

# CONNECTICUT

## AN OVERVIEW OF STATE'S DEBT

### JANNEY FIXED INCOME RESEARCH

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## Four major state bond issuance programs offer a variety of high investment grade investor alternatives

#### GENERAL OBLIGATION

AA2/AA/AA

#### TRANSPORTATION - SPECIAL TAX

AA3/AA/AA

#### STATE REVOLVING FUNDS

##### CLEAN WATER

AAA/AAA/AAA

#### SINGLE FAMILY HOUSING

##### PROGRAM

AAA/AAA/AAA

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### SUMMARY

- Connecticut is wealthiest of fifty states, but faces a relatively large amount of bond and pension liabilities.
- Following declines during the recession, state revenues are recovering due in large part to recent tax increases.
- Four major bond programs offer a variety of security structures.

### INTRODUCTION

Connecticut is a prolific issuer of bonds with \$13.6 billion of general obligation debt outstanding and another \$9 billion of direct, indirect and conduit loans outstanding. Like most states, the Constitution State is challenged by the aftermath of the Great Recession, and was particularly impacted by the economic downturn of the financial services industry. The state's strong wealth metrics are a positive credit factor, but high levels of debt and underfunded pensions are a longer term structural problem which must be addressed in coming years. Generally we believe the state's ability and willingness to meet debt service obligations are strong.

### GENERAL OBLIGATION ISSUES

Connecticut has about \$13.6 billion of general obligation debt outstanding, which is backed by the full faith, credit and taxing power of the state. The following considerations reflect directly on GO debt, but are also factors for most of the state's issues.

- Aa2/AA/AA
- State is wealthiest of fifty based on per capita income levels
- Elevated debt and liabilities - a recent Moody's report comparing the combination of debt and pension liabilities as a percent of GDP for all states ranked Connecticut as third highest of the fifty. Pension funding is relatively low 53% of liabilities as of 6-30-10.
- State has struggled with budget gaps, but an expected \$500 million shortfall in FY 2010 turned into a \$449 million surplus. Gap for FY 2011 was recently estimated at \$434 million. The state's rainy day fund, once at \$1.4 billion, was largely depleted in FY 2009 and 2010.
- State raised income tax rates (from 5% to 6.5% for high earners), imposed a 10% corporate tax surcharge for 2010 and 2011 and raised cigarette excise tax rate in 2009.
- Large dependence on recently volatile financial industry with personal income tax accounting for 37% of state revenues.
- Revenue recovery is strong – in four quarters ending 3 Q 2010, CT was third after California and New York in pace of personal income tax withholding increases – positive in all four quarters.
- In addition to addressing high liability levels, future challenges include dealing with end of federal stimulus funding as well as requirements of new federal healthcare law.

Connecticut Debt as of June 30, 2010

Bond Program	Amount	Security	Ratings
<b>Direct Debt</b>			
General Obligation	13,592,708,000	Full faith credit etc.	Aa2/AA/AA
Transportation	3,030,485,000	Motor vehicle fuel taxes and other transportation related fees and taxes	Aa3/AA/AA
<b>Revenue Bonds</b>			
University of CT	168,167,000	Student Fees	Aa2/AA/AA-
State Universities	276,471,000	Student Fees	Aa2/AA/NR
State Revolving Fund Clean Water	767,817,000	Loans to municipalities - rating based on high credit quality and overcollateralization	Aaa/AAA/AAA
State Revolving Fund Drinking Water	54,132,000	Loans to municipalities - rating based on high credit quality and overcollateralization	Aaa/AAA/AAA
Bradley Airport	188,785,000	Airport Revs	A3/A/A
Bradley Parking Garage	43,005,000	Backed by Apcoa Bradley Parking	NR/BB/NR
Ct. Development Auth.	19,225,000	Various	Various
Ct. Housing Fin. Auth.	4,189,023,000	Single Fam Mtg Program	Aaa/AAA
Ct. Res. Recov. Auth.	16,200,000	Various	Various
Ct. High. Ed. - Supp. Loan Auth.	157,035,000	State's college loan program	Aa2/NR/NR
Capital City Econ. Dev. Auth.	102,681,000	Various	Various
UConn Foundation	6,735,000	University support	Aa3/AA-/NR

Source: CT CAFR, Moody's, S&P, Janney FIS

TRANSPORTATION - SPECIAL TAX OBLIGATION

- Both senior and second lien rated Aa3/AA/AA.
- Secured by pledged revenues which include motor fuels taxes (45%), motor vehicle registration fees (20%), oil company tax payments (13%), permits and fees (12%) and other sources.
- Bond proceeds, along with funds from other sources, support the state's highway and bridge capital program.
- S&P estimates debt service coverage at 2.6x in 2010.
- Revenue stream, primarily based on transportation taxes and fees, is susceptible to economic fluctuations.

STATE REVOLVING FUNDS - CLEAN WATER

- Aaa/AAA
- Issued to provide funds for loans to municipalities for water and wastewater purposes.
- A combination of high average credit quality of the underlying municipal borrowers, as well as program overcollateralization, warrant AAA ratings from Moody's and S&P.

Special Tax Obligations issued to support transportation projects have debt service coverage of 2.6x

Housing program is one of strongest in the nation

### SINGLE FAMILY HOUSING PROGRAM

- Aaa/AAA
- Security is collateral of underlying single family (84%) and some multi-family loans (16%).
- 72% of single family loans are FHA, RDA or VA insured.
- 10% are covered by conventional mortgage insurance.
- 18% have loan to value levels below 80%.
- One of strongest state housing programs.
- No state guarantees or explicit backing.

### HEALTH AND HIGHER EDUCATION ISSUES

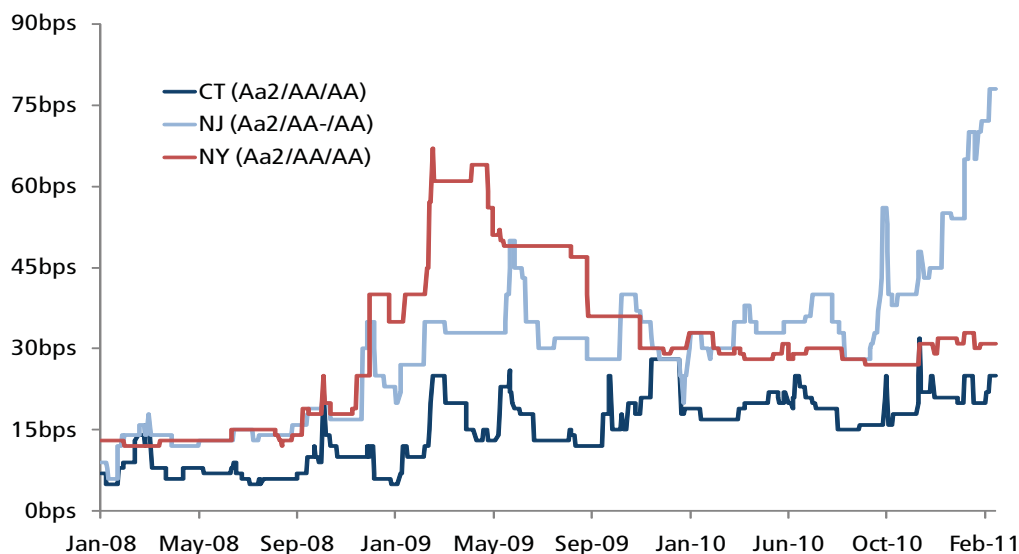
- Conduit issuer with no state backing.
- Supports borrowing for healthcare organizations, higher education institutions and other non-profit entities.
- In most cases the credit quality is based on the issuer – Yale is Aaa/AAA while bonds issued for Bristol Hospital, originally insured by Radian, are no longer rated.

### TRADING LEVELS

The graph compares the spreads of Connecticut, New York and New Jersey, like rated states with some economic dependence on the financial services industry. Spread is the yield differential between the yield of a given security and a benchmark AAA yield, in this case for ten year maturities. Connecticut yields have been consistently below those of comparable states, reflecting market and investor perception of credit quality. It is notable that all three states have seen their spreads widen over the past three years. New York saw pressure in early 2009, facing a \$16 billion budget gap and income tax revenue declines from the downturn in the financial services sector. More recently New Jersey has experienced rising spreads as it struggles to address large debt and pension liabilities.

Connecticut GO bonds trade with lower yields than other bonds in the same rating category such as those of New York and New Jersey

Ten Year Maturity CT Yield Spreads



Source: Thomson MMD, Janney FIS

High wealth levels and sovereign taxing power offset elevated liabilities in the short term, but these structural issues must be addressed in the future.

## CONCLUSION

Connecticut has the wealth and taxing power to work through the financial impact of the Great Recession, but needs to address longer term structural deficits, including significant debt and pension liabilities. Unlike some states which have a dizzying variety of state backed agencies and appropriation backed debt, Connecticut has fewer distinct issuers. The high ratings of most programs reflect in varying ways the wealth and financial stability of the state, as well as strong structures of specific programs. A demonstrated willingness to increase taxes, although difficult for taxpayers, is a credit positive in a time when many states (New Jersey) are holding the line on tax increases.

## ANALYST CERTIFICATION

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