

## Connecticut's \$512MM GOs May Not Reflect State's Problems

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by Maria Amante

Preliminary price talk on Connecticut's \$512MM general obligation issuance carries some additional yield for investors, but the market could demand more, said a portfolio manager and trader.

This is the second time Connecticut has tapped the market this year after selling \$550MM Series 2016A in March. This week's deal comes on the heels of two downgrades last Thursday (May 19th) -- one from Fitch, the other from Standard & Poor's. Standard and Poor's and Fitch Ratings both downgraded the state one notch to AA-/stable. Connecticut is rated Aa3/negative by Moody's Investors Service.

Preliminary price talk on a \$56MM Series 2016B tax exempt general obligation bond due 2026 is a 4% coupon with a 2.23% yield, according to traders. That's about +60bps to AAA MMD. During March, Connecticut priced \$7.25MM in 4% Series 2016A general obligation bonds due 2026 yielding 2.52% or about +65bps to AAA MMD.

One must look at AA and A rated scales for perspective on pricing, said Neil Klein, Senior Portfolio Manager and Principal at Carret Asset Management [\$1.9 billion AUM]. The average 10-year yield for AA rated credits is 2.03% on the MMD scale and 2.11% for A rated credits, according to Klein. That means Connecticut is about +20bps wide to other AA credits and +12bps to A rated credits, he said.

The market is somewhat mixed on pricing. Those yields are too expensive for some investors and do not compensate for the risks associated with Connecticut, said one trader.

"It's cheaper than MMD, a higher yield, but it's not outrageously wide," Klein said. "The spread is in line with our expectations of where Connecticut falls compared to other states faced with similar fiscal challenges."

The retail order period began today and opens to institutional investors tomorrow, according to the roadshow. Another \$300MM Series 2016C variable rate debt will price on June 13<sup>th</sup>. Both transactions close on the 14<sup>th</sup> of June, the treasurer's office said.

"We have found having a portion of our bonds as variable rate has been a significant savings for the state," the Connecticut State Treasurer's Office said in a statement to *Debtwire Municipals*. The Treasurer's office declined to comment on this week's pricing.

Bank of America Merrill Lynch and Williams Capital Group are lead underwriters on the transaction, representatives for both declined to comment for this story.

"Connecticut is getting dragged through the mud, from the way the street looks at Connecticut and other states -- at this time, the state is on negative watch (from Moody's)," Klein said. "Investors want to see a plan, the ratings agencies want to see a plan ... but we believe that Connecticut has the wherewithal, politically and financially, to get past the near-term challenges."

“We’re waiting for a different category of pricing before we get involved,” the trader said. “Pennsylvania is worth more, but the market has it the other way. Connecticut has strong demand for in-state paper, very concentrated wealth buys Connecticut bonds. It should be cheaper than Pennsylvania and richer than New Jersey, maybe about +85bps.”

Yields on 10 year Pennsylvania general obligations are about +70bps to the AAA MMD and New Jersey is about +95bps, the trader said. The Commonwealth of Pennsylvania is rated Aa3/negative by Moody’s Investors Service, AA-/negative by Standard & Poor’s and A/stable by Fitch Ratings. New Jersey is rated A2/negative by Moody’s Investors Service, A/negative by Standard & Poor’s and A/stable by Fitch Ratings.

In FY16, Connecticut faced a \$259MM deficit, or 1.4% of total spending from a decrease in income tax receipts, according to an investor road show. A \$406MM budget reserve papers over the deficit, leaving the state with an end balance of \$147MM.

The state needed to revise the budget earlier this month to address a projected FY17 deficit of \$963MM, according to the road show. That revision reduced spending by \$825MM and incorporated structural changes to balance the budget, according to the road show.

Connecticut’s total budget is about \$18bn. In FY16 it reported \$17.73bn in revenue to \$ 17.99bn in expenses. With the revisions, FY17 will see \$17.8bn in spending and revenue.

“Parts of Connecticut are very affluent which can aid in filling the deficit,” Klein said. “The state potentially has room to raise the state income tax level... we believe that Connecticut has the resources to move through the crunch in a positive way.”

The state’s pension problems are well-publicized. Although Connecticut’s funded its actuarially required contribution since 2012, the State Employees’ Retirement System has a 43.3% funded ratio and 14.9bn in unfunded actuarial accrued liabilities (UAAL). The Teachers’ Retirement System has a 59% funded ratio and \$10.8bn in UAAL.

Connecticut has \$17.2bn in general obligation debt outstanding.