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Ratings

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Summary:

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

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Summary:

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Credit Profile		
US$300.0 mil GO bnds (Connecticut) ser 2017A due 01/15/2037		
Long Term Rating	AA-/Negative	New
US$35.0 mil GO rfdg bnds (Connecticut) ser 2017A due 01/15/2022		
Long Term Rating	AA-/Negative	New
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA-' long-term rating, and negative outlook, to the University of Connecticut's $300 million general obligation (GO) bonds, 2017 series A, and approximately $35 million 2017 refunding series A GO bonds. At the same time, S&P Global Ratings has affirmed its 'AA-' rating, with a negative outlook, on the university's $1.3 billion parity debt outstanding.

We base the rating on the security provided by the state debt service commitment, which is defined by Public Act 95-230 (UCONN 2000), and the master indenture. The State of Connecticut (GO rating: AA-/Negative) is obligated to pay an annual amount sufficient to cover debt service on any state debt service commitment-authorized GO debt of the university. As part of the state's contract with bondholders, the funds necessary to meet the debt service commitment are paid by the state treasurer to the trustee from Connecticut's general fund and these payments are not subject to further legislative authorization or appropriation. Although the bonds are secured by a GO pledge of the university and do not carry a GO pledge of the state, in our view the debt service payment mechanism established by the statute and bond documents, which mandates and obligates the state to make annual payments without further legislative approval, provides strong bondholder security similar to Connecticut's GO pledge. Under the UCONN 2000 legislation enacted in 1995, the debt service commitment extends for the life of the bonds. The 2017A bonds will fund various capital projects for the university and a health center, while the refunding series 2017A bonds will be used to pay debt outstanding for interest cost savings.

Connecticut has a long track record of supporting investments in the university. In 1995, the legislature approved the UCONN 2000 program to strengthen the university and the overall economic development prospects of the state. Since that time it has been expanded and extended by the legislature (21st Century UCONN) and includes three phases of investment to modernize, expand, and rehabilitate the university's physical plant. The current program

extends through 2024 and totals $4.6 billion, including $4.3 billion of bond authorization for project funding plus cost of issuance secured by the debt service commitment, of which $2.5 billion in project funding has been issued to date, with a par value of $2.4 billion. The most recent expansion/extension was during the 2016 legislative session.

The University of Connecticut was founded in 1881, has 32,027 students, and offers seven undergraduate and 23 graduate and professional degree programs at 14 colleges and schools. In addition to the main campus in Storrs, Conn., there are four undergraduate regional campuses located throughout the state. A sixth campus houses the university's health center, which includes the school of medicine, the school of dental medicine, medical and dental clinics, and John Dempsey Hospital in Farmington; a seventh campus houses the School of Law. The university is the flagship institution of the State of Connecticut. The university has received a significant amount of support from the state in the form of operating appropriations and the issuance of the debt service commitment bonds to modernize, enhance, and expand its physical plant.

The 'AA-' GO rating on the state of Connecticut reflects what we view as the state's:

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

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 that 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 0.9% state employment growth in 2016, and 0.5% 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 October 2016, the state's rate was 5.1%.

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 currently projects a small drawdown in 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 drew 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 projected would produce a $200,000 general fund operating surplus in fiscal 2017. However, the state now expects to run a $67.7 million operating deficit, or 0.4% of estimated general fund expenditures, following release of its November consensus revenue estimate.

The state projects a $1.3 billion budget gap based on a new fixed cost methodology that will need to be closed in fiscal 2018 in the upcoming biennium budget, or 7.3% of projected 2018 general fund revenue. Connecticut's projection is based on the difference between the consensus revenue estimate and growth in fixed costs. Using a current services cost basis approach, which assumes no change in the current level of services and includes growth in wages and inflation, the state legislative Office of Fiscal Analysis projects a larger $1.5 billion budget gap.

Part of the general fund budget gap in 2018 is attributable to the diversion of $682.6 million of sales tax to the state's transportation fund and municipal revenue share account, which is expected to lead to a slight overall decline in general fund revenue, despite overall projected tax revenue growth. Connecticut is projecting a 3.2% economic growth rate for personal income tax in fiscal 2017 and 3.3% in fiscal 2018, while also projecting sales tax economic growth of 3.1% in fiscal 2018.

We believe out-year gaps might be difficult to close due to tax increases already imposed in the past two biennium budgets and expenditure cuts that have already occurred. Connecticut indicates that after reductions in the number of employees since 2008, the number of executive office agency employees per 1,000 residents is now lower than in 1960.

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 total 33% of 2018 general fund consensus revenue estimates, a level that we believe could potentially rise should

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future revenue growth fall below current projections. In fiscal 2017, these costs are estimated to constitute 28% of fiscal 2017 revised general fund appropriations, up from a previously estimated 26% in 2016. Driving fixed costs is the state's high debt load, scheduled increases in OPEB pre-funding, and increasing pension contributions, caused by realized retirement system investment returns that have fallen below what we view as somewhat aggressive returns assumptions. Connecticut did, however, reduce net bond authorizations by $642 million in the most recent budget revisions to ensure that total debt authorizations stay below 90% of the state's statutory debt limit, which could help stabilize debt service costs.

The most recent midfiscal 2017 budget revisions consisted largely of what we viewed as ongoing structural measures. 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 $847.2 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. Weak investment returns and what we view as an aggressive 8.0% rate of return assumption have led to increasing annual pension contributions. 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. While the state projects these factors will raise fixed costs by $1.1 billion in fiscal 2018, it projects fixed costs will grow by only $255.3 million in fiscal 2019.

The state has recently disclosed a settlement with its state employee unions that could restrain potential increases in future annual state pension payments. If approved by the state legislature, the agreement would lengthen the amortization period of the unfunded pension liability and move to level annual state pension contributions from level percent of payroll, while at the same time lowering the assumed pension funds' investment rate of return to 6.9% from 8.0%. The potential increase in state annual pension costs from the lower assumed rate of return would be largely offset by the move to a longer unfunded liability amortization period. However, the net effect could lower the actuarial funded ratio.

Weak income tax growth has underlined recent revenue shortfalls, particularly in volatile capital gains taxes, underpinned by the lack of a bounceback in high wage jobs since the last recession. In 2014, the top 1% of taxpayers paid 36% of the state income tax, and these taxpayers' income is particularly affected by capital gains. 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.

Connecticut 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 we believe it will likely not get resolved for some time. 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 $22 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, the date of the last audit, 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 Malloy 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.

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 systems' annual required contribution (ARC), which helps ameliorate what we view as currently low retirement systems' funded levels. A previous pension bond issuance includes a covenant to pay the teachers' retirement ARC as long as the bonds are outstanding. Connecticut 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 43.30% using state actuarial assumptions), while the teacher retirement funded ratio on a GASB basis was 61.51% in 2015.

Connecticut has since released a fiscal 2016 teachers' retirement system valuation, which showed an increase in unfunded liability, in part due to a reduction in its assumed rate of return to 8.0% from 8.5%. The report shows a 56% actuarial funded ratio. However, the state's GASB 68 pension valuation report for fiscal 2016 keeps the aggressive 8.5% return assumption and rolls over assumptions used in its year earlier valuation. On that basis, the fiscal 2016 teachers' system net pension liability to total pension liability was 59.5%.

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 '2.1' to Connecticut.

(For further information, see the full report on Connecticut's GO debt published Dec. 1, 2016, on RatingsDirect.)

Outlook

The negative outlook reflects our outlook on the state of Connecticut.

The negative outlook on the state reflects our belief that projected fixed costs as a percent of the budget could rise significantly enough to seriously impede the state's ability to maintain structural balance in periods of national growth. The state is already projecting what we view as large budget gaps that will need to be closed in the upcoming fiscal 2018-2019 biennium budget. The state projects debt service, pension, and OPEB costs will total 32.6% of fiscal 2018 general fund revenue, a level that we see as high and potentially growing in future years. Fixed cost growth has led to large out-year budget gap projections that might be difficult to manage following previous biennium tax increases and expenditure cuts. Should fixed costs rise substantially further as a percent of the budget, pension funded ratios decrease below 40%, or the state resort to structurally unbalanced budget balancing measures during a time of national economic growth, we could lower the rating.

However, should fixed costs stabilize as a percent of the budget and the state maintains structural balance, or should economic growth enable the state to restore its budget stabilization fund to the point it could provide protection in the next economic downturn, we could revise the outlook to stable. Our current rating anticipates that Connecticut can achieve near structural budget balance during periods of economic expansion, but that it might fall out of structural budget alignment during economic downturns, and will likely maintain what we would characterize as low reserve levels for the near future, despite national economic growth. Connecticut previously issued debt to cover operating deficits in the last recession, some of which remains outstanding.

Ratings Detail (As Of December 21, 2016)		
Connecticut Hlth & Ed Fac Auth		
Long Term Rating	AA-/Negative	Affirmed
Connecticut		
Long Term Rating	AA-/Negative	Affirmed
Connecticut approp		
Long Term Rating	A+/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO bnds ser 2012 B dtd 04/26/2012 due 04/15/2021-2032		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO bnds ser 2016C due 05/15/2034		
Long Term Rating	AA-/A-1/Negative	Affirmed
Connecticut GO (AGM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed

Ratings Detail (As Of December 21, 2016) (cont.)		
Connecticut GO (AGM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO (AGM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO (BAM) (SECMKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO (BAM) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO (FGIC)		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA-/Negative	Affirmed
Connecticut GO		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Capital City Economic Dev Auth, Connecticut		
Connecticut		
Capital City Economic Dev Auth (Connecticut) GOEQUIV		
Long Term Rating	AA-/Negative	Affirmed
Capital City Economic Dev Auth (Connecticut) GOEQUIV		
Long Term Rating	AA-/A-1/Negative	Affirmed
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)/Negative	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		
Long Term Rating	AA-/Negative	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		

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Ratings Detail (As Of December 21, 2016) (cont.)		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev rfdg bnds (Connecticut) (Connecticut State University System Issue) ser P-1 due 11/01/2036		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev rfdg bnds (Connecticut) (Connecticut State University System Issue) ser P-2 due 11/01/2035		
Long Term Rating	AA-/Negative	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		
Long Term Rating	AA-/Negative	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		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) state supported rev bnds		
Long Term Rating	A+/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) APPROP		
Long Term Rating	A+/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) GOEQUIV		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth nsg home prog		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) nsg home prog taxable		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) st univ sys issue		
Long Term Rating	AA-/Negative	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		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) univ issue		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut Hsg Fin Auth, Connecticut		
Connecticut		
Connecticut Hsg Fin Auth (Connecticut) state supported spl oblig bnds		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hsg Fin Auth spl needs hsg mtg fin prog		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Connecticut Innovations Incorporated, Connecticut		
Connecticut		
Connecticut Innovations Incorporated (Connecticut) gen fd oblig bnds		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Dev Auth (Connecticut) GO		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed

Ratings Detail (As Of December 21, 2016) (cont.)		
University of Connecticut, Connecticut		
Connecticut		
University of Connecticut (Connecticut)		
Long Term Rating	AA-/Negative	Affirmed
Waterbury, Connecticut		
Connecticut		
Waterbury (Connecticut) GO spl cap reserve fd		
Unenhanced Rating	AA-(SPUR)/Negative	Affirmed
Many issues are enhanced by bond insurance.		

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