

July 2, 2009

Colorado; Appropriations; General Obligation

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Colorado; Appropriations; General Obligation

Credit Profile		
US\$300.075 mil Taxable certs of part (Justice & History Center (Babs)) ser 2009B due 09/15/2045		
<i>Long Term Rating</i>	AA-/Stable	New
US\$44.86 mil Tax Exempt certs of part (Justice & History Center) ser 2009A due 09/15/2019		
<i>Long Term Rating</i>	AA-/Stable	New
Colorado ICR due 12/31/2099		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to Colorado's series 2009A tax-exempt certificates of participation (COPs) and series 2009B taxable COPs. Standard & Poor's also affirmed the state's 'AA' issuer credit rating (ICR) and its 'AA-' underlying rating (SPUR) on the state's other lease debt. The ratings reflect:

- A broad and diverse state economy that is dealing with a national recession, but continues to exhibit better-than-average income, employment, and population trends;
- A history of making midyear budget corrections, when required, triggered by updated quarterly revenue forecasts;
- Good financial performance in recent years, offset by fiscal 2009 midyear revenue declines in the general fund due primarily to reduced individual income tax receipts; and
- A very low debt burden, constrained by constitutional limitations on state general obligation (GO) debt.

These strengths are tempered by constitutional limits on revenue growth imposed by the state's taxpayer bill of rights (TABOR) that will become effective again after the current voter-approved Referendum C exemption expires at the end of fiscal 2010, as well as school spending mandates under voter initiative Amendment 23.

The series 2009A and B COPs are payable from legally available moneys of the state that are annually appropriated as base rental payments under a lease agreement. Subject to annual appropriation, the state's obligation to pay base rentals is absolute and unconditional and the lease is not subject to abatement. Annually appropriate court fees and gaming revenues collected by the state for the historical society are also pledged to the COPs and the state plans in practice to use these funds, although the rating reflects the state's appropriation pledge. The series 2009B COPs will be issued as Build America Bonds (BABs), with the interest rate subsidy paid directly to the trustee. Although the state has pledged to pay the full interest payment, if one of the federal payments is late or otherwise unavailable, the state would need to pass a supplemental appropriation for the BABs' interest payment. The series 2009B COPs also have a subsidy fund equal to one semi-annual payment of the BAB interest subsidy, to assist with debt service timing in the event of a necessary supplemental appropriation. Proceeds from the series 2009A and B COPs will be used to finance the state's Ralph L. Carr Justice Complex and the Colorado History Center.

Echoing national trends, the Colorado economy has slowed in 2009 with increased job losses, declining retail sales, and housing market softness. However, the state has stayed on the positive side of most of these trends, and unemployment was well below the national average (7.6% for state versus 9.4% for the nation in May 2009). GDP growth in 2008 was the fourth fastest in the U.S. (2.9%). The state continues to attract net in-migration. The state housing market, while experiencing sharply lower housing starts and construction-related employment, is seeing

some stability; the Denver metro area is the best performing of the 20 metro areas in the May 2009 S&P/Case-Shiller Home Price Index. Still, the economy has impacted state finances, as revenues from individual and corporate income taxes as well as sales and use taxes have fallen sharply.

On a budgetary basis, the state maintained the 4%-of-expenditure budgetary reserve in fiscal 2008 and funded the maximum 6% budgeted increase in appropriations. The ending fiscal 2008 budgetary reserve was \$327 million, or 4.6% of appropriations. Fiscal 2008 included a \$43 million surplus balance that was directed, as required by law, to transportation and capital construction projects. On a GAAP basis, the state ended fiscal 2008 (June 30) with a total general balance of total general fund balance of \$207 million, equal to 2.5% of total expenditures (lower than the budgetary balance due to a number of GAAP-based accruals).

Fiscal 2009 has been a challenging year for state finances, with gross general fund revenues declining 13.6% from the previous year on a budgetary basis (based on the June 2009 Office of State Planning and Budget, or OSPB, report). This difference of \$1.05 billion from the prior year is primarily a result of lower individual income tax revenues (also down 13.6% from the prior year), which made up 61% of total general fund revenues in fiscal 2008 and are projected to make up the same proportion in fiscal 2009. Sales and use taxes (30% of the fiscal 2009 total) were down 8.9%, and corporate income tax revenues (4% of total) declined by a significant 45%. Much of the revenue declines occurred mid-fiscal year, giving the state less time to make adjustments that encompassed a full year of spending. Steps taken to balance the fiscal 2009 budget included reducing growth of general fund appropriations, which had been subject to a 6% limit, to only 4.2% (down from prior forecasts). The state also transferred in \$362 million in balances from various special purpose cash funds. Improved federal Medicaid funding, as part of the federal stimulus, added an additional \$198 million. The unappropriated reserve, which had previously been required at the 4% of appropriations (on a budgetary basis) was relaxed to a 2% requirement. Finally, special legislation required the treasurer and controller to temporarily transfer \$458 million to the general fund from certain cash funds, with the amount returned immediately in the new fiscal year. These funds do not represent a long-term balancing action, but do allow the state to make spending reductions for fiscal 2010 that would cover a whole year of expenditures. With these actions, the projected ending reserve would be \$356 million, or 4.8% of appropriations on a budgetary basis and meet the 2% year end reserve requirement.

For fiscal 2010, the OSPB June 2009 projection shows that gross general fund revenues will rise by 7% from the prior year, driven by a projected 5% increase in individual income taxes and an 8% increase in sales and use taxes over prior-year totals. For both of these revenue streams, the projected fiscal 2010 growth is well below fiscal 2008 peaks and, in the case of individual income tax, below fiscal 2007 levels. The current, adopted fiscal 2010 budget shows only a 0.35% increase in general fund appropriations over the prior year. Aiding the budget is \$346 million in enhanced federal Medicaid reimbursements as part of the stimulus package. However, in order to meet the required 2% year-end reserve on a budgetary basis, the OSPB is projecting an additional \$81 million gap will need to be bridged, whether through reduced appropriations or new resources. The legislative projections, which assume more serious unemployment levels, show a \$384 million gap. As a result, the governor has announced steps to bridge the more conservative, legislative gap estimation. The governor has directed department heads that these actions should focus on expenditure reductions, with an emphasis on permanent and ongoing cuts.

Constitutional prohibitions on GO debt have resulted in very low debt levels. State tax-supported debt, consisting entirely of general fund lease obligations, totals \$896 million, or roughly \$184 per capita, and includes the current issuances as well as the projected \$87 million Building Excellent Schools Today (BEST) issuance for August 2009. The state has added additional programs in recent years for appropriation-backed state issuances, although nearly

all of these programs depend on independent or previously committed funding for debt services. This includes the Higher Education Capital Construction Lease Program (which had an issuance in November 2008), the BEST program (which plans to issue its first debt in August 2009), and current issuance. The issuance of state-backed leases for these projects in recent years represents a departure from historical state practice, which has generally limited the inclusion of the state's appropriation pledge to long-term debt issuance.

Outlook

The stable outlook reflects the state's strong economic fundamentals even in light of the current national recession. The outlook also recognizes a recent history of demonstrated willingness to implement interim budget adjustments in support of the general fund's fiscal position as revenue's have slowed or declined.

Economy -- Slowing, Though Outpacing Nation Overall

The state's population continues to grow at a healthy although somewhat tempered pace, increasing 13% between 2000 and 2008 to 4.86 million. In-migration has resulted in high education levels and a larger-than-average proportion of the state's population being of working age, resulting in above-average incomes compared with the nation as a whole. Even in the current difficult economic climate, the state is projecting 2.8% and 1.8% population growth in 2009 and 2010, respectively, including continued in-migration. Unemployment in 2008 was 4.9%, below the national rate of 5.8%. As the recession has deepened, Colorado unemployment rate has continued to grow but it still trending well below the national rate. In May 2009, the state rate of 7.6% was higher than in 2008, but still well below the national rate of 9.4% for the same period. The state's June quarterly report is projecting a 7.2% yearly unemployment rate for both 2009 and 2010.

Statewide income levels are slightly above the national average. State per capita effective buying income is 108% of the nation, while median household effective buying income was 107% of the national average. Retail trade, a driver of state sales tax revenues, dropped 0.8% in 2008, reversing a trend of growth (increases of 7.6% in 2006 and 8.0% in 2007). State projections for calendar 2009 include a 1.7% decline in 2009 followed by a 3% increase in 2010. Per capita retail spending is 107% of the national level.

For the housing market, residential permit activity has dropped over multiple years (from 45,900 in 2005), falling 16% in 2006, 23% in 2007, 36% in 2008, and a projected 44% in 2009. The OSPB is projecting a 42% increase in 2010 from a much depressed base level in the previous year. The decline in housing starts has affected employment, as have losses related to real estate activity. However, home prices statewide have not dropped as significantly as in other parts of the nation, particularly in faster-growing western states and Florida. The Denver metro area (which contains more than half the state's residents) has seen median home prices continue to decline; however, the most recent data has shown some stability. The S&P/Case-Shiller Home Price Index in May 2009 showed that single-family home prices in the Denver metro area were down 5.5% from a year earlier, but this decline was the lowest of the 20 U.S. metro areas listed. Moreover, the May 2009 figure showed a very slight 0.1% increase from February 2009.

Financial Performance -- Softening Revenue Streams

The biggest impact on the state's fiscal 2009 financial result were declines in numerous major revenue streams, many of which took hold halfway through the year. During this challenging year for state finances, gross general fund revenues declined 13.6% (a difference of \$1.05 billion) in fiscal 2009 from the previous year (based on the June 2009 OSPB report). The three biggest general fund revenue streams all saw significant declines: individual income taxes, sales and use taxes, and corporate income taxes.

Individual income taxes are the dominant general fund revenue source. They accounted for nearly two-thirds (61%) of total general fund revenues in fiscal 2008 and are projected to make up the same proportion in fiscal 2009. Individual income taxes declined by 13.6% in fiscal 2009 (\$672 million) -- the same percentage as the overall general fund revenue decline, which underlines the impact of this revenue stream. Significant job losses, lowered salaries, and financial market turmoil have all affected individual income in fiscal 2009. Although the OSPB projects that unemployment will continue to grow and job growth will be limited, it estimates a 5.2% individual income tax revenue increase. OSPB ties this to a number of factors including some personal income recovery in calendar 2010 (2.5% growth projected).

Sales and use taxes are the second-largest general fund revenue source (28% in fiscal 2008 and 30% in fiscal 2009). After five straight years of growth, sales and use tax revenue dropped 8.9% in fiscal 2009 (a decline of \$205 million). OPSB attributes this decline to a large decrease in auto sales and overall lower spending linked to disposable-income declines. Current fiscal 2010 projections for this revenue stream show an 8.3% increase due to increased consumer confidence and some alterations in the way the tax is collected.

Corporate income tax revenue has historically been the most volatile of the state's major revenue streams, making up 6% of fiscal 2008 general fund revenues and 4% of fiscal 2009's. In fiscal 2009, this revenue stream fell a large 45% (\$227 million) from the prior year, exceeding even revised March 2009 projections of a 33% decline. These declines reflect the market challenges of the last year, as well as various state credits and programs that corporations use that can make this revenue stream more volatile. The OSPB projection of a 23% increase for fiscal 2010 reflects credit and financial markets returning to more normal circumstances, as well as the positive effect of federal stimulus funding.

In fiscal 2009, the state has recently changed various statutes that affect spending limitations. Through fiscal 2009, the state is also constrained by law to limit general fund appropriation growth to no more than 6% per year. However, as a result of SB 09-228, the state's general fund appropriations are no longer constrained by a growth limit of 6%, starting in fiscal 2010. The statutory required general fund reserve, previously at 4% of appropriations, was lowered to 2% for fiscals 2009 and 2010. Additionally, starting in fiscal 2009, the state is no longer required to transfer to excess general revenues beyond the required reserve to capital spending and transportation, at least until fiscal 2013. These changes have the collective effect of allowing the state more flexibility with reserve requirements during a challenging financial period as well as allowing more revenue during a recovery period to be used to rebuild general programs.

The state has also shown a strong history of making midyear reductions as well, if required, to respond to weaker revenue conditions. In the middle of the most recent fiscal year, in response to the slowing revenue climate, the governor reinforced this trend by implementing a midyear hiring freeze for the executive branch, and requesting a deferral of capital spending and certain grants. For the upcoming fiscal year, the governor's current proposed

spending reductions are a timely response to executive and legislative branch June 2009 revenue projections.

TABOR And Other Voter Initiatives

The TABOR voter initiative, passed in 1992, limits growth in state revenues to inflation plus population growth rates. Revenues fell below the TABOR limit in fiscals 2002 and 2003, which could have triggered a permanent "ratchet down" in permitted revenues if Colorado hadn't modified its calculation of state population. After a four-year absence of TABOR revenues, the state again had excess TABOR revenue in fiscal 2005. Referendum C, which passed in November 2005, has put a temporary moratorium on TABOR, allowing the state to retain more than \$6 billion in revenues from fiscals 2006 to 2010. Referendum C has the effect of raising revenues that can be kept in the general fund. TABOR limits will resume in fiscal 2011, reset at the highest state revenue level of the preceding five years.

The state must also contend with prior voter initiative Amendment 23, which increases local school funding 1% over inflation for 10 years, and another voter initiative that lowers residential assessment ratios compared with commercial property. Combined, these two initiatives have had the effect of increasing state funding for local school operations, and increasingly crowding out general fund appropriations for other purposes.

Debt -- Limited By Constitution

Debt is low given the state constitution's prohibition on long-term GO debt. Colorado's lease financing has been limited, but has seen some increases in recent years. The Higher Education Capital Construction Lease Program, which includes the \$231 million in lease-backed debt issued in November 2009, has added to state debt. These leases, while backed by any available state resources, subject to appropriation, if required, are supported in practice by federal mineral revenues received by the state for leasing of mineral rights on federal lands. In addition to the current 2009A and B COPS, the state has plans to issue \$87 million in August 2009 as part of its BEST program. This new state program to finance K-12 school construction is backed by the state's credit, but in practice uses revenues from state school lands paired with matching funds from participating school districts.

The state regularly issues general fund cash flow notes maturing within the fiscal year. The state sold \$350 million of general fund cash flow notes for fiscal 2009 and plans to sell \$650 million in general fund cash flow notes for fiscal 2010 in July 2009. The state also plans to issue \$600 million of additional notes in fiscal 2010 to fund the state's required interest-free cash flow loan programs to schools, with a projected \$300 million to be issued in July 2009. The school cash flow loan notes are secured by repayments from the participating school districts as well as various state-specific money.

As of Dec. 31, 2008, the state's Public Employees' Retirement Association pension fund (excluding the health care fund) was 69.8% funded, down from 75.1% in 2007 and a high of 105.2% in 2000. Total unfunded actuarial accrued liability in 2008 was \$16.8 billion, or \$3,457 per capita. Since Dec. 31, 2004, total actuarial accrued liabilities have increased by 31%, or \$4 billion, on an absolute basis.

Colorado's other postretirement employee benefits (OPEB) plan is funded through the Public Employees Retirement Association (PERA) and is a cost-sharing, multi-employer plan with a health care trust fund in place. The estimated liability is \$1.11 billion as of Dec. 31, 2008. PERA has released a report on OPEBs for state employees, some school district employees, some local districts, and judicial employees, in which it says total liability is 18.7% funded, using

the historical difference between pay-as-you-go billed to the state, school districts, and others, and the actual pay-as-you-go costs. Colorado's share of this liability has not been calculated and it does not include an estimate of the state portion of the liability in its annual financial statements. There have been no significant changes to PERA allocations or amended benefits in the last year.

Financial Management Assessment: 'Good'

The state's financial management practices are considered 'good' under Standard & Poor's Financial Management Assessment (FMA). An FMA of 'good' indicates that practices exist in most areas, although not all may be formalized or regularly monitored by government officials. Highlights of the state's management techniques include:

- Quarterly monitoring of revenue and expenditures, coupled with the statutory requirement to initiate midyear adjustments to ensure adequate reserves;
- Formal revenue and expenditure forecasting that utilizes outside sources and consultants to support budgetary projections;
- Statutory budgetary general fund balance target equal to 2% of expenditures;
- Lack of a formal debt management policy;
- Lack of a formal multiyear, statewide capital improvement plan, although various departments maintain independent plans subject to legislative approval; and
- Detailed and formal investment management policies, including public posting and quarterly review of investment results.

Related Research

- USPF Criteria: "GO Debt," Oct. 12, 2006
- USPF Criteria: "Appropriation-Backed Obligations," June 13, 2007

Ratings Detail (As Of July 2, 2009)		
Colorado COP hgr ed cap Construction lse Pur Fing ser 2008		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Colorado certs of part bnds (Fleet Management Prog) ser 2005A		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Colorado certs of part (Colorado State Penitentiary li Proj) 2006B		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Colorado certs of part (Fleet Management Prog) ser 2003		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Colorado certs of part (Fleet Management Prog) ser 2004		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Colorado (UCDHSC Fitzsimons Academic Projs) certs of part ser 2005B		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Ratings Detail (As Of July 2, 2009) (cont.)		
Colorado (Fleet Management Prog) ser 2006A		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Capitol Pkg Auth, Colorado		
Colorado		
Capitol Pkg Auth (Colorado) certs of part Ser 2004		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Colorado Dept of Transp, Colorado		
Colorado		
Colorado Dept of Transp Colorado certs of part ser 2004		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Grand Junction Colorado St Lsg Auth Inc., Colorado		
Colorado		
Grand Junction Colorado St Lsg Auth Inc. (Colorado) (CBI Laboratory Facs Proj) ser 2006		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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