FITCH DOWNGRADES CONNECTICUT'S GO BONDS TO 'AA'; OUTLOOK TO STABLE

Fitch Ratings-New York-03 June 2010: Fitch Ratings assigns ratings to the following State of Connecticut (the state) general obligation (GO) bonds:

--$200 million series 2010B (new money) 'AA';
--$400 million series 2010C (refunding) 'AA'.

In addition, Fitch downgrades the following ratings:

--Approximately $13.7 billion in outstanding state GO bonds, to 'AA' from 'AA+'.

The new bonds are expected to sell via negotiation during the week of June 7, 2010.

The Rating Outlook has been revised to Stable from Negative. Other state credits affected by this rating action are listed at the end of this release.

RATING RATIONALE:
--The downgrade reflects the state's reduced financial flexibility, illustrated by its reliance on sizable debt issuances during the current biennium to close operating gaps in the context of already high liabilities. The state faces large structural imbalances beyond the current biennium.
--The state is the nation's wealthiest as measured by per capita personal income, although the current downturn is affecting key concentrations in manufacturing and financial activities.
--Large budget reserves were accumulated through conservative revenue estimating and strong tax collections leading into the recession. Significant revenue declines in the downturn and persistent spending pressures from Medicaid and employee fringe benefits, among other needs, have enlarged structural imbalances and led to the planned depletion of these reserves.
--Tax-supported debt is high. Most GO bonds, excluding GO bonds issued to fund the teachers' retirement system, amortize rapidly.
--Unfunded liabilities for employees are significant, including for state employee and teacher pensions and for other post-employment benefits.

KEY RATING DRIVER:
--Ability to maintain budgetary balance given constrained fiscal flexibility and high liabilities.

SECURITY:
GO bonds to which the full faith and credit of the state will be pledged for payment of principal and interest.

CREDIT SUMMARY:
The downgrade of the state's GO rating to 'AA' reflects the state's reliance on borrowing to address its ongoing fiscal challenges in the context of already high liabilities and large projected structural gaps. The state issued $916 million in deficit notes to eliminate its fiscal 2009 budget gap after the close of the fiscal year, and now plans an additional $956 million deficit note borrowing, payable from a non-general fund utility assessment, to close the remaining fiscal 2011 gap, after fully depleting its budgetary reserve. Although the state has taken other balancing actions to confront recession-related revenue weakness, including tax rate increases and spending cuts, it has relied primarily on one-time resources, including deficit borrowing, fund transfers, reserve fund transfers and pension contribution cuts to return to balance. Such one-time actions further constrain the state's operating flexibility in the near term as it seeks to address large projected imbalances beginning in fiscal 2012, even assuming revenue performance achieves current targets. Despite the high burden of its debt and other liabilities, the state continues to benefit from vast wealth and income resources. The Stable Outlook at this rating level incorporates Fitch's view that the state

will be able to address its near- and longer-term budgetary challenges in a manner consistent with an 'AA' rating.

The state's volatile revenue system periodically leads to budget imbalance, although its recent practice of setting aside large reserves had supported the credit. Large surpluses through fiscal 2007 enabled the state to set aside a $1.38 billion budget reserve fund (BRF), equal to 8% of fiscal 2009 appropriations. State tax receipts, particularly from personal income, eroded steadily in the course of fiscal 2009 with economic weakening, ending the year down 14.5%, to $10.7 billion. Despite balancing actions including transfers, spending cuts and use of federal stimulus, the fiscal year ended with a $947.6 million deficit, equal to 5.8% of appropriations. The state closed the deficit through the November 2009 sale of GO economic recovery notes (ERNs), while preserving the BRF balance to resolve forecast gaps in the fiscal 2010-2011 biennium budget. The state has issued ERNs in the past, albeit after first depleting the BRF.

The fiscal 2010-2011 biennium enacted budget achieved balance largely through use of one-time resources, including planned borrowing, as well as tax rate changes and spending cuts. One-time resources included planned BRF draws of $1.04 billion in fiscal 2010 and $342 million in fiscal 2011, federal stimulus of $879 million in fiscal 2010 and $595 million in fiscal 2011, and an authorized $1.3 billion securitization in fiscal 2011. Recurring measures included tax and fee increases, including a new personal income top rate at 6.5% for high earners and a temporary corporation tax surcharge; tax changes were projected to yield $845 million in fiscal 2010 and $606 million in fiscal 2011. Including rate changes, net tax receipts were forecast to rise 2.1% in fiscal 2010, to $10.9 billion, and remain flat in fiscal 2011. Spending reductions included measures to reduce labor-related expenses going forward.

A weakening outlook for revenues and the impact of new spending needs, particularly Medicaid, reopened large gaps in the fiscal 2010-2011 biennium budget. As of February 2010, the state forecast a fiscal 2010 gap of $504 million, or about 3% of forecast revenues. State actions to close the gap included delaying a portion of pension contributions ($100 million), shifting planned use of BRF funds to fiscal 2010 ($239 million), other transfers ($65 million) and spending cuts ($65 million). Subsequently, the state's April 30 consensus revenue forecast raised the fiscal 2010 outlook $124 million, primarily due to strengthening withholding performance and moderating sales tax declines. To resolve the remaining fiscal 2011 gap, revised downward to $417 million, the state is cutting expenditures $163 million, including another pension contribution reduction ($100 million), recognizing additional federal stimulus ($335 million) and transferring a now-expected fiscal 2010 surplus to fiscal 2011 ($140 million). The largest component of fiscal 2011 gap-closing remains the planned borrowing, lowered to $956 million from $1.29 billion; the borrowing will be supported by non-general fund utility assessments. Future general fund surpluses through fiscal 2017 will be directed toward repayment of existing ERNs and the planned borrowing, delaying the state's ability to begin rebuilding the BRF balance. Even with the benefit of recurring actions in this biennium, the state forecasts a structural gap of $2.6 billion in fiscal 2012, or 14.7% of fiscal 2011 planned spending.

The state's fixed debt burden is high, with net tax-supported debt as of March 31 at $19.6 billion, including subsequent issues, or 10.2% of 2009 personal income. Three-quarters of net tax-supported debt is GO, a large share of which is issued for local schools; excluding $2.3 billion in GO pension bonds issued for the teachers' retirement fund (TRF), the debt burden falls to a still high 9% of personal income. Funding levels for the state's major pension systems remain a concern. As of June 30, 2008, the state employees' retirement system (SERS) was funded at 52%, and the TRF was funded at 70%, the latter following deposit of pension bond proceeds. Although the state fully funds its actuarially required contribution to TRF, it has lowered its payment to SERS by $100 million, to $844 million, as part of budget gap closing.

The state has a wealthy, diverse economy, but has experienced broad recession-related weakness. The state lagged the nation into the recession, with employment losses beginning in mid-2008. After peaking in mid-2009, the pace of job losses appears to be slowing, with April 2010 employment down 0.8% from April 2009, less severe than the 1% national decline for April 2010 and significantly improved from the 5% loss recorded by the state in August 2009. Recent unemployment rates are tracking well above pre-recession levels, with April 2010 at 9%, compared to 8% in April 2009. Job losses have been particularly severe in construction (down 6.7% in April 2010), manufacturing (down 3.2%), and professional and business services (down 3.1%). The state's large financial activities sector, with insurance concentration in Hartford and banking in Fairfield County, is down 2.7%. The state is the wealthiest as measured by personal income per capita, at 139% of the national average in 2009. Personal income in the state has fallen sharply in the current downturn, with fourth quarter 2009 down 2.2% from the fourth quarter of 2008, versus a 1% decline nationally.

In conjunction with the downgrade of the state's GO rating, Fitch has downgraded the following state-related ratings and revised the Rating Outlook to Stable from Negative:

--University of Connecticut GO bonds to 'AA-' from 'AA';
--University of Connecticut student fee revenue bonds, series 1998A to 'AA-' from 'AA';
--Connecticut Development Authority GO bonds series 1993A to 'AA-' from 'AA';
--Connecticut Development Authority state general fund obligation bonds and refunding bonds to 'AA-' from 'AA';
--Capital City Economic Development Authority parking and energy fee revenue bonds to 'AA-' from 'AA';
--Connecticut Health & Educational Facilities Authority (child care facilities program) to 'A+' from 'AA-';
--Waterbury (CT) GO special capital reserve fund bonds to 'AA-' from 'AA'.

Applicable criteria available on Fitch's website at 'www.fitchratings.com' include:
--'Tax-Supported Rating Criteria', dated Dec. 21, 2009.
--'U.S. State Government Tax-Supported Rating Criteria', dated Dec. 28, 2009.

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Additional information is available at 'www.fitchratings.com'.