S&P Global Ratings

RatingsDirect®

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

Primary Credit Analyst:
David G Hitchcock, New York (1) 212-438-2022; david.hitchcock@spglobal.com

Secondary Contact:
Eden P Perry, New York (1) 212-438-0613; eden.perry@spglobal.com

Table Of Contents

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

Credit Profile		
US$510.82 mil go rfdg bnds ser 2016B due 05/15/2027		
Long Term Rating	AA-/Stable	New
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO bnds ser 2012 B dtd 04/26/2012 due 04/15/2021-2032		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded

Rationale

S&P Global Ratings has lowered its ratings on the State of Connecticut's general obligation (GO) debt outstanding to 'AA-'from 'AA', appropriation-secured debt to 'A+' from 'AA-', and Connecticut's moral obligation debt to 'A-' from 'A'. The outlook on all debt is stable.

At the same time S&P Global Ratings has assigned its 'AA-' rating and stable outlook to Connecticut's $510 million GO refunding bonds.

The downgrade reflects our view of reduced state budgetary flexibility. Substantial revenue shortfalls over the past year have left Connecticut with what we believe are low reserves and an increasing share of the budget devoted to fixed costs. In our opinion, Connecticut has less flexibility to meet unanticipated revenue shortfalls, such as those that occurred in fiscal 2016, and may be poorly positioned should there be a national economic downturn in the next several years. The state is not budgeting to restore reserves in fiscal 2017, and projected out-year budget gaps in 2018 and beyond could prove troublesome in view of Connecticut's historically cyclical finances. Our stable outlook reflects that recent budget adjustments have been largely of an ongoing structural nature. However, rising debt service, pension, and other postemployment benefit (OPEB) costs have pushed fixed costs to what we see as a significant portion of the overall budget and could potentially hamper the state's ability to make further budget cuts should new revenue shortfalls develop. At the same time, tax increases enacted in the last two bienniums have constrained revenue-raising ability, in our view.

Despite multiple midbiennium budget adjustments, state budget reserves have been falling since fiscal 2014. Connecticut's April revised consensus revenue forecast projects a fiscal 2016 general fund operating deficit of $259.1 million, which we calculate will draw down reserves to $149.9 million, or only 0.8% of 2016 net general fund appropriations. The legislature recently passed fiscal 2017 budget cuts of $824.7 million, and additional revenue measures of $136.3 million, which are projected to produce just a $200,000 general fund operating surplus in fiscal 2017. At the same time, the state legislative Office of Fiscal Analysis (OFA) projects a $1.3 billion out-year fiscal 2018 budget gap (6.6% of projected 2018 appropriations) based on maintenance of current service levels, a gap which will need to be addressed in next year's biennium budget. As a result, we expect state reserves will remain low for the foreseeable future.

Budget cuts have had the unintended impact of raising the proportion of the budget composed of fixed costs and constraining future budget-cutting flexibility. The state estimates that if Gov. Malloy signs the legislature's recently passed fiscal 2017 budget revisions, combined debt service, pension, and OPEB costs will comprise 28% of fiscal 2017 general fund appropriations, up from a previously estimated 26% in 2016. Connecticut has recently reduced net bond authorizations by $642 million, a process required by law when debt reaches 90% of the state's statutory debt limit, which could help stabilize future debt service costs.

Based on current state budget projections, we calculate fiscal 2016 general fund revenues have fallen 3.6% below the original budget estimates, and fiscal 2017 revenues will fall 5.1% below, not including enacted revenue enhancement measures. The state attributes much of the revenue shortfall against budget to volatile capital gains taxes, based on a recent study of the 50 largest state taxpayers.

At the same time, we believe Connecticut retains a number of credit strengths that support our 'AA-' rating, which include what we consider:

- High wealth and income levels;
- A diverse economic base, which has experienced cyclical performance over time;
- Ongoing revenue and expenditures that remain near structural alignment, assuming the governor signs the legislature's recent fiscal 2017 budget revisions;
- Active monitoring of revenues and expenditures to identify and correct midfiscal year budget gaps, as exemplified by midyear budget adjustments made for fiscal years 2015, 2016, and 2017; and
- Adequate operating liquidity, which has improved following the state's move to budgeting based on generally accepted accounting principles (GAAP), and issuance of GAAP conversion bonds in 2014 to provide liquidity to assist in the transition.

Offsetting factors, in our opinion, include a history of cyclical state budget performance and currently weak revenue trends. We expect revenue growth to remain slow for the next several years, the result of economic weakness in Connecticut's high-paying financial sector. The state also has what we consider above-average debt levels, high unfunded pension liabilities, and large unfunded OPEB liabilities. These represent a significant fixed-cost pressure, which we expect to remain high for the foreseeable future.

S&P Global Ratings understands that the series 2016B bonds will be used to refund certain debt outstanding.

We believe Connecticut has taken timely midyear corrective action following successive downward revisions in projected fiscal years 2016 and 2017 state income tax. However, because the recent April downward revision in forecast revenue does not allow enough time to make significant adjustments before the June 30 year-end of fiscal 2016, the state will dip into its budget stabilization fund (BSF) for the new $259.1 million estimated 2016 operating deficit. Recent 2017 budget revisions passed by the legislature, but not yet signed by the governor, consist largely of ongoing structural measures, in our opinion. The state estimates only about 2% of 2017 budget items are of a one-time nature, including a $50 million deferral of municipal revenue sharing that we believe could be continued into following years, if necessary.

However, we also believe that the $961 million of midbiennium budget adjustments made for fiscal 2017 leave Connecticut with constrained flexibility to solve future revenue shortfalls, particularly as we believe pension and OPEB costs are likely to grow faster than revenues. Last year, the governor briefly proposed funding less than the actuarial annual required contribution (ARC) for legacy pension plans due to potentially rising pension costs, and we feel the state's large pension liability and potentially weak current investment returns could boost ARC payments. At the same time, an increased matching contribution for annual employee OPEB costs is scheduled to go into effect in fiscal 2018.

Underlying recent revenue shortfalls is continued weakness in income tax, underpinned by the lack of a bounceback in high wage jobs since the last recession. After two rounds of well-publicized tax rate increases in recent bienniums, and the high profile move of General Electric's headquarters to Boston, we believe raising taxes further at this point would be politically difficult.

We view the state's high income level as a key credit strength, with per capita income at 141% of the nation in 2014. However, Connecticut has been slow in regaining its highest paying jobs, which we believe has been pressuring state revenues. The state estimates that it has only recovered 8,200 of the 54,100 jobs lost during the financial crisis that payed wages of more than $80,000, while adding 61,500 jobs paying wages under $50,000, compared with 39,900 jobs lost in that category during the recession. Connecticut has one of the highest concentrations of financial services employment in the country, at 8% of total jobs as of 2014, according to IHS Global Insight Inc., which reports this sector has had consecutive years of job losses since 2008, and forecasts average Connecticut financial sector job losses of 1.2% per year through 2020. Nevertheless, IHS Global Insight estimates that Connecticut experienced slow 0.7% total employment growth in calendar 2015, compared with 2.0% for the nation. IHS Global Insight projects 1.1% state employment growth in 2016, and 0.8% in 2017, led by the services industries, although it projects continued slower state employment growth than that of the nation. Connecticut's unemployment rate remains slightly elevated compared with that of the U.S., but has improved since the recession, dropping to 5.6% in 2015 (compared with 5.3% for the nation) from 9.3% in 2010, according to the federal Bureau of Labor Statistics.

We consider Connecticut's level of approximately $22 billion in tax-backed GO and transportation debt, after an expected sale of $300 million of new money series 2016C bonds in a few weeks, to be high and rising slowly. At fiscal year-end 2015, we calculate the state had $5,716 of tax-backed debt per capita. Combined GO, capital lease, and transportation special tax bonds outstanding have risen by about $1.4 billion since fiscal year-end 2014. We estimate tax-backed debt per capita at about $6,023 after the expected series 2016C sale. Fiscal year-end 2015 tax-backed debt to income was 8.5%. Our calculation of tax-backed debt service as a percent of total governmental fund expenditures, less federal revenues and restricted grant funds during fiscal 2015, is what we view as high at 12.3%. 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, and the state senate has passed cancellation of $642 million of net bond authorizations as the state approaches 90% of its statutory debt cap. The state house is expected to pass the bill in the coming days.

We consider combined unfunded pension liabilities as high, at $26.6 billion at fiscal year-end 2015. Since fiscal 2012, Connecticut has been fully funding its retirement system ARC, a bond covenant requirement of its previous pension bonds issuance, which helps ameliorate what we view as currently low retirement systems' funded levels. The state funds the 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 eventually lead to a fully funded system if continued. We view the fiscal 2015 pension funds' combined 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 43.3% using state actuarial assumptions), while the teacher retirement funded ratio on a GASB basis was 61.51%.

In addition, we consider OPEB high at $22 billion, including both the SERF's 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. A score of '2.0' is indicative of a 'AA' rating. However, we have reduced our rating one notch, as permitted under our state rating criteria, to reflect what we believe will be continuing minimal reserve levels and high fixed costs.

Outlook

Our stable outlook assumes state budget-cutting and revenue-raising flexibility will remain constrained by low fund balances and high fixed costs, but that Connecticut can achieve near structural budget balance during periods of economic expansion. The current rating level contemplates that the state could fall out of structural budget alignment during economic downturns, and will likely maintain what we would characterize as low reserve levels over our two-year outlook horizon, despite national economic growth. Connecticut previously issued debt to cover operating deficits during recessions, some of which remains outstanding from the last economic downturn.

Should Connecticut restore material budgetary flexibility either through the build-up of material ongoing reserve levels, or if fixed costs fall as a percent of budget, we could potentially raise our rating on the state. However, should unfunded pension or OPEB liabilities rise significantly, or large revenue shortfalls reoccur without additional offsetting budget adjustments, we could lower our rating.

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, Connecticut 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 Feb. 15, 2016, authorized unissued GO debt stood at $3.1 billion, which does not take into account $500 million of issued series 2016A bonds, $300 million of series 2016C bonds that are expected to be issued shortly, and net cancellation of $642 million of bond authorizations by the state senate, which is waiting deliberation in the state house of representatives. Cancellation of debt authorization must be considered by state statute when Connecticut's debt approaches 90% of the state debt limit.

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. It has relatively broad service responsibilities with about 28% of the state's 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), S&P Global Ratings 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 OFA 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. At the end of fiscal 2015, the budgetary reserve was at 2.2% of expenditures, and is projected to fall to 0.8% at the end of fiscal 2016, with little change expected in fiscal 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), S&P Global Ratings assigned a score of '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 2.4% from 2005-2015, compared with 8.8% for the nation, according to the U.S. Census Bureau. Population has declined in each of the past two years, with a 0.2% decline from 2013-2015. However, the state's age dependency ratio of nonworking age population-to-total population of 58.7% was slightly better than that of the nation at 60.2% in 2014.

The state's average unemployment rate in 2015 was 5.6% versus 5.3% for the U.S. The seasonally adjusted state unemployment rate in February 2016 was 5.5%, again slightly above the nation's 4.9%, according to the federal Bureau of Labor Statistics. 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, and projects a 1.2% average annual loss of payroll jobs in this sector through 2020. In 2014, financial activities comprised 7.7% of payroll employment, compared with 5.7% for the nation, according to the federal Bureau of Labor statistics. 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, 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 $66,972 in 2015 was 140% of that of the U.S., and GDP per capita of $69,667 in 2014 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 1.0% compared with 2.2% for the nation, and fell 0.5% in 2013 compared with 1.3% growth 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's original budget projected personal income growth of 3.6% in fiscal 2016, and 4.4% in fiscal 2017, compared with IHS Global Insight's current forecasted personal income growth of 3.1% in calendar 2016 and 4.0% in calendar 2017. Recent projected revenue shortfalls are attributable in part to a downsizing in Connecticut's forecasted total personal income tax growth rate.

On a scale from '1.0' (strongest) to '4.0' (weakest), S&P Global Ratings assigned a '1.9' to Connecticut's economy.

Budgetary Performance

State statutes create what we view as a favorable budget reserve fund structure from a legal standpoint, although since fiscal 2014 Connecticut has allowed reserves to be drawn down to what we view as minimal levels, with no plans to replenish reserves through at least fiscal 2017, based on recent 2017 midbiennium budget revisions. We believe OFA projections of substantial out-year budget gaps of $1.3 billion in fiscal 2018 and $1.4 billion in 2019, assuming current service levels and inflation, indicate that replenishing reserves after fiscal 2017 may be difficult.

Connecticut statutes authorize a budgetary reserve fund at a maximum of 10% of general fund appropriations, and require that all unappropriated general fund surpluses go into the budget reserve fund, which can only be drawn on to fund operating deficits. At fiscal year-end 2015, the BSF held an amount equal to about 2.2% of general fund spending, and based on the state's current revenue forecast we calculate that the BSF will be drawn down to 0.8% of appropriations at the end of fiscal 2016, with only a minimal $200,000 additional deposit budgeted for fiscal 2017.

We consider state liquidity as good. Connecticut projects a weekly cash position that runs throughout each current fiscal year. Currently, the state reports its consolidated cash position at $1.8 billion, and weekly cash positions have been running about $500 million above comparable periods in the previous year. 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, Connecticut 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 2015 to close fiscal 2016 projected midyear gaps, as well as additional legislatively enacted adjustments in December 2015 and March 2016. The legislature passed $961 million dollars of midbiennium fiscal 2017 budget revisions in May 2016, including $824.7 million of cuts, to bring balance back to the 2016-2017 biennium budget. The 2017 revisions are currently waiting for the governor's signature.

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. As of Feb. 15, 2016, Connecticut had $352.6 million of deficit financing economic recovery notes outstanding relating to the original deficit bonds in 2009 of $915.8 million. State reserve levels over time indicate cyclical financial performance. The state's BSF was as high as 8.0% of general fund appropriations at fiscal year-end 2008, before dropping to 0.6% at fiscal end 2010, and rising most recently to 3.0% at fiscal year-end 2014. It is budgeted to end with what we calculate a 0.8% balance at fiscal year-end 2016.

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 31.8% of total state income tax collections in 2014, while comprising only 0.7% of income tax filers.

Connecticut estimates that one-time revenue in its originally enacted 2016 budget totaled about 0.8% of budgeted revenues, while we estimate midyear adjustments increased one-time items by about another 0.8%. The state also estimates that if the governor's proposed 2017 midyear adjustments are implemented, only about 2% of fiscal 2017 revenues consist of one-time items following passage by the legislature of midbiennium revisions. The state budget projects revised personal income tax withholding growth on an economic basis of 3.3% in fiscal 2016, not including the effect of tax law changes, and also 3.3% in fiscal 2017, compared with IHS Global Insight's projected personal income growth of 3.1% in calendar 2016 and 4.0% in calendar 2017. However, Connecticut estimates that total taxable income (withholding and estimates and finals only) rose 5.3% in fiscal 2015, rose 0.3% in fiscal 2016, and will grow 2.9% in fiscal 2017, after the inclusion of volatile capital gains and final income settlements. Personal income growth has particular importance, as personal income taxes (withholding and estimates and finals) comprised about 57% of fiscal 2015 general fund tax revenue in fiscal 2015 (53% of total general fund revenue). Capital gains tax is estimated to comprise a large part of personal income tax due to the 31.8% of the personal income tax derived from millionaires, and the 7.7% of estimated state gross income in 2013 derived from capital gains. The state believes that a recent study of the 50 largest taxpayers' returns indicates that less-than-forecasted revenue is largely attributable to fluctuation in capital gains tax.

A positive inclusion in budgets since fiscal 2012 has been full funding of the annual actuarially required state retirement system pension contribution, using Connecticut'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. The 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 43.3% using state actuarial assumptions), while the teacher retirement funded ratio on a GASB basis was 61.51%.

To the extent the governor's recent proposal to move its Tier 1 pension system to a pay-as-you-go funding method was revived, the pension-funded ratio could deteriorate. Currently, a commission is looking at alternatives to the governor's original proposal.

Connecticut 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. In fiscal 2015, the state had a $113.2 million operating deficit, bringing the BSF down to $406.0 million, or 2.2% of budgetary operating expenditures. After originally budgeting for a balanced budget, the state currently projects a $259.1 million general fund operating deficit in fiscal 2016, which would bring the BSF down to $146.9 million, or 0.8% of appropriations.

On a GAAP basis, the most recent audited fiscal year (2015) ended with a negative $148 million total general fund balance position (which includes the BSF), or 1.0% of general fund expenditures and transfers out, somewhat worse than negative $41 million, or 0.3% at fiscal year-end 2014, but 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.

On a scale from '1.0' (strongest) to '4.0' (weakest), S&P Global Ratings assigned a score of '1.8' 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 previous debt issued for state pension liabilities.

We calculate that Connecticut's approximately $22 billion in GO and tax-supported debt, after an expected $300 million series 2016C sale in a few weeks, combined with the recent 2016A GO sale, would put the state's total tax-supported debt per capita at about $6,023, a level we consider high. Debt levels have been rising: at fiscal year-end 2015, we calculate total tax-supported debt per capita was $5,707. Compared with income, debt ratios were also high at fiscal year-end 2015, in our opinion, at 8.8% of 2014 personal income and 8.2% of gross state product. We calculate tax-supported debt service at 12.3% of total GAAP general governmental expenditures, less federal revenue and restricted grants, in fiscal 2015, 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 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. However, Connecticut is in the process of cancelling substantial debt authorizations, as it is required to be considered when approaching 90% of its statutory debt cap.

On a positive note, at fiscal year-end 2015 the amortization of tax-backed debt outstanding remained rapid at 66% in 10 years 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. It has no direct placement debt outstanding.

Because almost all state pension plan liabilities are attributable to either state employees or state-funded teacher pension plans, GASB 68's new accounting breakout of the state-only liability does not appreciably change overall state pension liabilities. The SERF has recorded a significant unfunded pension liability of $14.9 billion as of June 30, 2015, almost unchanged from fiscal 2014, and the SERF actuarial funded ratio in 2015 was low, in our opinion, at 43.3% on an actuarial basis. The market value funded ratio was 40.6%. The actuarial earnings assumption was lowered to 8.00% from 8.25% starting in fiscal 2014. SERF had an investment return of 2.8% in fiscal 2015 and 15.6% in fiscal 2014. Connecticut did not fund the full actuarial ARC in fiscal years 2008-2011, but has effectively funded the full 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 state's pension bond sale a few years ago contained a covenant to maintain full ARC funding, and we anticipate that Connecticut will continue to fully fund the ARC on a unit credit method. The governor released a proposal to fund less than the ARC for the state's oldest tier of pension plans, in part to avoid a spike in annual payments if investment returns came in below assumptions under the state's remaining 17-year amortization of the unfunded liability. The proposal has been tabled and a state commission is now looking at other alternatives, which could include simply extending the amortization period to achieve the same effect.

The Teachers' Retirement Fund had an unfunded liability of $10.8 billion at June 30, 2014, under its most recent valuation, 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 S&P Global Ratings' 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, on RatingsDirect). Total unfunded pension liability, as calculated by 2015 combined valuations of $26.6 billion, including the judge's retirement system, is high at $7,418 per capita and 11.1% of personal income.

Connecticut's OPEB liability is significant compared with that of other states (see "Diverging Trends Underlie Overall Stable U.S. State OPEB Liability," published Nov. 17, 2014), but recent actions to reduce 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 for state employees of $19.5 billion. Connecticut has historically funded 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), but is scheduled to begin a $132.6 million step-up matching contribution to the OPEB fund in fiscal 2018 to match increased employee contributions. Pay-as-you-go costs for funding state employee 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 state employee 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), S&P Global Ratings assigned a score of '3.3' to Connecticut's debt and long-term liabilities.

Connecticut GAAP Financial Summary*

Audited GAAP basis					
(Mil. $)	**2015**	**2014**	**2013**	**2012**	**2011**
General fund (GF)					
Revenue	17,954	17,400	20,135	19,334	17,707
Expenditures	16,936	16,591	18,738	18,406	17,415
Transfers in	206	460	134	414	518
Transfers out	1,375	(1,215)	(1,212)	(1,156)	(1,214)
Other	3	703	4	27	53
Net result	(148)	547	322	212	(351)
Total GF balance	(190)	(41)	(589)	(912)	(1,297)
as % of GF expenditures and transfers out	(1)	(0.3)	(3.4)	(5.3)	(8)
Budget reserve fund (which is included in total fund balance)	406	519	271	93	0
as % of GF expenditures and transfers out	2.2	3.4	1.5	0.5	0.0
Debt service fund					
Revenue and other financing sources	496	466	424	447	448
Expenditures	461	466	467	452	427
Net	9	(1)	(43)	(5)	21
Total fund balance	668	660	660	703	709
Transportation fund					
Revenue	1,372	1,393	1,197	1,214	1,112
Expenditures	907	855	824	802	759
Net transfers and other	(433)	(540)	(353)	(376)	(348)
Net result	32	(2)	20	36	6
Total fund balance	257	227	229	209	200

*Totals may not add due to rounding. GAAP--Generally accepted accounting principles.

Related Criteria And Research

Related Criteria

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- General Criteria: The Interaction Of Bond Insurance And Credit Ratings, Aug. 24, 2009
- USPF Criteria: Moral Obligation Bonds, June 27, 2006

- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- USPF Criteria: Standby Bond Purchase Agreement Automatic Termination Events, April 11, 2008
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011

Ratings Detail (As Of May 19, 2016)		
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Hlth & Ed Fac Auth		
Long Term Rating	AA-/Stable	Downgraded
Connecticut		
Long Term Rating	AA-/Stable	Downgraded
Connecticut approp		
Long Term Rating	A+/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO (AGM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO (AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO (FGIC)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO		
Long Term Rating	AA-/Stable	Downgraded
Connecticut GO		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Capital City Economic Dev Auth, Connecticut		
Connecticut		
Capital City Economic Dev Auth (Connecticut) GOEQUIV		

Ratings Detail (As Of May 19, 2016) (cont.)		
Long Term Rating	AA-/Stable	Downgraded
Capital City Economic Dev Auth (Connecticut) GOEQUIV		
Long Term Rating	AA-/A-1/Stable	Downgraded
Capital City Economic Dev Auth (Connecticut) pkg & energy fee rev		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
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)/Stable	Downgraded
Connecticut Hlth & Educl Facs Auth (Connecticut) state supported rev bnds		
Long Term Rating	A+/Stable	Downgraded
Connecticut Hlth & Educl Facs Auth (Connecticut) APPROP		
Long Term Rating	A+/Stable	Downgraded
Connecticut Hlth & Educl Facs Auth (Connecticut) GOEQUIV		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Hlth & Ed Fac Auth nsg home prog		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Hlth & Ed Fac Auth (Connecticut) nsg home prog taxable		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Hlth & Ed Fac Auth (Connecticut) st univ sys issue		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Hlth & Educl Facs Auth (Connecticut) ser G&H		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
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)/Stable	Downgraded
Connecticut Hlth & Ed Fac Auth (Connecticut) univ issue		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut Hsg Fin Auth, Connecticut		
Connecticut		
Connecticut Hsg Fin Auth (Connecticut) state supported spl oblig bnds		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Hsg Fin Auth spl needs hsg mtg fin prog		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Connecticut Innovations Incorporated, Connecticut		
Connecticut		
Connecticut Innovations Incorporated (Connecticut) gen fd oblig bnds		
Long Term Rating	AA-/Stable	Downgraded
Connecticut Dev Auth (Connecticut) GO		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded

Ratings Detail (As Of May 19, 2016) (cont.)		
University of Connecticut, Connecticut		
Connecticut		
University of Connecticut (Connecticut)		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GO		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GO		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GOEQUIV		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GOEQUIV		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GO rfdg bnds (Connecticut)		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GO rfdg bnds		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut (Connecticut) GO (AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Univ of Connecticut		
Long Term Rating	AA-/Stable	Downgraded
University of Connecticut GO		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Univ of Connecticut GO		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Univ of Connecticut (Connecticut) GO		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded
Waterbury, Connecticut		
Connecticut		
Waterbury (Connecticut) GO spl cap reserve fd		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded

Many issues are enhanced by bond insurance.