

# **FITCH RATES \$300MM UNIVERSITY OF CONNECTICUT GO BONDS 'A'; OUTLOOK STABLE**

Fitch Ratings-New York-26 March 2018: Fitch Ratings has assigned an 'A' rating to \$300 million of University of Connecticut (UConn) general obligation (GO) bonds, 2018 Series A. The par amount of the bonds is subject to change pending final sale.

The bonds are expected to be sold via negotiation the week of April 16, 2018.

The Rating Outlook is Stable.

## **SECURITY**

Bonds are a general obligation of UConn, additionally secured by a pledge of and lien on a state of Connecticut (Issuer Default Rating [IDR] A+) 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 one notch below the state 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 rating of 'A+/'Stable reflects expectations for relatively flat economic and revenue performance that will continue to challenge the state in matching revenues to expenditures, together with the state's broad economic resource base and the continued fiscal flexibility inherent in a state's budget autonomy. The state's long-term liabilities are expected to remain well above the U.S. state average, an elevated although still moderate burden on the wealthy resource base and one that limits expenditure flexibility compared to that of most states.

### **Economic Resource Base**

Connecticut has a wealthy, mature and diverse economy anchored by a large finance sector and important manufacturing and education and health sectors. The impact of the Great Recession on Connecticut was severe and the economic and revenue recovery has been very slow compared to previous economic cycles. Over 2012-2016, employment in the state rose at roughly half of the pace enjoyed by the nation, and current employment remains below the pre-recession peak. The state forecast is for fairly weak employment growth over the next several years. The state is the wealthiest in the U.S. as measured by per capita personal income, although aggregate personal income gains have trailed the nation and key finance and manufacturing sectors are experiencing only modest growth after the retrenchment of recent years.

### **KEY RATING DRIVERS**

#### **Revenue Framework: 'a'**

Tax revenues are diverse, although the largest tax revenue source, personal income tax (PIT), is subject to considerable cyclical. Sales, corporate income, transportation and gaming taxes serve to diversify the tax base. Baseline growth of taxes has been marginal, requiring tax policy changes to boost revenues, and modest future economic growth will continue to constrain resources. The state has unlimited legal ability to levy taxes.

#### **Expenditure Framework: 'aa'**

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

#### Long-Term Liability Burden: 'a'

The burden of debt and unfunded pension liabilities in relation to resources is elevated and among the highest for a U.S. state but still considered moderate. Net tax-supported debt consists primarily of GO and transportation borrowings, with much of GO borrowing undertaken on behalf of local schools. Unfunded pensions are more significant, with recent reforms providing budgetary savings but raising the unfunded liability.

#### Operating Performance: 'a'

Gap-closing capacity remains strong but its robustness has been reduced by the state's modest economic growth during the current national economic expansion and the resulting repeated need for gap-closing actions. Reserve balances are low and the state has continued to increase taxes and cut spending throughout the expansion, reducing its means to tackle future cyclical budgetary challenges, while out-year budget gaps remain an issue to be addressed. Under current law, windfall revenue received in fiscal 2018 related to federal tax laws is deposited to the state's budget reserve fund and will improve balances, unless offsetting action is taken by the state. Frequent revenue re-forecasting allows the state to identify revenue underperformance and quickly implement corrective actions.

#### RATING SENSITIVITIES

**RATING LINKED TO STATE CREDIT QUALITY:** The rating on UConn's GO bonds is sensitive to changes in the state's IDR, to which it is linked.

**MAINTAINING FISCAL RESILIENCE:** Connecticut's IDR is sensitive to the state's ability to rebalance financial operations to its current economic profile in a manner consistent with the current rating level.

#### 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. 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 will be funded by UConn GO bonds benefitting from the state's debt service commitment. Of this amount, about \$2.7 billion in par debt service commitment bonds have been issued to fund \$3.1 billion of university project construction to date, with almost \$1.4 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, including the newly located Hartford campus and the UConn Health Center in Farmington. Current bond proceeds will fund various projects dispersed among these areas and include new construction of academic and research facilities, new classroom facilities, equipment purchases, infrastructure improvements and building renovations.

## STATE OF CONNECTICUT

Connecticut has a diverse, mature and wealthy economic base, with flat to modestly declining population trends and an aging demographic profile. In contrast to past economic expansions, the state's performance in the current expansion has been unusually slow and uncertain. The state projects positive medium-term economic growth but at rates below the nation's.

The state's operating performance has suffered from the need to address chronic economic and fiscal challenges throughout the current prolonged period of national economic expansion, along with the significant delay in enacting a budget for the current biennium, highlighting the narrowed options for closing a substantial \$5 billion (15% of general fund biennial revenues) forecast budget gap. While the budget was largely enacted with recurring actions on the part of the state, including achieving sizable budgetary savings from a renegotiated labor contract, budget gaps for both fiscal years 2018 and 2019 have been identified. The rating assumes that the state will continue to proactively manage its challenged financial operations.

For further information on the State of Connecticut, please see Fitch's press release dated March 15, 2018, 'Fitch Rates \$617MM Connecticut GO Bonds 'A+'; Outlook Stable,' at [www.fitchratings.com](http://www.fitchratings.com).

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Date of Relevant Rating Committee: Dec. 5, 2017

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

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

## Applicable Criteria

U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)

<https://www.fitchratings.com/site/re/905637>

U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)

<https://www.fitchratings.com/site/re/898466>

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