

New Issue: MOODY'S ASSIGNS Aa2 RATING TO \$219 MILLION STATE OF COLORADO BUILDING EXCELLENT SCHOOLS TODAY ("BEST") CERTIFICATES OF PARTICIPATION AND AFFIRMS Aa2 RATING ON COLORADO'S EDUCATION INTERCEPT PROGRAMS

Global Credit Research - 29 Nov 2010

Aa2 RATING AFFIRMED ON \$183 MILLION OUTSTANDING BEST CERTIFICATES OF PARTICIPATION; OUTLOOK IS STABLE

State
CO

**Moody's Rating
ISSUE**

RATING

State of Colorado Building Excellent Schools Today Certificates of Participation, Series 2010 D	Aa2
Sale Amount	\$95,690,000
Expected Sale Date	12/09/10
Rating Description	Certificates of Participation
State of Colorado Building Excellent Schools Today Certificates of Participation, Series 2010 E	Aa2
Sale Amount	\$121,000,000
Expected Sale Date	12/09/10
Rating Description	Certificates of Participation
State of Colorado Building Excellent Schools Today Certificates of Participation, Series 2010 F	Aa2
Sale Amount	\$2,000,000
Expected Sale Date	12/09/10
Rating Description	Certificates of Participation

Opinion

NEW YORK, Nov 29, 2010 -- Moody's Investors Service has assigned a Aa2 rating and stable outlook to the State of Colorado's \$219 million Building Excellent Schools Today (BEST) Certificates of Participation, which consist of \$95.69 million Series 2010D Qualified School Construction Bonds, \$121 million Taxable Build America Bonds Series 2010E, and \$2 million Series 2010F tax-exempt bonds. The proceeds of the certificates, together with local matching dollars, will be used to finance school construction. The certificates are payable from anticipated state base rent payments, under master and supplemental financing lease agreements. The rating action also applies to \$183 million in outstanding BEST COPs.

Moody's also affirmed its Aa2 rating on the Colorado Higher Education Enhancement Program and the Colorado School District Enhancement Program. These programs ensure payment of debt service by the state if institutions of higher education of school districts are unable to make debt service payments.

Rating Rationale

The Aa2 rating on the BEST bonds is one notch below the state's issuer rating of Aa1, which is based on the state's strong long-term economic performance, its higher-than-average income per capita, and its low relative debt levels. The state's budgeting flexibility is constrained, however, by constitutional restrictions and voter initiatives. The BEST COPS rating also reflects the limited subject to appropriation nature of the state's payment obligation and the state's established track record of making appropriation-backed debt payments under similar financing agreements.

The ratings for the two intercept programs are based on Moody's assessment of the program mechanics, history and state commitment. These attributes were set forth in two reports, "Moody's Affirms Aa3 Rating for the Colorado School District Enhancement Program" released February 29, 2008 and "Moody's Assigns Aa3 Rating to the Colorado Higher Education Enhancement Program," released October 22, 2008.

Credit strengths

- * Program and lease-purchase financing specifically authorized by state statute
- * State's covenant to request annual appropriation in amounts equal to debt service payments, and its reliance on appropriation-backed debt for other capital financings
- * Low debt ratios

Credit challenges

- * COP payments are subject to legislative appropriation
- * Complex system of constitutional revenue limits and spending requirements, reflecting an active voter initiative process in the state. Voter approval is required for any state tax increase

* Lack of certain financial management best practices, such as consensus revenue forecasting

* Increasing constraints on liquidity

DEBT REPAYMENT SUBJECT TO ANNUAL APPROPRIATION

The BEST capital construction program was approved by state statute in the 2008 legislative session. Once these series have been issued, the state will have issued a just more than \$400 million of these securities. The state has limited maximum annual lease payments on bonds issued under the BEST program to \$40 million in fiscal year 2010, \$60 million in fiscal 2011, and \$80 million in fiscal 2012 and thereafter. Maximum annual certificate payments after the issuance of Series D, E, and F will approximate \$20.1 million.

The 2010 certificates are payable solely from amounts annually appropriated by the general assembly. As is standard in Colorado, the state has identified specific revenue streams from which it anticipates making these appropriations. The state has identified revenues from the State School Land Trust and certain excess Lottery revenues as a source of payment for the certificates. The State School Land Trust receives rent and royalty payments from various land lease agreements in the state. The state has capped the amounts that are used for the BEST program, including certificate payments, from the State School Land Trust to the greater of 50% of annual rent and royalty payments or the annual lease payments on the bonds.

Additional security for the bonds is provided by the state's ability to appropriate funds from any legally available source, including the state general fund, if revenues from the State School Land Trust and the Lottery revenues are insufficient to make certificate payments.

The obligation to make lease payments is absolute and unconditional, once appropriated, and the availability of the state general fund, if needed, mitigates risk of non-payment. In addition, although the state is not a frequent debt issuer, it does rely on subject-to-appropriation financing structures and thus has a strong incentive to appropriate for full and timely payment.

BALANCING PLANS SINCE START OF FISCAL YEAR RELY ON NON-RECURRING ACTIONS

Colorado faced an immediate shortfall after adopting its FY 2011 budget as the federal FMAP extension provided a lower level of assistance than had been assumed in the adopted budget. Furthermore, certain Medicaid payments were shifted from FY 2010 to FY 2011 even as Medicaid caseload increased. To address this imbalance and to bolster its reserves, the state engaged in two rounds of balancing actions in August and October.

Implemented and proposed balancing actions have relied heavily on non-recurring actions. Actions include nearly \$120 million of cash sweeps into the general fund, further slowing of Medicaid payments and the redirection of \$156 million of ARRA education jobs assistance for budget relief. This year's budget also benefited from stronger revenue collections at the end of FY 2010, resulting in nearly \$77 million in resources for FY 2011. These actions are expected to provide an additional \$34.8 million of year-end reserves that will be applied to help balance the FY 2011-2012 budget.

The state will again adjust its budget after the December revenue forecast.

In keeping with state policy, the state continues to maintain a budget surplus of 2% of general fund appropriations (\$135 million in fiscal 2011) providing some cushion for unrealized revenues or unanticipated expenditures. Fiscal 2010 unaudited results reflect a significant reduction in total reserves, with the unreserved undesignated fund balance falling to zero. Colorado had maintained positive GAAP fund balances for the previous nine fiscal years. Monthly borrowable funds, an important source of liquidity for the state, are running 15% to 20% below year-ago levels.

COMPLEX CONSTITUTIONAL CONSTRAINTS GOVERN STATE FINANCES

State finances are strongly influenced by a number of statutory and constitutional limitations and requirements affecting spending and revenue growth. The constitutional amendment known as TABOR ("Taxpayer Bill of Rights") was passed by voters in 1992 and limits state revenue and expenditure growth to the rate of population growth plus the rate of inflation. In the event that tax revenues decline in any year, the constitutional growth limit going forward is applied to the lower revenue base. Any annual tax revenues that exceed the constitutional limit must be refunded (unless voters approve otherwise) in the following year.

The state experienced severe revenue declines in fiscal 2002 and fiscal 2003 and, as a result of the TABOR amendment, state revenues available for appropriation in the subsequent years was severely limited. In November 2005, voters suspended the growth limit on revenues and allowed the state to retain revenues in excess of the TABOR limit for the period of July 1, 2005 through June 30, 2010, providing the state with much needed fiscal relief. The state estimates that it will have retained more than \$5 billion in revenues during the enacted period. These excess monies were used to fund healthcare, higher education, and public employee retirement plans. The 2005 referendum also established a new revenue cap as a limit on state spending. The cap is set at the recent peak revenue year of fiscal 2008 and will be adjusted by population change and inflation, with the result that near-term spending limits are higher than they would otherwise be under the original TABOR rules.

Additionally, in November 2000 voters diverted a portion of the state's income tax to a separate State Education Fund, and required total state K-12 education funding to increase annually by the inflation rate plus 1% through 2010, and by the inflation rate thereafter. While the increased education spending is exempted from the constitution's base spending and revenue limits, future revenue declines may mean that the K-12 constitutional spending increases will have to be made at the expense of other state programs.

COLORADO UNEMPLOYMENT BELOW NATIONAL AVERAGE

Colorado's unemployment rate remains below the national level, with the September 2010 seasonally adjusted unemployment rate of 7.7% less than the nation's (9.8%) for that same period. State forecasts project calendar year employment will increase 1.3% in 2011 compared to a 1.7% decline in 2010. State personal income is expected to grow 1.7% in 2010 and to increase more than 4% in 2011. Colorado is a wealthy state, with per capita income equal to 105% of the U.S. average.

The state economy is diverse, with below average employment concentration in manufacturing and a variety of service sector strengths. Looking ahead, the economic outlook is favorable, reflecting the growing population and workforce, relatively low costs of living and doing business, and mix of technology and service industries.

LOW STATE DEBT BURDEN, SIZABLE UNFUNDED PENSION LIABILITY

Colorado has no general obligation debt and is among the states with the lowest net tax-supported debt as a result. According to the Moody's 2010 State Debt Medians report, Colorado ranked 42nd in net tax-supported debt per capita. The state's \$2 billion outstanding net tax-supported debt - comprised mainly of transportation bonds issued during 2000-2004 under a now-exhausted voter authorization - amounts to only about 1% of state personal income.

The state's pension system currently suffers from a relatively low funding ratio of 67% and a statutorily-set pension contribution that is less than the actuarially required contribution. The state has implemented a plan to increase its contributions and more quickly amortize its unfunded pension liability. In contrast to the pension situation, the state does not face significant cost pressure with respect to retiree healthcare benefits. This mainly reflects a relatively modest, fixed monthly subsidy benefit provided by the state. The state has an established trust fund for these benefits, and expects - based on continuation of the current budgetary contribution of only 1% of payroll - to amortize its unfunded liability in less than 40 years

Outlook

The outlook for Colorado's certificates of participation is stable. The state has a history of timely appropriations for lease payments and generally conservative fiscal practices, including minimal debt. The economy is showing signs of recovery and we expect Colorado to benefit from its low-cost business environment.

What could move the rating UP?

- * Strong economic and revenue growth leading to greater budgetary flexibility and reserves
- * Trend of state voter actions indicating value placed on maintaining state's fiscal health and flexibility.

What could move the rating DOWN?

- * Failure to return to positive fund balances, especially in the context of weak revenues, the return of constitutional revenue constraints and spending limitations, and education funding requirements
- * Significant weakening in liquidity
- * Trend of voter actions that further constrain the state's fiscal flexibility
- * Continued reliance on non-recurring actions to balance budget

The principal methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in October 2004.

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