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Kansas Issuer Credit Rating Lowered to 'AA' From 'AA+' on Structurally Unbalanced Budget; Outlook Negative.

NEW YORK (Standard & Poor's) Aug. 6, 2014–Standard & Poor's Ratings Services lowered its issuer credit rating (ICR) on the State of Kansas to 'AA' from 'AA+'. At the same time, Standard & Poor's downgraded Kansas' annual appropriation-secured debt to 'AA-' from 'AA'. The outlook on both ratings is negative.

"The downgrades reflect our view of a structurally unbalanced budget, following state income tax cuts that have not been matched with offsetting ongoing expenditure cuts in the fiscal 2015 budget," said Standard & Poor's credit analyst David Hitchcock. In our opinion, recent shortfalls in income taxes will leave both fiscal years 2014 and 2015 with ending general fund balances much less than projected in the enacted fiscal 2015 budget.

"The negative outlook reflects our belief that there will be additional budget pressure as income tax cuts scheduled in future years go into effect, or if midyear revenue shortfalls resume, although the state recently announced a small positive revenue variance for July," Mr. Hitchcock added. We believe the state could easily face a negative general fund balance in fiscal 2015 should even relatively small negative revenue variances resume, absent midyear corrective action

The 'AA' ICR reflects our opinion of Kansas':

- Economy, which has generally moved in line with the nation but with lower-than-average unemployment, despite a below-average demographic profile and concentration in the manufacturing industry;
- Recently strong general fund balance position that is being drawn down to what we believe could be low levels at the end of fiscal 2015;
- Governmental framework, which we consider strong; and
- Ability to support cash flow needs through the use of interfund certificates of indebtedness and manage disbursements between fiscal years to preserve liquidity even during prior periods of low fund balances.

Offsetting credit factors for the ICR include what we consider Kansas':

- Likely need for future expenditure cuts to offset enacted cuts in income
- tax rates in future years; and
- Significant unfunded pension liabilities that offset, in part, the state's moderate tax-supported debt burden.

The lower rating on the appropriation-secured bonds reflects debt service payments that are subject to annual state appropriation.

The negative outlook on the ICR reflects what we view as the potential for greater structural budget imbalance in the next two years. Should the general fund fall into a significant structural budget imbalance, potentially as a result of a substantial negative general fund balance developing in mid-fiscal 2015, or a significant mismatch between revenues and expenditures in fiscal 2016 as further income tax rate cuts go into effect, we could lower the rating. Should revenues come in close to budget in fiscal 2015, and the state takes action toward structural budget alignment in fiscal 2016 to offset potential revenue losses from income tax rate cuts, we could revise the outlook to stable.

The negative outlook on the state's appropriation-secured debt reflects the negative outlook on the Kansas ICR.

RELATED CRITERIA AND RESEARCH

Related Criteria
USPF Criteria: State Ratings Methodology, Jan. 3, 2011
USPF Criteria: State Credit Enhancement Programs, Nov. 13, 2008
USPF Criteria: Financial Management Assessment, June 27, 2006
Related Research

U.S. State And Local Government Credit Conditions Forecast, July 8, 2014
Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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