STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Connecticut; Gas Tax

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Connecticut; Gas Tax

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US$600.0 mil spl tax oblig bnds transp infrastructure purp ser 2014 A due 09/01/2034		
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US$130.0 mil spl tax oblig bnds transp infrastructure purp ser 2014 B due 09/01/2025		
Long Term Rating	AA/Stable	New
Connecticut sr lien gas		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' long-term rating, and stable outlook, to Connecticut's $730 million series 2014A special tax obligation (STO) bonds for transportation infrastructure purposes, and series 2014B STO refunding bonds for transportation infrastructure purposes.

At the same time, Standard & Poor's has affirmed its 'AA' rating, with a stable outlook, on the state's STO senior parity bonds ($3.3 billion) and second-lien bonds ($399.3 million). The STO bonds are secured by a first-lien pledge of revenues to the special transportation fund (STF), paid before transportation operations. According to bond counsel, the funds are deemed to be appropriated each year and no further legislative approval is required.

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

- A diverse mix of pledged revenues, in our view, that are levied on a diverse statewide economic base (population: 3.6 million);
- Connecticut's continued efforts to maintain a balance between revenue sources and programmatic responsibilities when the fund is projecting imbalance;
- Strong 2.76x coverage of future maximum annual debt service (MADS) after this issuance by state-estimated fiscal 2014 pledged revenues for combined senior- and second-lien bonds, excluding Build America bonds (BAB) interest subsidy and fund interest earnings, and 3.47x coverage of senior-lien MADS alone;
- State projections for annual debt service coverage (DSC) of more than 3x for senior-lien bonds, and more than 2.5x annual DSC on combined senior- and second-lien bonds, through at least fiscal 2018; 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 annual future debt issuance of about $600 million per year; 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.

We understand that proceeds from this bond issue will fund various projects included in the transportation infrastructure program. The 2014 general assembly has authorized $606.4 million of STO bonds in fiscal 2015.

The senior-lien bonds are secured by a first-lien pledge on funds deposited in the STF and are 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 coverage is strong, in our view, we do not make a rating distinction between senior- and second-lien bonds outstanding. All bonds are fixed rate. The combined STO annual debt service has a declining annual debt service schedule after fiscal 2016.

Pledged revenues are diverse, in our opinion, and include motor fuels taxes (37% of estimated fiscal 2014 pledged revenues before transfers out of the transportation fund); oil companies' tax payments (28%); motor vehicle receipts (17%); and licenses, permits, and fees (10%). Fiscal 2014 estimated revenues are based on preliminary collections received by the state comptroller. Total pledged revenues also include BAB interest subsidy payments and interest income revenues, offset by transfers out of the pledged STF, including a $76.5 million transfer to the general fund in fiscal 2014. This transfer to the general fund in fiscal 2014, this was more than offset by changes in statutory law that deposited all of the state's transportation related oil company tax (90%) directly to the STF, instead of the previous practice of transferring a portion of the oil tax from the general fund to the transportation fund. The net effect is estimated by the state to have created an increase in pledged revenues in fiscal 2014, despite essentially flat trends in pledged revenues. Connecticut has budgeted for only $6.5 million in transfers out of the STF in fiscal 2015 for the emissions enterprise fund, consistent with prior years, and projects about $150 million of transfers in from the state's general fund during fiscal years 2016-2018.

Fiscal 2014 estimated pledged revenues collected by the state comptroller to date, not including pledged BAB interest subsidy or interest earnings, covered future senior-lien MADS of $360.4 million occurring in fiscal 2016 by 3.47x, and combined senior- and second-lien MADS also in 2016 by 2.76x. We calculate annual DSC for these in fiscal 2014 at 3.42x and 2.79x, respectively. Fiscal 2013 pledged revenues of $1.2 billion covered annual debt service on senior- and second-lien bonds by 2.9x, in line with the previous year and slightly better than previous years. Estimated revenues were up slightly in fiscal 2014 after being relatively flat in 2013, following growth in fiscal years 2009-2012 that resulted from legislative changes that enhanced pledged revenues. This followed recession-related declines in pledged revenues in fiscal years 2008 and 2009.

Connecticut projects pledged revenues will increase in fiscal years 2015 and 2016 due to reduced transfers from the transportation fund to the general fund in 2016, and transfers in from the general fund beginning in fiscal 2016. The state otherwise projects relatively flat revenue growth, the result of small annual declines in motor fuels tax revenues offset by small increases in license fees and department of motor vehicle-related sales tax. The forecast of relatively flat revenue is reasonable, in our view, and aligned with general trends in fuel efficiency and reduced vehicle miles, although we view the projected increase in state general fund transfers to the transportation fund in fiscal 2016 and beyond as a potential risk, since these amounts have not yet been budgeted by the state legislature. A statutory change in 2013 that required resources of the STF to be used only for transportation purposes could translate to reduced adjustment of flows between the state's general fund and the STF, but the historical track record has been uneven during periods of budget strain.

Connecticut projects future annual DSC after issuance of additional debt of about $600 million per year to range from 2.6x-3.0x through fiscal 2018. Senior-lien coverage is projected to be 3.0x-3.7x. The state monitors fund revenues and expenditures monthly and regularly revises its forecast, which we view as positive from a credit standpoint as it allows for regular adjustments to the financing plan to maintain coverage levels. DSC has historically been above the 2.0x ABT requirement, ranging from 2.9x-3.5x for senior-lien bonds and 2.5x-2.9x for combined senior- and second-lien bonds since fiscal 2009.

Outlook

The stable outlook reflects Standard & Poor's view that the financial integrity of the fund and strong DSC levels will continue over the two-year outlook horizon. Economic trends have stabilized and Connecticut has implemented several revenue adjustments that should contribute to consistent coverage levels in the future. We view this bond program as closely linked to the state given ongoing transfers and revenue adjustments that occur with the general fund, but the credit structure and strong coverage are also key credit considerations. We do not see the potential for a higher rating in the next two years given the sizable capital requirements and projected debt issuance. A steep decline in DSC, or credit deterioration of the state that could potentially lead to substantial transfers to the state general fund from the transportation fund, might have negative rating implications.

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 a 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.

Connecticut -- Special Tax Obligation Bond Debt Service Coverage

(Mil. $)

Fiscal year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014e**	**2015p**	**2016p**	**2017p**
Motor fuels tax, motor vehicle receipts, licenses, permits, fees	858.2	859.3	839.1	864.2	873.1	882.5	881.1	880	878.8
Sales tax -- DMV	57.1	67.8	71.9	76.6	79	82.2	83.2	84.2	85.3
Oil companies tax	141.9	141.9	165.3	226.9	199.4	380.7	379.1	377.3	377.3
Federal grants [BAB subsidy]	0	3	9.4	12.9	12.4	12.1	12.1	12.1	12.1
Interest income	15.6	6.7	5.5	2.2	4.1	6.8	7.2	7.7	8.3
Transfers from/(to) other funds	(6.6)	64.7	101.1	75.1	88.7	(83.0)	(6.5)	146.3	156.3
Transfers to Transportation Strategy Board (TSB)	(15.3)	(15.3)	(15.3)	(15.0)	(15.0)	(15.0)	(15.0)	N/A	N/A
Total revenues	1,050.9	1,128.1	1,177.0	1,242.9	1,241.7	1,266.3	1,341.2	1,507.6	1,518.1
Refunds	(8.9)	(10.2)	(9.8)	(10.0)	(9.2)	(10.6)	(10.7)	(11.0)	(11.2)
Total net pledged revenues	1,042.1	1,117.9	1,167.2	1,232.9	1,232.5	1,255.7	1,330.5	1,496.6	1,506.9

Connecticut -- Special Tax Obligation Bond Debt Service Coverage (cont.)									
TSB projects account transfers	15.3	15.3	15.3	15.0	15.0	15.0	15.0	0.0	0.0
Total pledged revenues	1,057.40	1,133.20	1,182.50	1,247.90	1,247.50	1,270.70	1,345.50	1,496.60	1,506.90
Pledged revenue without BAB subsidy or interest income	1,041.8	1,123.5	1,167.6	1,232.8	1,231.0	1,251.8	1,326.2	1,476.8	1,486.5
Coverage of senior-lien MADS alone ($360.4 million in fiscal 2016) without BABs (x)	2.9	3.1	3.2	3.4	3.4	3.5	3.7	4.1	4.1
Coverage of combined senior- and junior-lien MADS ($452.8 million in fiscal 2016) (x)	2.3	2.5	2.6	2.7	2.7	2.8	2.9	3.3	3.3

DMV--Department of Motor Vehicles. MADS--Maximum annual debt service. BAB--Build America bonds. e--Estimated. P--projected. N/A--Not applicable.

Transportation Overview

The Department of Transportation (DOT) was established in 1969, and replaced the Connecticut Highway Department. The DOT is headed by a commissioner appointed by, and reporting to, the governor. Total employment as of Sept. 5, 2014, increased to 2,951, compared with 2,892 in 2013, 2,789 in 2011, and 2,964 in 2010. The state's transportation system includes roads (21,431 miles), bridges (5,602), a 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 funding from 1985-2015 is estimated at $28.2 billion and includes federal state and local funds, with an additional $3.6 billion projected for fiscal years 2016-2018. Connecticut expects that about $600 million of STO bonds will be issued annually over the next three years to support the program, with the remainder of the program largely funded by anticipated future revenues and federal sources.

Financial Update

The state estimates that the transportation fund recorded another surplus in fiscal 2014, which follows four years of surplus operations in fiscal years 2010-2013 after recording deficits in fiscal years 2008 and 2009. The surplus for fiscal 2014 is estimated at $8.9 million, with a cumulative balance of $173.5 million or 13.9% of expenditures. Various legislative changes have been made over time to address sizable projected shortfalls and support increased debt authorization. Changes were made in fiscal 2009 to enhance the fund with the most significant being transfers from the general fund. Ongoing budget pressure in the general fund has reduced the amount of these transfers and the fiscal 2014 budget actually includes a transfer from the STF to the general fund of $76.5 million, although this has been eliminated in fiscal 2015, other than a $6.5 million statutory ongoing annual transfer to the Emission Enterprise Fund. The state projects that transfers from the general fund will result in $146.3 million of net transfers in to the transportation fund in fiscal 2016, although this is projection, not an actual budgeted amount.

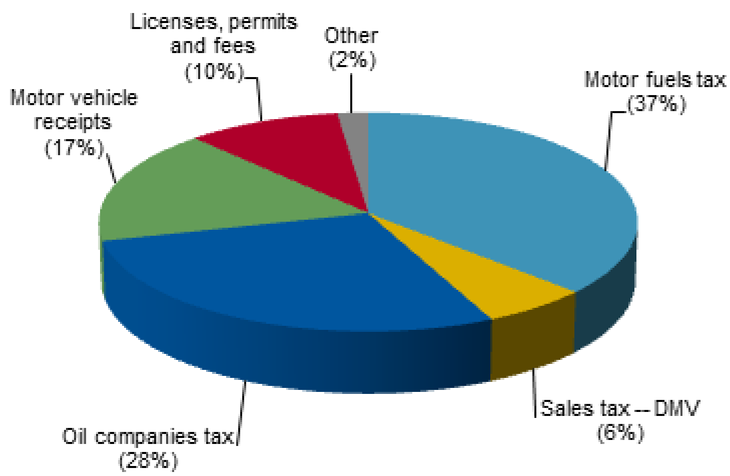
Major revenue enhancements to the fund have included:

- Oil companies tax (an increased direct statutory deposit to the transportation fund from the general fund);
- Motor vehicle fee increases in previous years; and
- A motor fuels tax increases in previous years.

The state expects no major increases in transportation tax rates, unless there were a future increase in the size of Connecticut's capital plan. The transfers and revenue enhancements projected by the state are projected to contribute to surplus operations until fiscal 2017 when the state projects a manageable deficit of about $900,000 after transportation related expenses. The key risk to the plan in our view is the realization of general fund transfers beginning in fiscal 2016 as well as continued economic recovery. In our opinion, Connecticut has a long history of adjusting revenues or expenditures to ensure the fund's financial stability.

Chart 1

Fiscal 2014 Estimated Pledged Revenues Before Transfer To The General Fund



DMV--Department of Motor Vehicles

Related Criteria And Research

Related Criteria

USPF Criteria: Special Tax Bonds, June 13, 2007

Ratings Detail (As Of September 26, 2014)		
Connecticut gas (AGM) (MBIA)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut gas (AMBAC) (MBIA)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Ratings Detail (As Of September 26, 2014) (cont.)		
Connecticut spl tax oblig bnds		
Long Term Rating	AA/Stable	Affirmed
Connecticut 2nd lien		
Long Term Rating	AA/Stable	Affirmed
Connecticut gas tax		
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.		