDP than the nation during the recession, although annual growth was stronger than that of the nation in 2007 and 2008 before the recession.

The state budget projects personal income growth of 3.6% in fiscal 2016, and 4.4% in fiscal 2017, compared with IHS Global Insight's projected personal income growth of 4.0% in calendar 2016 and 4.8% in calendar 2017. The current projected mid-fiscal 2016 deficit is attributable in part to a downsizing in the state's forecasted personal income tax withholding component growth in fiscal 2016 to 3.2% from an originally budgeted 5.2%.

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

Budgetary Performance

State statutes create what we view as a favorable budget reserve fund structure. State statutes authorize a budgetary reserve fund at a maximum of 10% of general fund appropriations, and requires all unappropriated general fund surpluses go into the budget reserve fund, which can only be drawn on to fund operating deficits. Currently the BSF holds an amount equal to about 2% of general fund spending.

We consider state liquidity as good. The state projects a weekly cash position that runs throughout each current fiscal year. As of Oct. 17, 2015, available pooled cash stood at $2.2 billion. The state sold $560 million GAAP funding bonds in fiscal 2014 to improve its fiscal year-end general fund balance on a GAAP basis, which has boosted its liquidity and allowed the state to transition into budgeting on a GAAP basis. In addition, the state has been able to access external debt markets to sell deficit funding bonds in previous years when it ended in a deficit budgetary position.

We consider Connecticut to have a diverse revenue mix. On a budgetary basis, 53% of fiscal 2015 total general fund revenues were derived from personal income tax, while 24% came from sales tax.

The state has also had a history of making timely midyear budget adjustments, including multiple midyear allotment rescissions imposed by the governor in fiscal 2015, and another rescission in September of fiscal 2016 to close projected midyear gaps.

Connecticut uses a consensus revenue forecasting process to produce a five-year revenue forecast for budgeting purposes. We believe the state has substantial legal authority to cut expenditures, but cyclical revenue trends and high costs in such areas as pension and OPEB may somewhat limit state flexibility. Connecticut considers OPEB benefits as a contractual right of employees.

We believe state budgetary performance has shown cyclical trends, with the state at times issuing deficit financing notes. Currently, Connecticut still has about $520.3 million of deficit financing economic recovery notes outstanding relating to original financing in 2009 of $915.8 million.

In our view, a degree of dependence on top taxpayers, who contribute a greater share of capital gains tax, contributes to cyclicality. The state estimates that millionaires contributed 29.4% of total state income tax collections in 2013.

Connecticut estimates that one-time revenue in its enacted 2016 budget totals about 0.8% of budgeted revenues. The state budget projects personal income growth of 3.6% in fiscal 2016, and 4.4% in fiscal 2017, compared with IHS Global Insight's projected personal income growth of 4.0% in calendar 2016 and 4.8% in calendar 2017. Personal income growth has particular importance, as personal income taxes comprised about 57% of fiscal 2015 general fund tax revenue in fiscal 2015 (53% of total general fund revenue).

A positive inclusion in budgets since fiscal 2012 has been full funding of the annual actuarially required state retirement system pension contribution, using the state's unit credit actuarial cost method, that 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 GAAP basis, using the entry age normal actuarial method. On a GASB 67 GAAP basis, the employees' retirement system has what we regard as a low 39.54% funded ratio (compared with 41.5% using state actuarial assumptions) at fiscal year-end 2014, while the teacher retirement funded ratio, on a GASB basis, has a 61.56% funded ratio. To the extent the governor's recent proposal to move its Tier 1 pension system to a pay-as-you-go funding method, the pension funded ratio could deteriorate.

One potential recent pressure point was a federal review of the state's Medicaid reimbursement. One-half of requested reimbursement for the January through March 2014 quarter was deferred by the federal government earlier in the year pending review. Approval of a state Medicaid Plan Amendment has resulted in the recent release of nearly all of the deferred funds.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.7' to Connecticut's budgetary performance.

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.

We calculate that Connecticut's approximately $22 billion in GO and tax-supported debt, after this upcoming GO sale, puts the state's total tax-supported debt per capita at about $6,202, a level we consider high. Debt levels have been rising: at fiscal year-end 2014, we calculate total tax-supported debt per capita was $5,460, up from $5,137 at fiscal year-end 2013. Connecticut's debt is high compared with that of its peers (see "2015 U.S. State Debt Review: U.S. State Debt Levels May Be More Sustainable Than The Condition Of The Nation's Infrastructure," published Oct. 19, 2015, on RatingsDirect). Compared with income, debt ratios were also high at fiscal year-end 2014, in our opinion, at 9.0% of personal income and 7.9% of gross state product. We calculate tax-supported debt service at 12.2% of general governmental expenditures, less federal revenue and restricted grants, in fiscal 2014, which we again consider high. The debt service burden has been stable over time, but recent bond issuance, including the GAAP conversion bonds, additional authorizations, and the governor's proposed new transportation program could increase this fixed-cost burden over time.

The state's new transportation infrastructure program is planned to remedy perceived underinvestment in transportation infrastructure in previous years. The program will take a number of years to ramp up, requiring the hiring of new engineers in the department of transportation and new design work and environmental permits. The new program involves up to $6.6 billion of additional state bonding in the initial five years, including fiscal 2016, consisting mostly of transportation fund secured bonds, and a small portion of new GO bonding. The potential exists for substantial further bonding beyond the initial five-year period, pending approval of future related new revenue.

On a positive note, the amortization of debt outstanding tax-backed debt remains rapid at 65% in 10 years at fiscal year-end 2014 under our calculation. Connecticut's debt profile is largely in fixed-rate obligations, with approximately 11% of state GO debt consisting of variable-rate debt. The state terminated a $280 million interest rate swap agreement on March 1, 2015, and has only limited remaining exposure to swap agreement risk in our opinion. The state has no direct placement debt outstanding.

The State Employees Retirement Fund (SERF) has recorded 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 SERF 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. SERF had an investment return of 5.0% in calendar 2014, below its actuarial assumption, although its five-year return has been 8.6%. Connecticut did not fund the full actuarial 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 GASB 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. As a result, while full annual funding of the pension ARC using the state's unit credit actuarial method has occurred for three fiscal years, it will not necessarily always result in full ARC funding on a GAAP entry age normal method.

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 teachers' system recently lowered its assumed rate of return to 8.0% from 8.5%, which is estimated to raise its unfunded liability by $1.9 billion, for the actuarial valuation to be completed as of June 30, 2016.

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 Debt Levels May Be More Sustainable Than The Condition Of The Nation's Infrastructure," published Oct. 19, 2015). Total unfunded pension liability, as calculated by 2014 combined valuations of $52.2 million, including the judge's retirement system, is high at $7,196 per capita and 11.8% of personal income. On a preliminary "roll forward" basis, using primarily just the SERF 2.76% actual investment return in fiscal 2015, compared with the 8% actuarial return assumption, state actuaries have determined that SERF had an actuarial funded ratio of 43.3% in 2015, and a market value funded ratio of 40.6%.

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 most recent state employee OPEB valuation, as of June 30, 2013, shows an unfunded actuarial accrued liability (UAAL) of $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 ($260.3 million as of June 30, 2015). Pay-as-you-go costs for funding retiree health costs were $538.3 million in fiscal 2015, which was in contrast to the sizable $1.5 billion ARC in 2015.

The unfunded OPEB liability had been $26.6 billion at June 30, 2008. The lower liability 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 forecasted 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 $6,118 per capita, a level we consider high.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '3.3' to Connecticut's debt and long-term liabilities.

Related Criteria And Research

Related Criteria

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria:
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Standby Bond Purchase Agreement Automatic Termination Events, April 11, 2008
- 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, Oct. 20, 2015

Ratings Detail (As Of November 6, 2015)		
Connecticut GO		
Long Term Rating	AA/Negative	Affirmed

Ratings Detail (As Of November 6, 2015) (cont.)		
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		
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) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Negative	New Rating
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		

Ratings Detail (As Of November 6, 2015) (cont.)		
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
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

Ratings Detail (As Of November 6, 2015) (cont.)		
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		
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.