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Moody’s Downgrades Kansas to Aa2, Rating Outlook Stable

On April 30, Moody’s lowered its issuer rating on the State of Kansas by one notch, to Aa2 from Aa1. Moody’s also downgraded the ratings on certain Kansas Development Finance Authority (KDFA) bonds, Kansas Department of Transportation (KDOT) state highway revenue bonds and other state-supported debt by one notch. Since Kansas does not issue general obligation (G.O.) bonds, the rating agencies assign an issuer rating to reflect what the general credit quality of the state would be. They then use that rating as the baseline to determine the credit ratings of appropriation-backed and other non-G.O. debt.

State of Kansas

	Ratings	Outlooks
Issuer Rating ⁽¹⁾	Aa2/AA+/AA	stable/stable/stable
Appropriation bonds ⁽²⁾	Aa3/AA/AA-	stable/stable/stable
KDOT Highway Revenue Bonds	Aa2/AAA/AA+	stable/stable/stable

⁽¹⁾ No G.O. debt outstanding. Listed ratings and outlooks reflect the issuer rating or the highest rating on state-supported debt.

⁽²⁾ Bonds secured by state appropriations and issued through KDFA.

Sources: Fitch Ratings; Moody’s; S&P

We continue to view the State of Kansas as a high-quality issuer that presents very little credit risk to investors. Though the state’s phased income tax rate cut presents the possibility of steep revenue declines and growing budget pressures, Kansas has a history of effective financial management that has generally maintained solid financial operations with adequate reserves. The state has extended a temporary sale tax increase to offset some of the income tax revenue losses and has taken other one-time actions to redistribute state funds. ***We believe that Kansas will take the necessary steps to ensure that it maintains a solid financial position and high credit quality, and Ascent will not reduce our holdings of Kansas state bonds as a result of this rating action.***

Moody's downgrade reflects the agency's view that the Kansas' credit strength has weakened marginally due to the state's:

- Income tax rate cuts that phase in through 2018, which are expected to reduce general revenues significantly and which have not been fully offset by other revenue increases;
- Relatively sluggish economic recovery;
- Use of non-recurring measures to balance the fiscal year (FY) 2014-2015 budget (specifically, reallocating revenues and expenses between the general fund and the State Highway Fund); and
- Underfunded pension plans that are expected to create rising funding costs going forward.

We expect that Moody's will review other Kansas issuers with direct or indirect financial ties to state appropriations, including the University of Kansas and Kansas State University. While we don't expect ratings on the state's universities to decline in tandem with the state's ratings, it is possible that Moody's could place those ratings under review for downgrade or assign negative rating outlooks. Kansas local school districts should be fairly well insulated from this action, given that recent court rulings could force the state to dedicate more funds to local districts.

While we acknowledge the issues that Moody's raises, we also weigh the relative strengths inherent in Kansas that support a strong credit rating, including:

- Historically strong governance with a proven track record of conservative financial management;
- An economy that has improved in line with national averages despite a heavier-than-average concentration in manufacturing (especially aerospace);
- Solid financial performance in recent fiscal years that has rebuilt reserves to adequate levels; and
- Relatively modest debt levels that somewhat offset the above-average unfunded contingent pension liabilities.

We will continue to closely monitor developments with Kansas' FY2014 financial results and FY2015 budget and their potential impacts on the state's credit rating.



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