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New Issue

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Contacts

Anne Cosgrove 212-553-3248
*VP-Senior Analyst*
anne.cosgrove@moodys.com

Genevieve Nolan 212-553-3912
*VP-Senior Analyst*
genevieve.nolan@moodys.com


# University of Connecticut

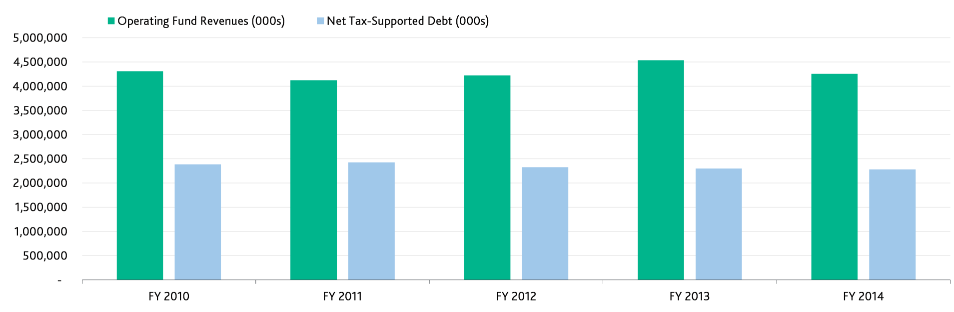
## New Issue - Moody's assigns Aa3 to $342 million University of Connecticut's GO bonds; outlook negative

### Summary Rating Rationale

Moody's Investors Service has assigned a rating of Aa3 to the University of Connecticut's $300 million General Obligation Bonds 2016 Series A and $42 million General Obligation Bonds Refunding 2016 Series A. The university plans to sell the bonds the week of April 4.

The Aa3 rating is derived from the strong legal security provided by the state debt service commitment (pursuant to the UConn 2000 program) which is deemed appropriated in amounts sufficient to pay debt service from the State of Connecticut's general fund (general obligation bonds rated Aa3 with a negative outlook). Additional security is provided by the university's full faith and credit pledge of assured revenues, defined as tuition, fees, and other resources for repayment of the bonds.

Exhibit 1
**Connecticut's Net Tax-Supported Debt has Increased**




*Source: Moody's Investors Service, CAFR*

### Credit Strengths

» Legislated support for application of operating surpluses to the Budget Reserve Fund (BRF)

» Wealthiest state in the nation with per capita personal income levels well above national

» levels

» Strong governance with the ability to make mid-year budget adjustments

## Credit Challenges

» Fixed costs for debt, pension and other post-employment benefits (OPEB) relative to budget are among the highest in the nation

» Vulnerability to financial market fluctuations due to effect on capital gains for very high wealth residents and employment in the financial services sector

» General fund balance sheet will remain negative over near term and rainy day fund modest due to state's slower recovery from the recession

## Rating Outlook

The negative outlook reflects the recent weakening state demographics that have led to budgetary strain. While we expect the state to solve the budgetary gaps with recurring solutions, we believe that the weakening demographics will continue and place negative pressure on the state's economy and finances in the next few years, while the very high fixed costs reduce flexibility and present additional challenges.

## Factors that Could Lead to an Upgrade

» Achievement and maintenance of higher GAAP-basis combined available reserve levels

» Established trend of structural budget balance

» Evidence of sustained stronger economic performance

» Reduced debt ratios relative to Moody's 50-state median and lower fixed annual costs

» Significantly improved funding of pension and post-retirement liabilities

## Factors that Could Lead to a Downgrade

» Lack of improvement in available reserve levels

» Reversion to significant one-time budget solutions, including deficit financings

» Revenue weakness driven by delayed economic recovery

## Key Indicators

Exhibit 2

| Connecticut | FY 2010 | FY 2011 | FY 2012 | FY 2013 | FY 2014 |
|---|---|---|---|---|---|
| Operating Fund Revenues (000s) | 12,856,987 | 13,935,599 | 16,378,765 | 16,909,327 | 16,934,668 |
| Balances as % of Operating Fund Revenues | -11.5% | -12.5% | -6.4% | -7.2% | -1.2% |
| Net Tax-Supported Debt (000s) | 18,467,835 | 18,247,554 | 18,615,067 | 19,623,311 | 19,748,617 |
| Net Tax-Supported Debt/Personal Income | 9.4% | 9.1% | 9.1% | 9.2% | 9.0% |
| Net Tax-Supported Debt/Personal Income 50 State Median | 2.8% | 2.8% | 2.8% | 2.6% | 2.5% |
| Debt/All Governmental Funds Revenue | 88.5% | 83.2% | 78.9% | 80.1% | 79.3% |
| Debt/All Governmental Funds Revenue 50 State Median | 23.4% | 22.7% | 24.3% | 23.8% | 23.0% |
| Adjusted Net Pension Liability/All Govt Funds Revenue | 207.9% | 189.7% | 243.4% | 236.0% | 213.3% |
| Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median | 57.1% | 48.7% | 63.9% | 60.3% | 59.2% |
| Total Non-Farm Employment Change (CY) | -1.1% | 1.1% | 0.9% | 0.9% | 0.7% |
| *Per Capita Income as a % of US (CY) | 137.5% | 135.9% | 136.3% | 135.5% | 135.4% |

*Data for 2015 are as of third quarter

*Source: Moody's Investors Service, CAFR*

## Recent Developments

On March 1, the Connecticut Comptroller reported that Connecticut's expected fiscal 2016 budget deficit projection had widened to $219.9 million from a deficit projection of $20 million the prior month due to downward revisions in personal income taxes, which are expected to be $464.4 million under budget. This is slightly over 1% of the general fund budget but is on top of a recent December 2015 Special Session where expenditures were reduced by over $300 million to close a projected deficit for 2016. The fiscal 2017 deficit is currently projected at about $900 million. The state will be working on a deficit mitigation plan.

## Detailed Rating Considerations

### Economy

Connecticut's economic recovery continues to lag that of the nation, however, as of December 2015, the state's unemployment rate of 5.2% was roughly on par with the national rate of 5.0% for the same period. Through December 2015, Connecticut regained 90% of the total jobs lost in the recession. From the peak in March 2008 to the low in February 2010, Connecticut lost 119,000 jobs, or 6.9% of its workforce. Real average earnings continue to improve as real median family income growth in 2014 surpassed the U.S. and Northeast averages for the first time in four years. The sectors with positive growth are education and health services, leisure and hospitality, transportation and utilities and professional and business services. The state's employment recovery is skewed towards lower-wage industries: The state's has experienced only 5.6% growth in average annual wages from fiscal 2011-2016 versus 16.9% in fiscal 2004-2008. Moody's Analytics projects that the state will regain its recessionary job losses by mid-2016. However, the state will continue to contend with high energy costs and high tax burdens. Furthermore, there continue to be some economic headwinds.

On January 13, General Electric Co. (GE, A1 stable) announced that it will move its corporate headquarters to Boston (Aaa stable) from Fairfield, CT (Aaa stable). According to Moody's Analytics, GE is the 20th-largest employer in Connecticut in terms of employees (4,300 with about 800 in the Fairfield headquarters). In addition, the state has had deteriorating demographics with two years of population loss since 2013.

### Finances and Liquidity

In fiscal 2013, the state implemented a plan to begin addressing Connecticut's sizeable $1.2 billion cumulative GAAP deficit. The state issued $560 million of general obligation bonds, which generated $598.5 million in proceeds (of the $750 million total authorized by legislature) amortizing the bonds over 15 years and reducing the accumulated GAAP deficit to $618.5 million. The remaining portion of the deficit will be amortized over 13 years starting in fiscal 2016, resulting in an annual payment of about $47.5 million. These amounts will be "deemed appropriated", meaning no further legislative action is needed to make the payments.

The GAAP bond proceeds are not counted as General Fund revenues, and the proceeds cannot be used for any current or future budget appropriations. While the funding strategy enabled the state to begin addressing its longstanding sizeable GAAP deficit and injects discipline into the plan, the additional debt adds to the state's already high debt levels and fixed costs. Even with the plan, the unassigned General Fund balance will remain negative over the near term.

#### LIQUIDITY

Connecticut's liquidity remains healthy. The state did not have to borrow for cash flow purposes in fiscal 2015 and does not anticipate cash flow borrowing in fiscal 2016. Cash balances averaged $1.5 billion in fiscal 2015 and stood at $1.7 billion, including bond proceeds, as of February 20, 2016.

## Debt and Pensions

#### DEBT STRUCTURE

Connecticut is a frequent borrower and the state's debt per capita and debt-to-personal income ranked first and second, respectively, among the 50 states for Moody's 2015 debt medians. Net tax-supported debt equaled $5,491 per capita and 9.0% of total state personal income, well above the 50-state median of $1,054 in debt per capita and 2.6% for debt-to-personal income. These high debt ratios are partly due to substantial capital financing for K-12 school building construction that is carried out at the local level in many other states. However, with the $2 billion POBs and the sale of $560 million in GAAP Conversion bonds to address a portion of the state's sizeable cumulative GAAP deficit, on top of the state's normal sizeable annual debt issuances, Connecticut's debt ratios will likely remain among the highest in the country. Connecticut adheres to a 20-year level principal repayment schedule for its general obligation debt, with a declining debt service schedule that provides some flexibility.

#### DEBT-RELATED DERIVATIVES

The state has $1.8 billion in variable rate debt, most of which is indexed to either SIFMA or CPI, or approximately 12.5% of the state's total G.O. debt. Only $55.6 million of the state's variable rate debt is swapped to fixed, based on 60% of LIBOR or a percentage point above CPI, after a $280 million swap was terminated at par on March 1, 2015. As of December 31, 2015, the mark-to-market was minimal, at negative $2.4 million against the state. In accordance with its swap guidelines, the state generally negotiates provisions that permit funding a required termination payment over a period of time to allow time for a refunding. Accordingly, the state would have 270 days to fund a termination payment for its general obligation swaps. The state has no plan to incorporate swaps into future GO bonds.

#### PENSIONS AND OPEB

Based on Connecticut's 2014 pension data, Connecticut's adjusted net pension liability (ANPL) was 213% of revenues, the second worst ratio in the 50-state median behind Illinois. Moody's adjusted net pension liability applies a bond index rate to determine the present value of plan liabilities, incorporates the market (rather than actuarial) value of plan assets and makes certain other changes to improve comparability of reported pension liabilities. Other pension ratios such as ANPL to personal income, GDP, and population are similarly very high for Connecticut.

The state is currently funding 100% of the actuarial required contribution for both plans.

Connecticut also has a very high OPEB liability. As of the 2013 valuation, the liability stood at $19.5 billion. The state is also responsible for the $2.4 billion Teachers' OPEB liability. The OPEB trust fund contained $229.6 million in net assets as of June 30, 2015.

## Governance

The state has a constitutional balanced budget requirement, strong, binding consensus revenue process supported by nonpartisan and objective economic analysis that is conducted three times a year (January, April and November) or can be scheduled more frequently during times of revenue shortfalls or economic distress. There is a constitutional cap on spending and a statutory limit on debt payable from the general fund. The state is not subject to mandated initiatives or voter referenda. The Governor has limited executive authority to cut expenses by up to 5% of an individual appropriation, not to exceed 3% of any fund, without legislative approval, and if a deficit exceeds 1% of the general fund, there are requirements for a timely deficit mitigation plan to be developed. A super-majority is not required for tax increases or legislatively enacted budget adjustments. There is monthly budget reporting by both the Governor's budget office and the State Comptroller and budget adoption has been timely. The state does not conduct a debt affordability analysis, however, both the Governor's budget office and the Office of Fiscal Analysis prepare Fiscal Accountability reports that include multiple-year financial planning including projections of debt issuance, debt levels and debt cost. The state has frequently maintained a rainy day fund over the years, and there are statutory requirements that all budget surplus funds be deposited to the rainy day fund at year-end.

## Legal Security

The UConn 2000 program is an arrangement between the University of Connecticut and the State of Connecticut pursuant to state statute and a master indenture dated November 1, 1995. The current offering of bonds is secured by a pledge of and lien upon the state debt service commitment, which is defined by the UConn 2000 Act as the state's commitment to pay an amount sufficient to make full and timely debt service. Payments are deemed appropriated from the state's general fund and do not require annual legislative action. The act directs the state treasurer to deposit payments into the debt service fund held by the trustee of the bonds. Although the legislature may exercise its power to change the statute, Moody's views the state to have made a long-term commitment to continue to service the bonds as a priority item of its general fund.

The bonds are general obligations of the University of Connecticut, further secured by and payable from amounts of the state debt service commitment appropriated out of the state general fund and obligated to be paid by the state treasurer. The bonds are payable from all of the university's assured revenues, which are defined in the master indenture to include tuition, fees, legally available gifts and grants, annual state appropriations for operating expenses, and the state debt service commitment. While assured revenues are legally pledged, the university expects to rely on the receipts of the pledged state debt service commitment and does not plan to budget other revenues for bond repayment.

Pursuant to the terms of the indenture for the bonds, the university covenants that so long as the bonds are outstanding it will establish and increase its tuition, fees and charges in an amount sufficient to meet its debt service requirements. Nonetheless, the state debt service commitment will continue to provide the primary source of bondholder security. We believe that the university would have very limited ongoing ability to assume responsibility for payment on the general obligation bonds, given the magnitude of annual debt service relative to its existing revenue base.

## Use of Proceeds

Proceeds of the new money issuance will be used for capital improvements to the university's facilities, part of the UConn 2000 Infrastructure Improvement Act. The refunding bond proceeds will be used to refund outstanding debt to provide net debt service savings.

## Obligor Profile

The State of Connecticut has a population of almost 3.6 million people. The state, located in the northeastern US, has a large and diverse economy with a gross state product of $253 billion. It is the wealthiest state in the country with per capita income of 141% of the US average.

The University of Connecticut is the state's flagship university and part of the state's system of public higher education. The university is a body politic and instrumentality and agency of the State of Connecticut. The state's support for the university reflects the status as the flagship institution of the state system of higher education.

The university is able to borrow money in its own name on behalf of the state for certain capital improvements at the university.

## Methodology

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

## Ratings

Exhibit 3

### Connecticut (State of)

| Issue | Rating |
|---|---|
| General Obligation Bonds, 2016 Series A | Aa3 |
| Rating Type | Underlying LT |
| Sale Amount | $300,000,000 |

| | |
|---|---|
| Expected Sale Date | 04/04/2016 |
| Rating Description | General Obligation |
| General Obligation Bonds, 2016 Refunding Series A | Aa3 |
| Rating Type | Underlying LT |
| Sale Amount | $42,000,000 |
| Expected Sale Date | 04/04/2016 |
| Rating Description | General Obligation |

*Source: Moody's Investors Service*

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Contacts

Anne Cosgrove 212-553-3248
*VP-Senior Analyst*
anne.cosgrove@moodys.com


CLIENT SERVICES

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
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