S&P Global
Ratings

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Connecticut; Gas Tax

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Connecticut; Gas Tax

Credit Profile		
US$750.0 mil spl tax oblig bnds transp infrastructure purp ser 2018B due 10/01/2038		
Long Term Rating	AA/Stable	New
US$100.0 mil spl tax oblig rfdg bnds transp infrastructure purp ser 2018C due 10/01/2026		
Long Term Rating	AA/Stable	New
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA' long-term rating, and stable outlook, to the State of Connecticut's $750 million series 2018B special tax obligation (STO) bonds for transportation infrastructure purposes, and $100 series 2018C million STO refunding bonds for transportation purposes. At the same time, S&P Global Ratings has affirmed its 'AA' rating on the state's STO parity senior bonds ($5.3 billion) and second-lien bonds ($123.8 million). The outlook is stable.

The series 2018B, the series 2018C, and parity senior STO bonds are secured by a first-lien pledge of revenues to the Special Transportation Fund (STF). According to bond counsel, the funds are deemed to be appropriated at time of issuance and no further legislative approval is required.

We base our ratings on our assessment of the following factors:

- A currently diverse mix of pledged revenues, in our view, that are levied on a large wealthy statewide economic base (population: 3.6 million);
- Connecticut's history of adding to pledged revenues when it has increased the size of its transportation capital program, as evidenced by increased allocation of general state sales tax in fiscal 2016, and an accelerated phase in of sales taxes from motor vehicles that begins in fiscal 2019, despite general fund budget stress;
- Strong 2.69x coverage on future senior-lien maximum annual debt service (MADS) alone after this issuance by unaudited fiscal 2018 pledged revenues, and 2.53x MADS coverage on combined senior- and second-lien bonds, excluding Build America bonds (BABs) interest subsidy and fund interest earnings;
- State projections for annual debt service coverage (DSC) of at least 2.4x for both senior-lien and combined senior- and second-lien bonds, after expected future debt issuances, through at least fiscal 2022, including BAB subsidies and interest earnings; and
- Strong bond provisions, including a 2.0x additional bonds test (ABT) for both first- and second-lien bonds, coupled with a fully funded debt service reserve account, and a 2.0x rate covenant.

Credit risks include what we consider:

- A sizable, but well-defined, capital improvement program that includes $3.7 billion of planned additional new money bonds through fiscal 2022, and the potential for greater bonding to the extent pledged revenue is increased, as has been previously proposed by the current governor; and

- A pledged revenue stream that is somewhat susceptible to economic conditions related to changes in the price and availability of motor vehicle fuel and motor vehicle sales, or potential changes in statutory funding formula. In fiscal 2016, the state delayed the deposit of pledged sales tax to the STF for two months ($35.2 million) to help balance state general fund operations, and reduced the sales tax deposit by $50 million in fiscal 2017, equal to about 3% of total pledged STO revenue. However, the most recent fiscal 2018-2019 biennium budget maintained its commitment to transportation funding.

We understand that proceeds from series 2018B will be used to fund various capital projects included in Connecticut's long-term transportation infrastructure program, while the 2018C bonds will refund certain outstanding first-lien debt.

The senior-lien bonds are secured by a first-lien pledge on funds deposited in the STF and paid before operating expenditures. The second-lien bonds are payable after required payments on the senior-lien bonds, in advance of funding operations. The indenture also requires that as long as the second-lien bonds are outstanding, after deducting for required reserves, pledged revenues for both liens must equal at least 2x annual debt service requirements. Because the structure of the second-lien bonds is the same as the senior-lien bonds, except for the flow of funds, and DSC is strong, in our view, we do not make a rating distinction between senior- and second-lien bonds outstanding. All STO bonds are fixed rate.

The state has made changes in its allocation of pledged revenue to the STF in recent years that in general have increased the overall amount of STO-pledged revenue, which has supported an expansion of its transportation capital plan.

Beginning in fiscal 2016, Connecticut made a statutory dedication of a 0.5% statewide general sales tax to the STF to be fully phased in during fiscal 2018, while the 2017 legislative session added additionally dedicated sales and use taxes collected on the sale of new and used motor vehicles, to be phased in originally over five years beginning in fiscal 2021; this was accelerated into 2019 in the 2018 legislative session. Sales tax is projected to be about 32% of pledged revenues in 2022. In our view, sales taxes, particularly derived from auto sales, have the potential to show more variation over the economic cycle than per gallon fuel taxes or motor vehicle license fees, but they are also likely to grow faster over time.

Actual unaudited fiscal 2018 STF revenue comprises what we view as a diverse mix of motor fuels taxes (31% of fiscal 2018 pledged revenues); general fund sales tax allocations (20%); oil companies' tax payments (19%); motor vehicle receipts (primarily vehicle registration fees; 16%); licenses, permits, and fees (8%); and sales tax from sales between individuals (5%); with these percentages not including the effects of legislative net fund transfers and refunds. The proportion derived from sales tax will increase when the new car sales tax allocation begins to be phased in starting in fiscal 2019. Pledged revenues also include BAB federal interest subsidy payments and fund interest income, which we do not include in our DSC calculations.

While we expect revenues overall to increase with the additional allocation of sales tax, the STF experienced a small 0.6% dip in total pledged revenue in fiscal 2016 primarily due to lower oil companies tax revenue. In fiscal 2016, there was a two-month $35.2 million delay in the allocation of sales tax to the STF in order to provide general fund budget relief, and a further $50 million budgeted reduction in sales tax allocated to the STF for fiscal 2017, also for budget relief. We believe that the state could make additional reductions in revenue flowing into the STF future years in the event of future state budget stress (Connecticut general obligation rating: A/Stable), but if such additional transfers occur, we expect them to remain relatively minor due to the need to fund ongoing transportation operations and the 2x STO gross revenue rate covenant.

Connecticut will go to voters in November 2018 with a proposed constitutional amendment to dedicate STF money for transportation purposes once they have been deposited in the STF, although this amendment would not prohibit the state from reducing the amount of general sales tax revenue initially flowing into the STF on an annual basis. The proposed constitutional amendment would mandate that all state motor fuel tax and oil company tax revenues first be deposited in the pledged STF that pays STO bonds on a priority basis, even if does not mandate specific motor fuel or oil company tax rates. This proposed constitutional restriction, however, does not apply to the allocation of general state sales tax revenues to the STF, which is determined under state statutory law, although once sales taxes go into the STF they would become pledged revenue. The $50 million reduction in allocated sales tax in fiscal 2017 represented only about 3% of total STF revenue. In previous years, the state has made other transfers and allocations of a one-time nature to and from the STF, but overall we believe pledged revenue has remained relatively stable and annual DSC strong. Legal covenants include a 2x annual DSC rate covenant and a fully funded debt service reserve.

We calculate unaudited actual pledged revenues collected by the state comptroller for the fiscal year ended June 30, 2018--not including pledged BAB interest subsidy or interest earnings--covered proposed future senior-lien MADS of $595.0 million occurring in fiscal 2021 after this sale by 2.69x, and combined senior- and second-lien MADS in 2020 by 2.53x.

The state projects annual DSC will remain at levels we view as strong through 2022, despite current plans to issue $3.7 billion of new money STO through fiscal 2022, in part due to the phase-in of additional sales tax as pledged revenue, and due to a currently declining debt service schedule after fiscal 2020 following sale of the series 2018A bonds. The additional sales tax revenue added in 2016 was part of the state's new 30-year Let's GO CT! infrastructure plan that was originally contemplated to involve as much as $100 billion of debt, pending potential further addition of new STF revenue. However, the state expects that any substantial expansion of current bonding plans would be met with additional pledged revenue not currently in statute. Connecticut has historically maintained annual DSC well above the 2.0x ABT requirement, ranging from above 3.0x for senior-lien bonds and 2.6x for combined senior- and second-lien bonds since fiscal 2009, but under current projections, allocated revenues, and anticipated additional debt issuance, the state projects annual DSC to decline to what we view as a still-strong 2.4x on both senior-lien and combined senior and subordinate debt, absent new revenue.

(For more information on the state and its economy, please refer to the most recent state GO analysis published July 27, 2018, on RatingsDirect).

Outlook

The stable outlook reflects S&P Global Ratings' view that the financial integrity of the STF and strong DSC levels will continue over the two-year outlook horizon. Fuel tax trends are stable and increased sales tax revenue is being phased into the pledged STF to offset expansion of the transportation capital program that, combined with a declining debt service schedule, is likely to result in strong and relatively stable DSC. If DSC weakens significantly, or Connecticut's historical focus on the integrity and support for the STF weakened so as to deplete STF resources in a significant manner, we could potentially lower the rating or revise the outlook on the bonds. We do not see the potential for a higher rating in the next two years given the sizable projected debt issuance and Connecticut's legal ability to reduce future allocations of pledged revenue up to its 2x rate covenant.

Bond Structure

Bond provisions are strong in our view. The senior-lien bonds are secured by a first-lien pledge on funds deposited in the STF and are paid before operating expenditures. The ABT requires 2x coverage (based on an historical earnings test adjusted for approved tax rate increases or decreases) of all senior- and second-lien debt. The second-lien indenture also requires that as long as second-lien debt remains outstanding, DSC for both liens must at least be equal to 2x annual debt. In addition, the debt service reserve fund must be funded at an amount equal to the MADS on the bonds outstanding. The debt service reserve fund is held with a trustee and is a combined debt service reserve available for both the first- and second-lien bonds.

Connecticut has also covenanted in both the senior- and junior-lien indentures to levy sufficient taxes and fees to provide DSC, and to provide sufficient pledged revenue so as to provide 2.0x annual DSC at the end of each fiscal year. Failure to provide such coverage, however, is not an event of default unless the state shall not enact legislation that would satisfy indenture covenants if additional debt were then to be issued.

Connecticut--Special Tax Obligation Bond Debt Service Coverage

(Mil. $)

Fiscal year	**2014**	**2015**	**2016**	**2017**	**2018***	**2019p**	**2020p**	**2021p**	**2022p**
Motor fuels tax	508	517	518	499	499	500	500	498	496
Oil companies tax	381	338	250	238	315	330	347	355	364
State sales tax	0	0	109	188	328	361	460	553	632
Motor vehicle receipts	236	250	252	243	253	253	255	257	259
Licenses, permits, fees	138	145	144	144	138	140	141	141	142
Sales tax--DMV	82	84	87	85	86	87	88	89	89
Federal grants (BAB subsidy)	12	12	12	12	12	12	12	12	11
Interest income	7	7	8	9	18	18	18	19	19
Transfers from/(to) other funds	(83)	35	(7)	(7)	(6)	(6)	(6)	(6)	(6)
Transfers to Transportation Strategy Board (TSB) (eliminated in 2016)	(15)	(15)	0	0	0	0	0	0	1
Total revenues	1266	1372	1374	1412	1643	1696	1815	1917	2007
Refunds	(11)	(11)	(21)	(17)	(15)	(19)	(20)	(20)	(21)
Total net pledged revenues	1256	1361	1353	1394	1628	1677	1796	1897	1986
TSB projects account transfers added back in	15	15	0	0	0	0	0	0	1
Total pledged revenues	1271	1376	1353	1394	1628	1677	1796	1897	1986
Pledged revenue without BAB subsidy or interest income	1252	1357	1332	1373	1598	1647	1765	1867	1956

Connecticut--Special Tax Obligation Bond Debt Service Coverage (cont.)

(Mil. $)

Fiscal year	**2014**	**2015**	**2016**	**2017**	**2018***	**2019p**	**2020p**	**2021p**	**2022p**
Coverage of senior lien MADS alone ($595.0 million in fiscal 2021) without BABs (x)	2.10	2.28	2.24	2.31	2.69	2.77	2.97	3.14	3.29
Coverage of combined senior- and junior-lien MADS ($631.0 million in fiscal 2020) (x)	1.98	2.15	2.11	2.18	2.53	2.61	2.80	2.96	3.10

DMV--Department of Motor Vehicles. BABs-Build America bonds. MADS--Maximum annual debt service. *Unaudited.

Transportation Overview

The Department of Transportation (DOT) was established in 1969, and replaced the Connecticut Highway Department. DOT is headed by a commissioner appointed by, and reporting to, the governor. Total employment as of Aug. 27, 2018, was 2,862 employees. The state's transportation system includes roads (21,508 miles, of which approximately 4,143 are maintained by DOT), state and local bridges (5,296), commuter rail, a bus system, and Bradley International Airport. The transportation infrastructure program was established in 1984 and has financed a broad range of projects across Connecticut. Total infrastructure program funding from 1985-2022 is estimated at $41.2 billion and includes federal state and local funds, with the state's share estimated at $20.7 billion, of which $19.8 billion is to be financed by bonds. Connecticut expects to issue about $750 million-$1.2 billion annually of additional new money STO bonds from fiscal 2019 through fiscal 2022.

Financial Update

The STF recorded a $45.2 million operating deficit in fiscal 2017, following a $37.2 million operating deficit in fiscal 2016, the first operating deficits since 2009, and following operating surpluses of $11.0 million in fiscal 2015 and $4.4 million in 2014. On an unaudited basis, Connecticut estimates an operating surplus in the STF of $131.7 million in the fiscal year ending June 30, 2018, bringing its balance to $229.3 million. The state projects that its STF cumulative fund balance will gradually rise in subsequent years to $468.6 million at the end of fiscal 2022.

As the size of the capital plan has increased, various legislative changes have been made over time to address projected shortfalls and support increased debt authorization including changes in fiscal years 2009 and 2016 to enhance the fund with additional transfers from the general fund, and a recent acceleration of the start of the five-year phase-in of a new allocation of sales tax from new and used car sales to the STF from 2021 to 2019. Ongoing budget pressure in the general fund reduced the amount of earlier transfers. In fiscal 2014, a one-time $76.5 million transfer was made from the STF to the general fund, offset by oil company taxes transferred to the STF, which are now deposited directly to the STF. In fiscal 2016, Connecticut delayed deposit of sales taxes into the STF by two months to provide $35.2 million of state budget relief, and another $50 million transfer to the state general fund in fiscal 2017. However, we believe over the long term the state has been responsive in adding new revenue to its STF to support transportation funding, including the recent actions to accelerate the phase-in of sales tax transfers to the STF. The 2017 legislative session added a new allocation to the STF of sales taxes from new car sales, to be phased in over five years--with the phase-in originally scheduled to begin in 2021, but subsequently accelerated to begin in fiscal 2019.

Major revenue enhancements to the fund in recent years have included:

- A new allocation of sales tax on car sales expected to be phased in over five years beginning in fiscal 2019 (an acceleration from its original 2021 phase-in), and an additional 0.5% sales tax that was added to the STF in fiscal 2018;
- The oil companies tax (of which all is now transferred directly to the STF as a statutory allocation, instead of being transferred from the general fund); and
- Motor vehicle fee increases in previous years.

Ratings Detail (As Of September 28, 2018)		
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed
Connecticut GASTAX (BAM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut special Tax Gas		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut Special Tax Gas		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.