State of Connecticut

New Issue Report

Ratings

Long-Term Issuer Default Rating	A+

New Issue

$750,000,000 Special Tax Obligation Bonds, Transportation Infrastructure Purposes, 2018 Series B	A+
$100,000,000 Special Tax Obligation Refunding Bonds, Transportation Infrastructure Purposes, 2018 Series C	A+

Outstanding Debt

Special Tax Obligation Bonds, Senior Lien	A+
Special Tax Obligation Bonds, Subordinate Lien	A+

Rating Outlook

Stable

Analysts

Marcy Block
+1 212 908-0239
marcy.block@fitchratings.com

Douglas Offerman
+1 212 908-0889
douglas.offerman@fitchratings.com

New Issue Summary

Sale Date: Selling via negotiation on October 15 and 16

Series: 2018 Series B and 2018 Series C

Purpose: Various transportation capital projects and refunding outstanding obligations for debt service savings.

Security: Gross lien on pledged revenues and other receipts deposited to the state's special transportation fund (STF) prior to any other uses.

Analytical Conclusion

The bonds benefit from steady growth prospects for pledged revenues, secure legal provisions and the ability of the revenue stream to withstand a significant decline and still provide coverage of debt service. Although pledged revenues supporting the special tax obligation (STO) bonds would warrant a higher rating, the 'A+' rating on both the senior and second lien bonds reflects the exposure of the STF to general state operating pressure, given the state's ability to statutorily adjust both the rates of pledged taxes and fees and their distribution among the state's funds or for other purposes.

Key Rating Drivers

Growth Prospects Steady: Most of the transportation-related revenues pledged to the bonds, including motor fuels taxes and motor vehicle receipts, are generally stable over time but have limited growth potential, while the oil company tax is more volatile. The addition of portions of the statewide sales tax has diversified pledged receipts beyond transportation-related activity. The addition of the motor vehicle sales tax on automobile purchases at dealerships, to be phased in over five years beginning in fiscal 2019, will further diversify pledged revenues.

Established and Stable Program: The STO bond program is a well-established part of a comprehensive and legislatively authorized long-term transportation infrastructure program. Management strengths include active revenue monitoring, multi-year forecasting, and the ability to curtail capital spending in the event of revenue weakness.

Leverage Limits and High Resiliency: A minimum of 2x maximum annual debt service (MADS) is required for additional bonds, limiting leverage of pledged resources. The bonds also carry a 2x annual coverage requirement. Pledged revenues can absorb a significant decline and still provide coverage of debt service under the current structure.

Linkages with General Fund: The credit is exposed to operations of the state of Connecticut by virtue of the state's ability to statutorily adjust both the rates of pledged taxes and fees and their distribution among the state's funds or for other purposes. Interdependence with general fund operations has led to periodic revenue and cost shifts, capping the STO rating at the state of Connecticut's 'A+' Issuer Default Rating (IDR).

Rating History (STO)

Rating	Action	Outlook/ Watch	Date
A+	Affirmed	Stable	9/27/18
A+	Downgraded	Stable	5/12/17
AA–	Downgraded	Stable	9/1/16
AA	Revised	Stable	4/5/10
AA–	Affirmed	Stable	10/23/09
AA–	Affirmed	Stable	5/7/08
AA–	Assigned	—	8/21/92

Related Research

Fitch Rates Connecticut's $850MM Special Tax Obligation Bonds 'A+'; Outlook Stable (September 2018)

Fitch Rates Connecticut's $889MM GO Bonds 'A+'; Outlook Stable (July 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Rating Sensitivities

Link to State Credit Quality: The rating is sensitive to changes in Connecticut's 'A+' IDR, by which it is capped. The state's IDR is sensitive to its ability to rebalance financial operations to current economic and revenue growth expectations in a manner consistent with the current rating level.

Consistently Solid Coverage: The rating is also sensitive to consistently solid coverage by pledged revenues and to ongoing careful management of the transportation fund.

Credit Profile

The STO bonds are secured by pledged revenues deposited to the STF and both senior and second liens carry an additional bonds test (ABT) requiring 2x coverage of aggregate principal and interest. Moreover, the state covenants under the second lien that any second lien issuance must meet all senior lien requirements; both senior and second lien bonds are subject to an annual 2x debt service coverage test. The bonds are also backed by an aggregate debt service reserve funded at MADS.

Pledged revenues are committed first to senior lien debt service and reserves, followed by second lien debt service and reserves; outstanding second lien bonds are scheduled to mature in fiscal 2022. After bond requirements are met, pledged revenues are available for operating expenses of the STF including for the departments of transportation and motor vehicles.

Expansion of Pledged Resources

Pledged revenues include taxes and fees on motor vehicle fuel, casual vehicle sales and licenses. The legislature expanded pledged revenues in its 2015 session to accelerate transportation capital spending; however, revenue changes were partly delayed as the state sought to shore up projected weak general fund performance, highlighting the historical linkage between the STF and the state's general operations.

Under the 2015 expansion of pledged resources, all taxes on oil companies' gross earnings and a designated portion of the statewide sales tax are now deposited directly to the STF and pledged to bondholders; the sales tax deposit was phased in through fiscal 2018. The inclusion of sales taxes in pledged revenues broadened the base of economic activity from which collections derive beyond transportation while tying future trends more closely to underlying state economic performance. Oil company tax collections are correlated to broader energy market trends, which exposes the STF to more heightened cyclicality, in Fitch Ratings' view.

The 2018 legislature accelerated by two years the five-year phase-in of the sales tax on motor vehicle purchases at dealerships deposited to the STF, which had been agreed to in a 2017 special session, and changed the rate of the deposits to the fund. The phase-in began in fiscal 2019 from the earlier fiscal 2021 and will reach 100% in fiscal 2023. The state estimates beginning a $29 million addition to the STF in fiscal 2019, escalating over the phase-in period to $368 million in fiscal 2023. In 2017, the legislature also referred a constitutional amendment for voter consideration in November 2018 that would ensure all monies once deposited to the STF are solely applied to transportation purposes, including debt repayment. The legislature would retain the ability to adjust rates and revenue allocations prior to pledged revenues being deposited into the STF.

Multiyear Planning

The state actively manages the STF through a five-year forecast period to maintain ample resources for projected debt service, capital program needs and operating expenses. The STO bond program is very well established, with a 20-year maturity for each series and flexibility to slow capital projects as necessary. Offsetting these strengths are forecast debt service that generally rises faster than pledged revenues and large planned spending for transportation capital, which the state indicates would rely on the identification of additional funding sources.

Connecticut announced a major expansion of transportation capital spending in 2015 under the "Let's Go CT!" initiative, intended as a multi-decade effort to address longstanding transportation needs beyond those already funded through the existing capital program. Fitch believes continued enhanced funding of the capital program will remain dependent on the sufficiency of available STF resources.

General Fund Shifts

Interdependence with the state general fund has led to revenue or cost shifts during periods of general fund fiscal stress, most recently in fiscal 2016. Although the Let's Go CT! initiative included the statutory designation of the STF as a perpetual fund, limiting the use of resources to only transportation, the new designation did not prevent the state from delaying the originally planned sales tax allocation phase-in to address general fund revenue underperformance.

As of fiscal 2018 estimates, the major revenues in the STF consist of motor fuels tax (30%), motor vehicle receipts (15%), oil company tax (19%), license, permit and fee revenues (8%), and a portion of statewide sales tax (20%). Sales tax revenue as a component of the STF is expected to increase to 32% in fiscal 2022 as part of the most recent agreement, contributing to smaller percentage contributions from the other taxes and fees.

Underlying Growth Prospects Steady

Underlying performance of most of the transportation-related receipts deposited to the STF is economically sensitive and not fast-growing, and Fitch expects growth prospects going forward to generally match historical trends.

Motor fuels taxes were essentially flat in fiscal 2018, largely reflecting flat performance in the gasoline tax. The state forecasts relatively flat to declining collections through fiscal 2022. Motor vehicle receipts grew by 4% in fiscal 2018, and the state has forecast essentially flat performance over the forecast period.

The oil company tax is more volatile, as it reflects broader crude oil price trends. The tax fell for three consecutive years, from fiscal 2015 through 2017, but grew rapidly in fiscal 2018 with gains in oil prices. General statewide sales tax deposited to the STF was approximately $328 million in fiscal 2018 and is currently forecast to grow to $632 million in fiscal 2022 due to the additional phase-in. The state's forecast for fiscal 2022 projects sales tax revenue as a larger component of the STF ($632 million) compared to the motor fuels tax ($495 million).

Fiscal 2018 estimated STF revenues increased 17% overall due to the sales tax deposit. Fiscal 2018 is estimated to have ended with a cumulative fund surplus of $229 million. Pledged revenues covered combined outstanding fiscal 2018 senior and second lien debt service by 2.8x. Including the current sale, Fitch calculates that fiscal 2018 pledged revenues cover projected MADS in fiscal 2021 by 2.6x.

The state's multi-year forecast assumes annual bond issuance through fiscal 2022. Based on these assumptions and the increasing deposits of sales tax revenue, annual coverage of outstanding senior and second lien bonds would equal 2.4x in fiscal 2022. Over the period of fiscal years 2019 through 2022, pledged revenues are forecast to grow at an average pace of 5% annually, given the phase-in of newly pledged revenues.

High Resiliency in Downturn Scenario

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers the results of the Fitch Analytical Sensitivity Tool (FAST), using a 1% decline in the national GDP scenario, as well as assessing the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on a 17-year pledged revenue history, FAST generates a 4% scenario decline in pledged revenues; however, pledged revenues include tax policy adjustments that have increased allocations of revenue to the STF, likely resulting in a more robust FAST outcome. Assuming full leveraging to the ABT, pledged revenues could withstand a decline equal to almost 13x the scenario output — a high level of resiliency. Based on the largest consecutive revenue decrease, which occurred in fiscal 2003 when revenue declined by 7.8%, revenues could withstand a decline equal to over 6x the scenario output and still fully fund debt service under the ABT.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.