

RatingsDirect®

Summary:

**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:

Gabriel J Petek, CFA, San Francisco (1) 415-371-5042; gabriel.petek@spglobal.com

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Credit Profile

US\$585.0 mil go bnds ser 2016E due 10/15/2036

Long Term Rating AA-/Stable New

US\$65.0 mil go bnds (Green Bnds) ser 2016F due 10/15/2036

Long Term Rating AA-/Stable New

Connecticut GO

Long Term Rating AA-/Stable Affirmed

Connecticut Hlth & Ed Fac Auth

Long Term Rating AA-/Stable Affirmed

Connecticut GO (BAM) (SECMKT)

Unenhanced Rating AA-(SPUR)/Stable Affirmed

Connecticut Hsg Fin Auth, Connecticut

Connecticut

Connecticut Hsg Fin Auth spl needs hsg mtg fin prog

Unenhanced Rating AA-(SPUR)/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AA-' rating to the State of Connecticut's \$585 million general obligation (GO) bonds, 2016 series E, and \$65 million taxable GO bonds, 2016 series F-green bonds. At the same time, S&P Global Ratings affirmed its 'AA-' rating on Connecticut's GO debt outstanding, its 'A+' rating on the state's appropriation-secured debt, and its 'A-' moral obligation debt rating. The outlook is stable.

The GO rating on Connecticut reflects our view of the following factors:

- High wealth and income levels;
- A diverse economy, whose performance has been cyclical;
- Ongoing revenue and expenditures that remain near structural alignment;
- 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:

- Above-average debt, high unfunded pension liabilities, and large unfunded other postemployment benefit (OPEB) liabilities, all of which create what we believe are significant fixed-cost pressures that restrain the state's budgetary flexibility;
- A history of cyclical budget performance, and currently weak financial reserves available to cushion against the next economic downturn. We expect revenue growth to remain slow for the next several years, the result of economic weakness in Connecticut's high-paying financial sector.

S&P Global Ratings understands that the series 2016E bonds will be used to fund various capital purposes, while the 2016F bonds are "green" bonds whose proceeds will fund priority clean water projects.

We view the state's high income level as a key credit strength, with per capita income at 140% of that of the nation in 2015, the best in the U.S. However, Connecticut has been slow in regaining its highest-paying jobs, which we believe has been affecting state revenues. The state estimates that it has only recovered 9,000 of the 54,400 jobs lost during the financial crisis that paid wages of more than \$80,000, while adding 53,000 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 7.8% of total jobs in 2015. IHS Global Insight Inc. estimates this sector had consecutive years of job losses between 2008-2014, before a 1.0% gain in 2015 and expected similar growth in 2016. IHS Global Insight estimates total employment rose a slow 0.7% in 2015, compared with 2.0% for the nation, and projects 1.0% state employment growth in 2016, and 0.6% in 2017, led by the services industries. Of note is a recent announcement by Sikorsky Aircraft of a major manufacturing plant expansion, following recent state tax incentives and union wage concessions, as well as a separate plant expansion announced by Pratt & Whitney.

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. As of July 2016, the state's rate was 5.7%.

Substantial revenue shortfalls over the past year have left the state with what we believe are low reserves and an increasing share of the budget devoted to fixed costs, although the budget appears in structural balance at present. In our opinion, Connecticut 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 projects out-year budget gaps in 2018 and beyond that we believe could prove troublesome in view of Connecticut's historically cyclical finances. Rising debt service, pension, and OPEB costs have pushed fixed costs to what we see as a significant portion of the overall budget and could hamper the state's ability to make further budget cuts should new revenue shortfalls develop. At the same time, tax increases in the two most recent biennia have constrained revenue-raising ability, in our view.

Despite multiple midbiennium budget adjustments, budget reserves have been falling since fiscal 2014. Connecticut estimates a fiscal 2016 general fund operating deficit of \$170.4 million, which will draw down the state's budget stabilization fund to \$235.6 million, or only 1.3% of 2016 general fund budgetary basis expenditures. At the end of fiscal 2016, the legislature passed fiscal 2017 budget cuts of \$847.2 million, and additional revenue measures of \$136.3 million, which the state projects will produce just a \$200,000 general fund operating surplus in fiscal 2017.

At the same time, the state legislative Office of Fiscal Analysis (OFA) projected 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 that 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. The state separately estimates that general fund fixed costs alone will increase \$867 million in fiscal 2018. As a result, the governor has ordered state agencies to identify potential 10% budget cuts for the 2018-2019 biennium.

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 combined debt service, pension, and OPEB costs will constitute 28% of fiscal 2017 revised general fund appropriations, up from a previously estimated 26% in 2016. Connecticut reduced net bond authorizations by \$642 million in the most recent budget revisions, a process required by law when debt reaches 90% of the state's statutory debt limit, which could help stabilize debt service costs.

The recent 2017 budget revisions 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 \$983.5 million of midbiennium budget adjustments for fiscal 2017 leave Connecticut with constrained flexibility to solve future revenue shortfalls, particularly because we believe pension and OPEB costs are likely to increase faster than revenues. In 2015, 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 against its assumed 8% rate of return could boost pension payments that are contractually required to match actuarial requirements. At the same time, an increased matching contribution for annual state employee OPEB costs is scheduled to go into effect in fiscal 2018, offsetting a new OPEB valuation released in August 2016 that slightly reduces unfunded OPEB liabilities.

Weak income tax growth has underlined recent revenue shortfalls, particularly in volatile capital gains taxes, underpinned by the lack of a bounce back in high wage jobs since the last recession. After two rounds of well-publicized tax rate increases in recent biennia, and a high profile move of General Electric Corp.'s headquarters to Boston, we believe raising taxes further at this point would be politically difficult.

The state also faces uncertainty following a recent lower court decision that its system of local school aid does not provide equity for poorer schoolchildren under the state constitution. The case is currently on appeal to the state supreme court, and will likely not get resolved for some time, in our view. While the decision does not require Connecticut to increase overall funding for cities and towns, which provide education, we believe pressure could build for such a result in order to hold harmless more wealthy municipalities from state aid cuts, particularly cuts in local aid that have already occurred in current midbiennium budget adjustments.

We consider Connecticut's level of approximately \$23 billion in tax-backed GO and transportation tax-supported debt, after this sale to be high, at \$6,159 per capita. At fiscal year-end 2015, we calculate the state had \$20.5 billion of tax-backed debt outstanding, or \$5,716 of tax-backed debt per capita, including combined GO, capital lease, and transportation special tax bonds. Fiscal year-end 2015 tax-backed debt to income was 8.5%. Our calculation of tax-backed debt service, less federal revenues and restricted grant funds during fiscal 2015, is what we view as high at 12.3% of total governmental fund expenditures. Gov. Dannel Molloy 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 Connecticut has cancelled recently \$642 million of net GO bond authorizations in fiscal 2017 as the state approached 90% of its statutory debt cap.

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 \$21 billion, including both the SERF's recently updated actuarial valuation as of June 30, 2015, and an older June 30, 2014, valuation for 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.

(For more information on Connecticut's GO debt, see the full analysis published May 19, 2016, on RatingsDirect).

Outlook

The stable outlook reflects our assumption that low fund balances and high fixed costs will continue to constrain state budget-cutting and revenue-raising flexibility, but that Connecticut can achieve near structural budget balance during periods of economic expansion. The current rating reflects our expectation 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 the last recession, some of which remains outstanding.

Upside scenario

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 raise our rating on the state.

Downside scenario

Should unfunded pension or OPEB liabilities rise significantly, or large revenue shortfalls reoccur without additional offsetting budget adjustments, we could lower our rating.

Ratings Detail (As Of October 12, 2016)		
Connecticut		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut approp		
<i>Long Term Rating</i>	A+/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO bonds ser 2012 B dtd 04/26/2012 due 04/15/2021-2032		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO bonds ser 2016C due 05/15/2034		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Connecticut GO (AGM) (SECMKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO (AGM) (SEC MKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO (BAM) (SECMKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO (BAM) (SEC MKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO (BAM) (SEC MKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO (FGIC)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed

Ratings Detail (As Of October 12, 2016) (cont.)

Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut GO		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Capital City Economic Dev Auth, Connecticut		
Connecticut		
Capital City Economic Dev Auth (Connecticut) GOEQUIV		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Capital City Economic Dev Auth (Connecticut) GOEQUIV		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth, Connecticut		
Connecticut		
Connecticut Hlth & Educl Facs Auth (Connecticut) rev bnds (Child Care Facs Prog) (ASSURED GTY)		
<i>Unenhanced Rating</i>	A-(SPUR)/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev bnds (Connecticut) (Connecticut State Univ Sys Issue) ser J dtd 06/22/2011 due 11/01/2012-2031		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev bnds (State Univ Sys Issue) ser D-1&2 dtd 03/15/2002 due 11/01/2003-2022		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev rfdg bnds (Connecticut) (Connecticut State University System Issue) ser P-1 due 11/01/2036		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev rfdg bnds (Connecticut) (Connecticut State University System Issue) ser P-2 due 11/01/2035		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev rfdg bnds (Connecticut) (Connecticut State Univ Sys Issue) ser K dtd 06/22/2011 due 11/01/2012-20		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev rfdg bnds (Connecticut) (Connecticut St Univ Sys Issue) ser L dtd 04/04/2012 due 11/01/2012-2029		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) state supported rev bnds		
<i>Long Term Rating</i>	A+/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) APPROP		
<i>Long Term Rating</i>	A+/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) GOEQUIV		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Ed Fac Auth nsg home prog		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) nsg home prog taxable		
<i>Long Term Rating</i>	AA-/Stable	Affirmed

Ratings Detail (As Of October 12, 2016) (cont.)		
Connecticut Hlth & Ed Fac Auth (Connecticut) st univ sys issue		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) ser G&H		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	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		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) univ issue		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Connecticut Hsg Fin Auth, Connecticut		
Connecticut		
Connecticut Hsg Fin Auth (Connecticut) state supported spl oblig bnds		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Innovations Incorporated, Connecticut		
Connecticut		
Connecticut Innovations Incorporated (Connecticut) gen fd oblig bnds		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Connecticut Dev Auth (Connecticut) GO		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Waterbury, Connecticut		
Connecticut		
Waterbury (Connecticut) GO spl cap reserve fd		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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