FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Connecticut's $1.1 Billion GO Bonds 'AA-'; Outlook Stable

Tue 24 May, 2022 - 1:56 PM ET

Fitch Ratings - San Francisco - 24 May 2022: Fitch Ratings has assigned an 'AA-' rating to $1.1 billion in state of Connecticut general obligation (GO) bonds, consisting of:

--$350,000,000 taxable GO bonds (2022 series A);

--$150,000,000 GO bonds (2022 series C);

--$567,565,000 GO refunding bonds (2022 series D).

Par amounts are subject to change pending final sale.

The bonds are expected to be offered by negotiated sale the week of May 23, 2022.

In addition, Fitch has affirmed the state's Issuer Default Rating (IDR) and outstanding GO bonds at 'AA-' and affirmed the ratings on bonds linked to the IDR as listed at the end of this release.

The Rating Outlook is Stable.

SECURITY

The GO bonds are supported by the full faith and credit of the state pledged to payment of principal and interest.

ANALYTICAL CONCLUSION

Connecticut's 'AA-' IDR reflects its superior gap-closing capacity, as well as its wealthy and diverse, yet slow-growing economic profile. The rating also incorporates the state's elevated liability burden, carrying costs and expenditure growth trends, which are likely to remain comparatively high over time.

Economic Resource Base

Connecticut has a diverse and mature economic base anchored by a large finance sector and important manufacturing and education and health sectors. Post-pandemic economic growth trails national trends. Connecticut has the highest per capita personal income of any state, though income growth has slowed in the prior decade.

KEY RATING DRIVERS

Revenue Framework: 'a'

The state's largest tax revenue source, personal income tax ([PIT], approximately 51% of operating/general fund revenues), is subject to considerable cyclicality, although the state instituted measures to shield the general fund from its volatility. Sales (21%), and corporate income (5%) taxes further diversify the revenue base. Absent tax policy changes, underlying revenues are expected to grow only modestly over time, consistent with the state's wealthy and diverse but slow-growing economic profile. The state has unlimited legal ability to levy taxes.

Expenditure Framework: 'aa'

Connecticut's natural pace of spending growth is expected to outpace revenues, requiring ongoing budget controls. The state has consistently demonstrated the ability to cover its comparatively high fixed costs, including making full actuarial contributions to pensions for more than a decade, and it benefits from the large degree of budget autonomy common to states.

Long-Term Liability Burden: 'a'

The state's long-term liability burden is elevated and among the highest for U.S. states, but still considered moderate relative to personal income. Long-term debt consists primarily of

GO and transportation borrowings, with much of GO borrowing undertaken on behalf of local schools. Net pension liabilities are a more significant burden, with the state carrying obligations for state retirees as well as for local school teachers. Other post-employment benefits are also a significant liability, although one the state has been able to modify.

Operating Performance: 'aaa'

Resilience is bolstered by strong mechanisms that set aside in the budget reserve fund (BRF) volatile revenue collections over specific thresholds and a required excess margin of revenues over budgeted spending, enabling rapid accumulation of balances. Budget management powers and strong fiscal monitoring, including frequent revenue and budget forecasting, allow the state to identify budget under-performance and address emerging gaps.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Consistent economic and revenue growth at or above Fitch's long-term expectations for national inflation or stronger over the medium term, raising Fitch's assessment for revenue growth prospects;

--Material and sustained success in gradually lowering its elevated liability burden to less than 10% of personal income, while actively managing a comparatively high fixed cost burden.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Weakening of budget management policies and practices that materially amplifies structural challenges;

--Actions that elevate the state's liability burden closer to or above 40% of personal income.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Connecticut Budgetary Update

Strong budgetary management policies, including relatively recent mechanisms that accelerate deposits to the BRF, and robust revenue performance have facilitated marked improvement to the state's financial position. Specific tools include a volatility cap that shifts non-withholding PIT and pass-through entities tax receipts above a threshold to the BRF, and a revenue cap mechanism that shifts a required excess of budgeted revenues over spending to the BRF.

State revenue collections have exceeded prudent budgetary expectations since the pandemic's onset. The state ended fiscal 2021 with a $1.7 billion surplus, around 8% of fiscal 2021 general fund appropriations, with $99 million deposited into the BRF. The state will add $200 million to the BRF balance in fiscal 2022, to a total of $3.3 billion. The budget also calls for the transfer of an additional $5.5 billion in revenues above the volatility and revenue caps to lower the state's pension liabilities: $3.4 billion in fiscal 2022 and $2.1 billion in fiscal 2023. Higher baseline spending for debt service, pensions and healthcare, among other needs, are partly offset by administrative efficiencies from an anticipated wave of state employee retirements.

Connecticut's fiscal 2023 budget includes some sizeable one-time and recurring tax cuts totaling $643 million in fiscal 2023. One-time policies include a $250 child tax credit funded from fiscal 2022 surplus ($125 million), as well as ARPA-funded expansions to the state earned income tax credit ($43 million) and reductions to state unemployment insurance taxes ($40 million). Recurring tax cuts include expended property tax credits ($60 million per year) and reduced car tax mill rates ($100 million per year). Fitch notes that these cuts largely put additional expenditure pressure on state finances.

Connecticut is also one of a handful of states implementing a gas tax holiday. The nine-month gasoline tax break, projected to reduce Special Transportation Fund (STF) revenue by a combined $240 million in fiscal 2022 & 2023. The state plans to more than offset lost STF revenues with larger-than-anticipated revenues in related streams, especially Gross Receipts Taxes on Oil Companies, which will remain robust amidst elevated petroleum prices. While affordable, this gas tax holiday nonetheless results in less funds available for transportation needs.

Federal Relief Provides Critical Support

Under the $1.9 trillion American Rescue Plan Act of 2021, Connecticut received $2.8 billion in direct federal aid to the state itself. The state projects it will spend or allocate all but $200 million of these funds by the end of fiscal 2023. While the enacted budget and outyear forecasts incorporate use of federal stimulus aid for operating needs, they also anticipate budget surpluses and sizable one-time spending, thereby lessening the risk of a fiscal cliff as federal aid rolls off.

Connecticut Economic Update

Connecticut's economy was affected by the pandemic and related public health measures in early 2020, and recovery has been uneven. The state's 13% decline in nonfarm payrolls from February through April 2020 was somewhat less than the national decline of 15%, and Connecticut's rebound in nonfarm payrolls has now surpassed the national recovery after lagging through the first quarter of 2022. Through March 2022, 92% of lost state jobs have been recovered compared to the US states' median of 89%. See "U.S. States -Labor Market Quarterly Tracker- 1Q 2022 Robust Post-Pandemic Employment Recovery Continues", May 2022.

Connecticut's unemployment rate has nonetheless improved to near all-time lows. The monthly unemployment rate for March 2022 was 4.9% versus the 3.6% national rate. Fitch calculates an adjusted unemployment rate to capture the large number of labor force departures since the pandemic began. Fitch's adjusted unemployment rate for Connecticut was an elevated 8.1% for March, well above Fitch's 4.9% median adjusted rate for U.S. states.

CREDIT PROFILE

The 'A+' rating on bonds carrying a SCRF, including CHESLA state-supported revenue bonds, reflects the credit quality of the state of Connecticut, whose IDR is 'A+'. The SCRF mechanism is a longstanding means for the state to provide additional security for various state authorities and municipalities on a contingent basis. Use of a SCRF is legislatively authorized and overseen by the state's treasurer, with the SCRF mechanism securing approximately $5.3 billion in outstanding debt, issued by a range of state entities.

Proceeds of state-supported revenue bonds support loans to eligible students attending higher education institutions in Connecticut and to Connecticut students attending higher education institutions outside Connecticut. The new money 2022 series B bonds are being issued under CHESLA's 2019 master resolution. There is approximately $61.6 million outstanding under the 2019 resolution prior to the current sale, and $89.4 million outstanding under the 1990 resolution.

Assets held under each resolution are only pledged to secure bonds issued under that resolution. Bonds issued under both the 1990 and 2019 resolutions are secured by SCRFs sized at maximum annual debt service. In the event of a draw to cover principal or interest, CHESLA covenants to certify the insufficiency to the state budget director and treasurer, and an amount to replenish the SCRF is deemed appropriated on or before December 1 without further legislative approval. The aggregate amount of outstanding CHESLA bonds that may be secured by SCRFs is $300 million.

For additional information on the state of Connecticut's IDR, see "Fitch Rates Connecticut's $800 Million GO Bonds 'AA-'; Outlook Stable," published on Dec. 09, 2021, available at www.fitchratings.com.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

Connecticut, State of (CT) [General Government]	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Connecticut, State of (CT) /General Obligation - Unlimited Tax/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Connecticut, State of (CT) /Special Capital Reserve Fund/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable
Connecticut, State of (CT) /State Appropriation/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable
Connecticut, State of (CT) /State Contract/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable
Connecticut, State of (CT) /UConn State Debt Service Commitment/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Connecticut, State of (CT)	EU Endorsed, UK Endorsed

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