ASSET PRESERVATION ADVISORS

"HARTFORD, WE HAVE A PROBLEM"

APR 2016

Perception is Far From Reality

A state that has long served as a home to many a hedge-fund manager and investment banker working in New York City, Connecticut offers charming towns, beautiful beaches and ease of access through rail, road or flight to New York and Boston. With wealth levels well above the national average and strong budget management, it begs the question, how could this state be in such poor financial health?

A Challenged Economy

The Great Recession left many challenges in its wake for cities and states with a large portion of employment in the financial services industry. Of the estimated 54,100 high-paying jobs lost during the financial crisis, only 8,200 have been recovered. The majority of recovered jobs having been lower-paying, which grew by 61,500 versus a loss of 39,900 during the Great Recession.[1] In March of 2016, Connecticut's unemployment rate still ranked well above the national average at 5.75% (national rate, 5%) and despite having a poverty rate that still falls *below* the national average, it has increased by 27% since 2005.[2]

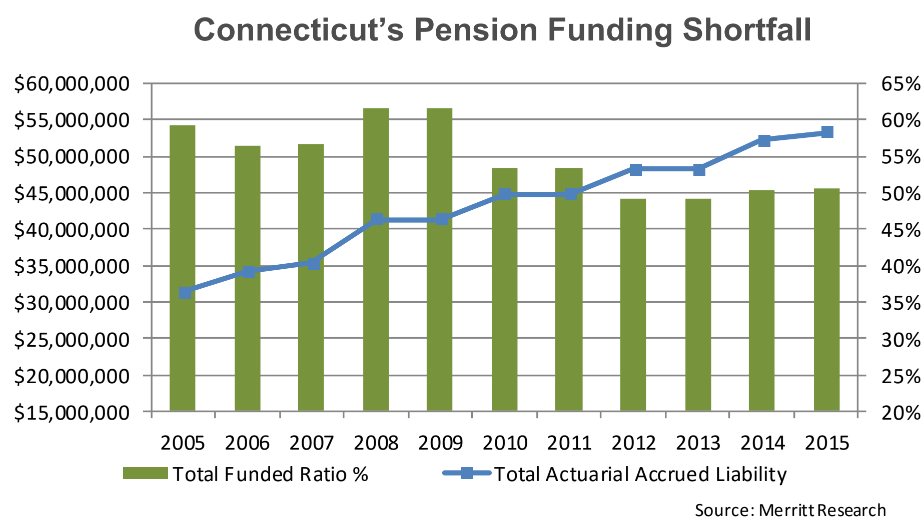
The state has been working on ways to address its projected $933 million budget gap (in 2017), at the time of this publication. Governor Dannel Malloy told reporters earlier this month that as many as 2,000 state workers could lose their jobs due to possible layoffs resulting from budget shortfalls. The state's 2016 budget had projected a negative general fund balance of approximately $20 million, which will be covered by the state's budget stabilization fund (BSF). With a current balance of $406 million or 2% of expenses, the BSF had already been drawn upon in the amount of $113 million in 2015[1], leaving reserves at a level that APA considers to be thin. Additionally, "days cash on hand," a measure of liquidity, is substantially lower than comparable double-A rated medians, at only 23 days versus 73 days.[2]

Adding to the perceived credit strength of the state is the fact that it is home to seventeen *Fortune500* companies. However, this number pales in comparison to other struggling states, like Illinois and New Jersey, who are home to 34 and 20, respectively.[3] Furthermore, General Electric, who has been headquartered in Fairfield, CT, announced that it will be moving its base to Boston, MA, citing high taxes as the reason for relocation.

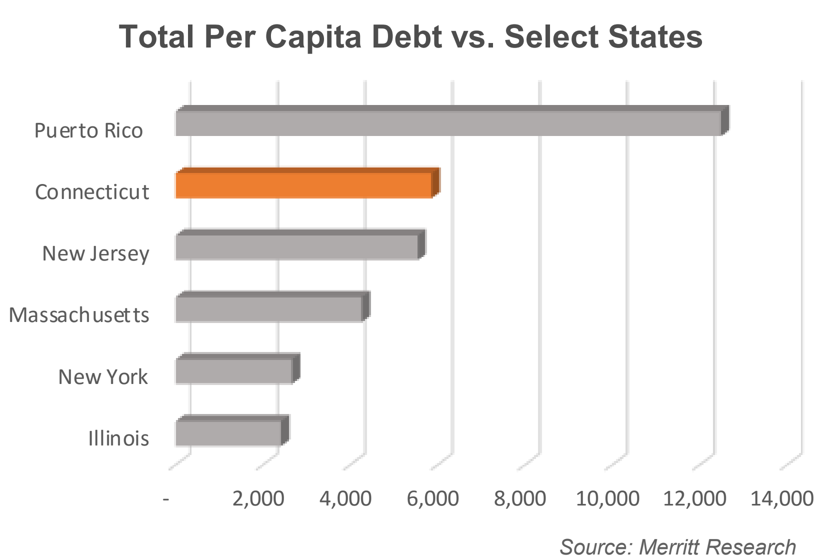
A Debt Laden State

Connecticut's bond prices may be insulated by the strong demand from wealthy residents for its in-state bond issues. "There is almost limitless money to buy Connecticut bonds" said Matt Fabian of Municipal Market Analytics. Absent this demand, it is likely that debt issued by Connecticut would reflect more tellingly its economic and financial challenges.

The state's pension system has been severely underfunded for some time. Even looking back more than 10 years, the funding ratio averaged just 54%, per year. Essentially, Connecticut has roughly half of what it needs to pay the benefits it has promised to its workers. The state's actuarial accrued pension liability is up from $31.9 billion in 2005 to $53.2 billion in fiscal year 2015. Connecticut has one of the lowest pension funding ratios, close to that of other states struggling with economic and financial challenges, like Kentucky and Illinois. While Connecticut has pared back its pension benefits and pledged to appropriate more funds, the state is facing an uphill battle.



In addition to its pension problems, the state of Connecticut has issued an exceedingly high level of debt, which accounts for approximately 12% of it's expenses.[2] According to a report released in September 2015 by the nonprofit Truth in Accounting (TIA), Connecticut ranked 2nd worst in the country based on "taxpayer burden." TIA used this metric to determine how much each taxpayer would have to take on in order to bring their state to a debt-free status. Similarly, from a per capital debt standpoint, Connecticut ranks amongst the most heavily debt burdened states.



Standard & Poor's (S&P) Ratings service lowered the outlook on Connecticut's debt from stable to negative with a warning to the state that it could lose its double-A rating. In its rating outlook, S&P specified that Connecticut's "relatively weak" post-recession economic growth has increased budget pressure despite a substantial tax hike in 2012.

APA believes that Connecticut could face further downgrades by the ratings agencies in the near term if the state doesn't strengthen their fiscal position. At this time, APA continues to remain highly selective when purchasing bond issued in the state of Connecticut.

For more information about Asset Preservation Advisors customized portfolio management, please contact:

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[1] Standard & Poor's Rating Report; Connecticut March 9, 2016
[2] Merritt Research ; March 2016
[3] Geo Lounge; July 28,2015; https://www.geolounge.com/fortune-500-list-by-state-for-2015/

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