FitchRatings

RATING ACTION COMMENTARY

Fitch Rates $288MM University of Connecticut GO Bonds 'A'; Outlook Stable

Wed 18 Nov, 2020 - 12:38 PM ET

Fitch Ratings - New York - 18 Nov 2020: Fitch Ratings has assigned an 'A' rating to $288 million GO bonds issued by the University of Connecticut (UConn), consisting of:

--$169,555,000 GO bonds 2020 Series A;

--$118,725,000 GO bonds 2020 Refunding Series A.

The bonds are expected to be offered by negotiated sale on Dec. 8, 2020.

The Rating Outlook is Stable.

SECURITY

The bonds are a general obligation of UConn, additionally secured by a pledge of and lien on a state of Connecticut debt service commitment for principal and interest, appropriated from the state's general fund without further legislative approval.

ANALYTICAL CONCLUSION

UConn's GO bonds are rated at 'A', one notch below Connecticut's 'A+' IDR based on the state's debt service commitment equal to principal and interest and appropriated without further legislative approval. Higher education is a constitutional state priority and legal protections are strong.

Connecticut's 'A+' IDR and GO rating reflect the large deposits it has made in recent years to the budget reserve fund (BRF), the state's rainy day fund, detailed budget monitoring, mechanisms to reduce spending and a willingness to raise revenues. These provide the state with broad flexibility as it confronts economic and revenue losses expected through the end of the fiscal 2020-2021 biennium due to the coronavirus pandemic. The ratings also incorporate Fitch Ratings' expectation that the state's wealthy and mature economy is likely to be flat or grow only slowly over time, a factor that will continue to challenge the state in matching revenues to expenditures. The long-term liability burden remains well above the U.S. state average. Although carrying costs for liabilities are a moderate burden on the state's resource base, they limit expenditure flexibility compared with most states.

ECONOMIC RESOURCE BASE

Connecticut has a diverse and mature economic base anchored by a large finance sector and important manufacturing, education and health sectors. The impact of the Great Recession on Connecticut was severe, and economic growth in the recovery that followed trailed that of the U.S. The state is the wealthiest in the U.S. as measured by per capita personal income. Prior to the coronavirus pandemic, growth had also begun to advance in key finance and manufacturing sectors.

KEY RATING DRIVERS

Revenue Framework: 'a'

The state's largest tax revenue source, personal income tax (PIT), is subject to considerable cyclicality, although the state has instituted measures to shield the general fund from its volatility. Sales, corporate income, transportation and gaming taxes diversify resources. Tax policy changes have been required since the Great Recession to boost revenues, and Fitch believes modest future economic expansion will continue to constrain underlying revenue growth potential. The state has unlimited legal ability to levy taxes.

Expenditure Framework: 'aa'

Connecticut's natural pace of spending growth is expected to outpace revenues given projections for weak revenue growth. The state has consistently demonstrated the ability to cover its comparatively high fixed costs, including making full actuarial contributions to pensions for more than a decade, and it benefits from the large degree of budget autonomy common to states.

Long-Term Liability Burden: 'a'

The state's long-term liability burden is elevated and among the highest for U.S. states, but still considered moderate. Long-term debt consists primarily of GO and transportation borrowings, with much of GO borrowing undertaken on behalf of local schools. Net pension liabilities are more significant, with the state carrying obligations for state retirees as well as for local school teachers.

Operating Performance: 'a'

Gap-closing capacity is strong and resiliency has improved with sizable deposits to the BRF in fiscal years 2018 and 2019, as required under the state's revenue volatility cap enacted in 2018. Cyclical revenues, budgetary burdens from fixed costs and forecast out-year budget gaps indicate structural challenges that remain unaddressed, although close budget monitoring, including frequent revenue forecasting, allows the state to quickly identify revenue underperformance and implement corrective actions.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Improved Economic and Revenue Growth Prospects: Strengthened trends in economic and revenue growth over a longer time frame;

--Lower Liability Burden: The state's ability to gradually lower its elevated liability burden while managing comparatively high fixed cost burden;

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--More Severe Downturn: Inability to address the fiscal effects of a return to economic contraction, consistent with Fitch's coronavirus downside scenario, and maintain an adequate level of fundamental financial flexibility, or an inability to quickly rebuild fiscal flexibility once growth resumes;

--Growing Liabilities and Structural Challenges: Erosion of strong budget management practices, including actions during the current recession that further build the state's liability burden or enlarge structural challenges.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CREDIT PROFILE

UConn GO bonds are issued by and carry the GO pledge of UConn, but their security and the 'A' rating rest with the debt service commitment of the state. Principal and interest are paid annually from the state's general fund, appropriated and obligated for payment by the state treasurer without requiring further legislative approval. Fitch rates the state's own GO bonds 'A+', on par with the IDR. State general fund obligations, with the strength of continuing appropriations, are seen as slightly less secure than the state's GO bonds, and the UConn bonds fall within this category. The state's debt service commitment is separate from the operating appropriations and allotments that the state makes available to the university and UConn GO borrowing is integrated into the state's overall debt management.

Over the last two decades, the state has prioritized renewal and expansion of facilities at UConn, the state's flagship public university system. The UConn GO bonds have been issued as part of the state's UConn 2000 program, first enacted in 1995 and extended multiple times since. In 2017, the state extended the program from fiscal 2024 to fiscal 2027, although total estimated cost was unaltered at $4.6 billion, of which $4.3 billion is being funded by UConn GO bonds benefiting from the state's debt service commitment. Of this amount, about $3.3 billion in par debt service commitment bonds have been issued to fund university project construction to date, with $1.5 billion currently outstanding.

Recent projects have been designed to expand UConn research facilities and faculty, particularly in science and technology. The majority of UConn 2000-funded projects have been at the main UConn campus in Storrs with additional projects at the regional campuses and the UConn Health Center (UCH) in Farmington. Current new issue bond proceeds will fund various projects dispersed among these areas and include new academic and research facilities, administrative and support facility improvements, and phase II of UConn's fine arts expansion.

For additional information on the state of Connecticut's IDR, see "Fitch Affirms Connecticut's IDR at 'A+', Rates $900MM GO Bonds 'A+'; Outlook Stable," published on May 15, available at www.fitchratings.com.

DATE OF RELEVANT COMMITTEE

14 May 2020

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Connecticut, State of (CT) [General Government]				
• Connecticut, State of (CT) /UConn State Debt Service Commitment/1 LT	LT	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

University of Connecticut (CT)	EU Endorsed

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