State of Connecticut – G.O.

Issuer: State of Connecticut		
Assigned	**Rating**	**Outlook**
General Obligation Bonds (2024 Series A)	AA+	Stable
General Obligation Bonds (2024 Series B) (Social Bonds)	AA+	Stable
General Obligation Refunding Bonds (2023 Series A) (Social Bonds)	AA+	Stable
Affirmed	**Rating**	**Outlook**
General Obligation Bonds	AA+	Stable

Methodology:

U.S. State General Obligation Rating Methodology

ESG Global Rating Methodology

Analytical Contacts:

Peter Scherer, Director
+1 (646) 731-2325
peter.scherer@kbra.com

Douglas J. Kilcommons, Managing Director
+1 (646) 731-3341
douglas.kilcommons@kbra.com

Rating Summary: The long-term rating for the State of Connecticut's General Obligation Bonds reflects the State's strong credit profile and significant and continuing progress in improving its financial position since FYE 2017. The rating, which was upgraded in May 2023, additionally recognizes the recent February 2023 extension of certain statutory fiscal guardrails which KBRA believes position the State to maintain strong reserves and achieve further progress in addressing its large unfunded pension liabilities in the years ahead.

The State first implemented enhanced statutory fiscal guardrails at the commencement FY 2018 which it covenanted to certain general obligation bondholders to maintain through June 30, 2023. Among the guardrails was a requirement to annually direct unappropriated general fund balances at fiscal year end toward the State's budget reserve fund (BRF or "Rainy Day Fund") and the implementation of a revenue volatility cap requiring the most volatile components of personal income tax receipts, in excess of an indexed threshold, to be deposited into the BRF. BRF balances exceeding 15% of ensuing fiscal year general fund appropriations were required to be deposited as supplemental contributions toward the State's unfunded pension liabilities. The guardrails resulted in a BRF funded to the full 15% of appropriations statutory limit in each year since FY 2020 and $8.56 billion in supplemental pension contributions between FY 2018 and FY 2023. The BRF balance increased from just 1.3% of general fund expenditures at FYE 2017 to a projected 23.2% at FYE 2023. BRF balances exceeding the 15% threshold at FYE 2023 (~$2.4 billion) are to be deposited toward unfunded pension liabilities by the end of the 2023 calendar year, supplementing the $3.73 billion actuarially determined employer contribution (ADEC) already appropriated for FY 2023, marking a fourth consecutive year of pension contributions in excess of the ADEC.

Statute enacted in February 2023 implemented a revised package of fiscal guardrails effective July 1, 2023, providing a covenant and indenture pledge that will become operational with the closing of the currently offered bonds (the first GO bonds to be offered since the July 1 effective date) to maintain a number of revised fiscal guardrails through FYE 2033, subject to an option for the Legislature to suspend the guardrails in the first half of 2028. Key provisions of the revised guardrails include an increase in the BRF balance cap to 18% of budgeted appropriations commencing on July 1, 2024, and the continuation of the revenue volatility cap, among other measures described in greater detail on page 3 of KBRA's report dated May 18, 2023. The legislation was passed unanimously by both legislative chambers signaling, in KBRA's view, broad continuing support for the conservative financial practices that have bolstered the State's financial position in the years since FYE 2017.

The State's general fund ended FY 2023 with a sizable surplus. Gross general fund receipts declined 3.6% YoY to $24.15 billion due to the fading impact of the prior year's broad federal stimulus and unfavorable capital market returns for the 2022 tax year which weighed on income tax receipts. Personal income and pass-through entity tax proceeds exceeded the revenue volatility cap by $1.32 billion, with this excess directed to the BRF resulting in estimated general fund revenues available for appropriation of $22.82 billion, an increase of 3.8% YoY. Total appropriations in contrast increased 7.5% YoY to $22.20 billion. A $625 million operating surplus was realized after accounting for supplemental appropriations and year-end adjustments implemented as part of the FY 2024 budget.

Connecticut's budget for the FY 2024 – FY 2025 biennium was signed into law on June 12, 2023. As of the Connecticut Office of Policy and Management's (OPM) latest November 2023 estimate, surpluses as well as sizable volatility cap deposits are expected in each budget year. Revenues are forecast at $22.53 billion for FY 2024 (down 1.3% YoY after volatility cap deposits) and $23.09 billion in FY 2025 (up 2.5% YoY). Estimates continue to factor in an uncertain economic environment as well as a number of policy changes and tax cuts which reduced revenues by $287 million in FY 2024 and $486 million in FY 2025 from baseline projections. The most impactful policy change from a revenue perspective was a reduction in the two lowest personal income tax brackets projected to reduce receipts $167 million in FY 2024 and $370 million in FY 2025 once fully phased in. Expenditures are projected to increase 0.8% YoY in FY 2024 to $22.04 billion and 1.9% YoY to $22.81 billion in FY 2025. Projected revenues exceed appropriations in each year.

Connecticut's economy has recovered significantly from the early months of the pandemic. Seasonally adjusted unemployment in October 2023 was 3.5%, lower than the U.S. average at 3.9%. Wealth levels remain very high, with per capita personal income of $84,972 at 130% of the national average in 2022. The longer-term, pre-pandemic economic growth trend in the State was sluggish. Real gross state product (GSP) contracted in seven of the last fifteen years. KBRA continues to monitor economic growth in the context of the broad pandemic recovery, with an eye toward the potential impact of macroeconomic headwinds in 2024.

The State has high debt levels, but this partly reflects its practice of issuing general obligation debt for certain university projects and for purposes that municipal entities and counties fund in other states, such as local school construction. Fixed costs (debt service, OPEB and pension) were 19.5% of general government expenditures in FY 2022, which KBRA views as high. Debt amortization is favorable with 80% of general obligation debt scheduled to retire within 10 years.

The Stable Outlook reflects Connecticut's diverse and high wealth economic base, strong reserve position, and effective financial management practices, which together provide a solid foundation for future financial performance.

Key Credit Considerations

The rating actions reflect the following key credit considerations:

Credit Positives

- State is projected to complete FY 2024 with a BRF balance exceeding the statutory cap at 15% of general fund appropriations and is positioned to direct surplus resources toward supplemental pension contributions for a fifth consecutive year.
- Strong financial management framework and recent extension of enhanced statutory fiscal guardrails through at least FY 2028 position the State for strong operating results.
- Strong wealth levels with the second highest per capita personal income level among all states.

Credit Challenges

- Lower relative growth in the economic indicators of population, employment, and gross state product, although there are recent signs of growth in population.
- Unfunded pension liabilities and tax-supported debt burden are high relative to personal income, each more than 3x the respective U.S. average. However, the State borrows for many local purposes and the comparison on a combined state and local basis is more moderate.

Rating Sensitivities

▪ Significant improvement in the funded ratios for the State's pension systems.	+
▪ Structural operating deficits in the general fund. ▪ Sustained weakening in the State's employment base and economic activity.	-

Rating Highlights	
Per Capita Personal Income (2022) (in dollars)	$84,972
as a % of U.S.	*130%*
Population (2022)	3,626,205
Growth 2010 to 2022	*0.8%*
Real GDP, % Change 2010 to 2022	
Connecticut	3.3%
New England	18.3%
United States	27.9%
Budget Reserve Fund Balance ($ in millions)	
FYE 2019	$2,506
FYE 2020	$3,013
FYE 2021	$3,112
FYE 2022	$3,313
FYE 2023[1]	$5,718
FYE 2024 (Budget)	$3,948
Direct Debt (2/1/2023) ($ in millions)	$26,162
Net Pension Liability[2] ($ in millions)	$40,364
Fixed Costs as a % of Governmental Expenditures (FY 2022)	19.5%

[1]Statute limits the BRF balance to 15% of the subsequent year's budget. To comply with this requirement, the State will need to apply ~$1.87 billion of this balance toward the State's pension liabilities as a supplemental contribution in addition to the ADEC.
[2]Reflects 6/30/2022 measurement date for SERS and TRS and 6/30/2021 for JRS.

Rating Determinants (RD)	
1. Management Structure, Budgeting Practices and Policies	AAA
2. Debt and Additional Continuing Obligations	A+
3. Financial Performance and Liquidity Position	AA+
4. State Resource Base	AA-

A detailed review of each rating determinant can be found in KBRA's report dated May 18, 2023. An update of RD 3: Financial Performance and Liquidity Position can be found below.

RD 3: Financial Performance and Liquidity Position Update

The State's financial position has improved markedly in recent years. Positive revenue performance, pandemic-related federal assistance, and expenditure discipline have supported BRF contributions in each year since FYE 2017 and budgetary surplus in each year since FYE 2018. Supplemental contributions to pensions in excess of the ADEC have additionally been made in each year since FY 2020. The BRF has been maintained at the statutory limit of 15% of appropriations at the end of each of the last four years and is projected increase to 16.2% of appropriations at the end of the current 2024 fiscal year per the phase in of an increased statutory limit of 18% of appropriations beginning July 1, 2024. Negotiations with the State Employees Bargaining Agent Coalition last year resulted in agreements lasting through FY 2025, with 2.5% general wages increases for FY 2022 (retroactive), FY 2023, and FY 2024, providing increased certainty for labor expenses.

Pandemic-Related Federal Assistance

The States received $1.382 billion in CARES Act funds in 2020 which were applied to pandemic-related costs incurred between March 1, 2020 and December 30, 2020. The use of such funds was accounted for outside of the general fund. The also State received $2.954 billion in ARPA funds in 2021, the allowable uses of which are more flexible. The State had originally budgeted to apply $560 million toward revenue replacement in FY 2022 but this appropriation was eliminated due to stronger than anticipated revenue performance. An additional $1.20 billion allocated for revenue replacement in FY 2023 was scaled back to $315 million and then eliminated altogether for the same reason. ARPA funds have instead been directly appropriated outside of the general fund to a broad range of governmental purposes. The State has now allocated all ARPA funds for spending through FY 2025.

Figure 1

State of Connecticut
American Rescue Plan Allocation and Spending
FYE June 30 (in millions)

	2022	2023	2024	2025	Total
Coronavirus State Fiscal Recovery Funds	$ 652	$ 1,471	$ 546	$ 143	$ 2,812
Coronavirus Capital Project Funds	30	77	26	9	142
Total	682	1,548	572	152	2,954

Source: State of Connecitcut

FY 2023 Operating Results

The general fund ended FY 2023 with a sizable surplus. Gross general fund receipts declined 3.6% YoY to $24.15 billion due to the fading impact of the prior year's broad federal stimulus and unfavorable capital market returns for the 2022 tax year which weighed on income tax receipts. Personal income and pass-through entity tax proceeds exceeded the revenue volatility cap by $1.32 billion, with this excess directed to the BRF resulting in estimated general fund revenues available for appropriation of $22.82 billion, an increase of 3.8% YoY. Total appropriations in contrast increased 7.5% YoY to $22.20 billion. A $625 million operating surplus was realized after accounting for supplemental appropriations and year-end adjustments implemented as part of the FY 2024 budget.

Figure 2

General Fund Summary Operations
Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)

	2019	2020	2021	2022	2023	2024 Nov Est	2025 Nov Est
Revenues	20,600	19,724	21,773	25,038	24,145	22,530	23,089
Plus BRF Draws	-	-	-	-	-	-	-
Less Volatility Cap Deposits to BRF	(950)	(530)	(1,241)	(3,047)	(1,322)	(479)	(452)
Revenues Available for Appropriation	19,650	19,194	20,531	21,991	22,823	22,530	22,637
Appropriations (Net Miscellaneous Adjustments)	(19,249)	(19,189)	(19,436)	(20,655)	(22,199)	(22,376)	(22,806)
Miscellaneous Adjustments	(0)	8	(0)	1	(0)	-	-
Prior Year Appropriations Continued into Current FY	134	165	139	758	834	-	-
Current Year Appropriations Cont. into Subsequ. FY	(165)	(139)	(758)	(834)	(833)	-	-
Actions Per Governor's Recommended Budget Adjustments Carryforwards/Use of Surplus	-	-	-	-	-	-	-
Operating Surplus (Deficit)[1]	**371**	**39**	**476**	**1,261**	**625**	**154**	**(169)**
Year End Surplus Transfer to BRF[1]	(371)	(39)	(476)	(1,261)	(551)	(154)	-
Unappropriated Surplus (Deficit)	**-**	**-**	**-**	**-**	**-**		

Source: Annual Financial Reports of the State Comptroller, OPM Letter dated September 30, 2023 and Rating Agency Presentation dated November 2023.

[1]As required by statute, the projected FY 2024 unappropriated surplus of $154 million would be transferred to the BRF after the audit of FY 2024 operations and the General Fund surplus is confirmed.

The $1.32 billion volatility cap deposit plus the $551 million surplus resulted in $1.87 billion available for deposit to the BRF, which, together with the beginning BRF balance of $3.31 billion, resulted in an ending BRF balance of $5.19 billion, or 23.2% of budgeted FY 2024 appropriations. As required by statute, the State will transfer amounts exceeding the BRF cap at 15% of subsequent year appropriations toward long-term liabilities the end of the 2023 calendar year toward supplemental SERS and TRS contributions. The contributions will be in addition to the $3.72 billion already appropriated in satisfaction of the full ADEC for the State's pension obligations in FY 2023, for a total contribution of $5.59 billion, or 150% of the ADEC.

Figure 3

Budget Reserve Fund Summary Operations
Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)

	2019	2020	2021	2022	2023	2024 Nov Est
Beginning BRF Balance	1,185	2,506	3,013	3,112	3,313	3,316
Transfers to General Fund	-	-	-	-	-	-
Transfers from General Fund (Outside of Volatility Cap)	371	39	476	1,261	551	154
Volatility Cap Deposit	950	530	1,241	3,047	1,322	479
Ending BRF Balance Before Statutory Post-Close Transfers to SERS/TRS	**2,506**	**3,074**	**4,730**	**7,420**	**5,186**	**3,948**
as a % of Ensuing FY Net GF Approps. [1]	*13.1%*	*15.0%*	22.8%	33.4%	23.2%	17.9%
Statutory Transfer to SERF and TRS Following Year End	-	(62)	(1,618)	(4,107)	(1,870)	(264)
Ending BRF Balance After Statutory Post-Close Transfer to SERS/TRS	**2,506**	**3,013**	**3,112**	**3,313**	**3,316**	**3,684**
as a % of Ensuing FY Net GF Approps.	*13.1%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*16.2%*

Source: Annual Financial Reports of the State Comptroller, OPM Letter dated September 30, 2023 and Rating Agency Presentation dated November 2023.

[*] Balances shown are based on KBRA calcluations and are provided for informational purposes only. In practice any ending balances, subject to any year end appropriations or carryforwards exceeding 15% of appropriations would be transferred to SERS/TRS as required by statute. This cutoff rises to 18% of appropriations beginning July 1, 2024.

Figure 4

State Contributions to SERS and TRS
FYE June 30 (dollars in millions)

	2019	2020	2021	2022	2023	2024 Proj.	2025 Proj.	2026 Proj.
Actuarially Determined Employer Contribution	$ 2,867	$ 2,825	$ 3,057	$ 3,437	$ 3,721	$ 3,595	$ 3,684	$ 3,788
Additional Contributions†	-	62	1,618	4,108	1,871			
Total Contributions	2,867	2,887	4,675	7,545	5,592			
Total Contributions as a % of ADEC	100%	102%	153%	220%	150%			

Source: State of Connecticut

† Additional contributions beyond the ADEC are not budgeted for FY 2023, but surplus General Fund amounts and volatility cap deposits that would otherwise push the Budget Reserve Fund balance above the statutory cap, designated at 18% of budgeted expenditures for FY 2024, may be available for this purpose.

Enacted FY 2024 – FY 2025 Biennium Budget

Connecticut's budget for the FY 2024 – FY 2025 biennium was signed into law on June 12, 2023. As of OPM's latest November 2023 estimates, surpluses as well as sizable volatility cap deposits are expected in each year. Revenues are forecast at $22.53 billion for FY 2024 (down 1.3% YoY after volatility cap deposits) and $23.09 billion in FY 2025 (up 2.5% YoY after volatility cap deposits). Estimates continue to factor in an uncertain economic environment as well as a number of policy changes and tax cuts which reduced revenues by $287 million in FY 2024 and $486 million in FY 2025 from baseline projections. The most impactful policy change from a revenue perspective was a reduction in the two lowest personal income tax brackets projected to reduce receipts $167 million in FY 2024 and $370 million in FY 2025 once fully phased in. Expenditures are projected to increase 0.8% YoY in FY 2024 to $22.04 billion and 1.9% YoY to $22.81 billion in FY 2025.

Figure 5

General Fund Revenues and Expenditures Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)													
	Actual										Budget		
	2019	Δ YOY (%)	2020	Δ YOY (%)	2021	Δ YOY (%)	2022	Δ YOY (%)	2023	Δ YOY (%)	2024 Nov Est	Δ YOY (%)	2025 Nov Est
Revenues													
Personal Income Tax	9,640	-2.5%	9,398	10.0%	10,340	17.3%	12,132	-7.5%	11,223	-3.1%	10,873	1.9%	11,079
Pass-through Entity Tax	1,172	6.0%	1,242	24.8%	1,550	48.9%	2,308	-11.2%	2,048	-14.0%	1,761	3.3%	1,819
Less: Volatility Cap Deposit	(950)		(530)		(1,241)		(3,047)		(1,322)		(479)		(452)
Net PIT and Pass-Through Entity Tax	9,862	2.5%	10,109	5.3%	10,649	7.0%	11,392	4.9%	11,950	1.7%	12,156	2.4%	12,447
Federal Grants (excl. ARPA)	2,084	-13.8%	1,797	-16.7%	1,496	29.3%	1,935	3.3%	1,998	0.4%	2,006	-6.3%	1,880
Sales and Use Tax	4,338	-0.5%	4,318	11.0%	4,793	0.5%	4,818	2.6%	4,945	4.6%	5,175	2.5%	5,302
Corporate Income Tax	1,061	-11.9%	934	23.4%	1,153	21.5%	1,401	8.2%	1,517	-0.1%	1,515	1.0%	1,530
Excise Taxes (Alcohol and Cigarettes)	421	-0.4%	419	2.6%	430	-5.7%	406	-8.5%	371	-7.1%	345	-4.1%	331
Indian Gaming Payments	255	-35.6%	164	39.4%	229	8.7%	249	12.2%	279	1.7%	284	0.8%	286
Statutory Transfers from Other Funds	110	24.0%	136	-15.8%	115	10.2%	126	-10.9%	113	-3.6%	108	-1.6%	107
Other	1,519	-48.3%	785	112.3%	1,667	-0.2%	1,664	-0.8%	1,652	-43.0%	942	28.2%	1,208
Total Revenues	**19,650**	-2.3%	**19,194**	7.0%	**20,531**	7.1%	**21,991**	3.8%	**22,823**	-1.3%	**22,530**	2.5%	**23,089**
Expenditures													
General Government	653	-2.8%	635	1.8%	646	16.0%	750	24.6%	934				
Public Safety	272	3.2%	281	1.3%	284	6.9%	304	13.9%	346				
Conservation and Development	170	0.9%	172	10.4%	189	23.0%	233	1.5%	237				
Health and Hospitals	1,194	0.7%	1,203	3.4%	1,244	2.6%	1,276	9.3%	1,395				
Human Services	4,312	1.0%	4,357	-2.3%	4,258	4.4%	4,445	11.8%	4,969				
Education, Libraries and Museums	5,208	-1.0%	5,155	2.9%	5,304	7.4%	5,698	6.4%	6,060				
Corrections and Judicial	1,968	1.8%	2,004	-0.5%	1,994	-4.1%	1,912	11.9%	2,139				
Debt Service	2,225	-0.9%	2,205	0.5%	2,216	4.9%	2,325	-5.4%	2,200				
Other	3,247	-2.1%	3,179	3.7%	3,297	12.5%	3,709	5.7%	3,919				
Total Expenditures	**19,249**	-0.3%	**19,189**	1.3%	**19,431**	6.3%	**20,652**	7.5%	**22,199**	0.8%	**22,376**	1.9%	**22,806**

Source: Annual Financial Reports of the State Comptroller, State Comptroller Letter dated September 30, 2023 and November 2023 Credit Presentation

Liquidity Position

The common cash pool represents the State's operating cash and includes the BRF. Available cash includes bond funds and other balances that can be made available to the common cash pool through temporary transfers under long established State practice. Variability in the level of cash in the common cash pool at a given point in the fiscal year reflects the seasonality of cash flow. The level of total available cash is impacted both by the rate of bond issuance and the rate of spending from those bond funds. The State has no plans to issue cash flow notes.

Figure 6

Available Cash Balance FYE June 30 (dollars in millions)							
	2018	**2019**	**2020**	**2021**	**2022**	**2023**	**10/28/2023**
Common Cash Pool	$1,871	$3,558	$4,353	$9,964	$12,758	$9,771	$8,370
Total Available Cash	$3,399	$4,827	$5,725	$11,551	$14,612	$11,300	$9,704

Source: State of Connecticut Treasurer's Office | Treasurer's Cash and Debt Monthly Reports.

Bankruptcy Assessment

Under Chapter 9 of the U.S. Bankruptcy Code, State governments are not permitted to petition courts for protection for creditors, including holders of their general obligation debt.

ESG Management

KBRA typically analyzes Environmental, Social, and Governance (ESG) factors through the lens of how issuers plan for and manage relevant ESG risks and opportunities. More information on KBRA's approach to ESG risk management in public finance ratings can be found here. Over the medium-term, public finance issuers will likely need to prioritize ESG risk management and disclosure with the likelihood of expansions in ESG-related regulation and rising investor focus on ESG issues.

KBRA analyzes many sector- and issuer-specific ESG issues but our analysis is often anchored around three core topics: climate change, with particular focus on greenhouse gas emissions; stakeholder preferences; and cybersecurity. Under environmental, as the effects of climate change evolve and become more severe, issuers are increasingly facing an emerging array of challenges and potential opportunities that can influence financial assets, operations, and capital planning. Under social, the effects of stakeholder preferences on ESG issues can impact the demand for an issuer's product and services, the strength of its global reputation and branding, its relationship with employees, consumers, regulators, and lawmakers, and, importantly, its cost of and access to capital. Under governance, as issuers continue to become more reliant on technology, cybersecurity planning and information management are necessary for most issuers, regardless of size and industry.

KBRA's ESG assessment can be found in the report dated December 10, 2021.