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Connecticut; Gas Tax

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Table Of Contents

Connecticut; Gas Tax

Credit Profile		
US$700.0 mil spl tax oblig bnds transp infrastructure purp ser 2015 A due 08/01/2035		
Long Term Rating	AA/Stable	New
US$140.0 mil spl tax oblig rfdg bnds transp infrastructure purp ser 2015 B due 08/01/2027		
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 $700 million series 2015A special tax obligation (STO) bonds for transportation infrastructure purposes, and $140 million series 2015B STO refunding bonds for transportation infrastructure purposes. At the same time, Standard & Poor's has affirmed its 'AA' rating on the state's STO senior parity bonds ($3.7 billion) and second-lien bonds ($334.4 million). The outlook is stable.

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 large 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, as reflected in recently increased pledged sales tax to help pay for an expanded capital program;
- Strong 2.78x coverage of future maximum annual debt service (MADS) after this issuance by state-estimated fiscal 2015 pledged revenues on combined senior- and second-lien bonds, excluding Build America bonds (BABs) interest subsidy and fund interest earnings, and 3.34x coverage on senior-lien MADS alone;
- State projections for annual debt service coverage (DSC) of more than 2.5x for senior-lien bonds, and more than 2.3x annual DSC on combined senior- and second-lien bonds, through at least fiscal 2020, 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 $4.2 billion of planned additional bonds over the next five fiscal years, which represent a $2.8 billion increase in bond authorizations added by the most recent legislative session, and potentially substantially more bonding after 2020 to the extent pledged revenue is increased in future years; 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, although recent legislative changes have added to pledged revenue.

We understand that proceeds from this bond issue will be used to fund various projects included in the transportation infrastructure program. The 2015 general assembly has authorized and the state bond commission has approved $700 million of new money STO bonds in fiscal 2016.

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 bonds are fixed rate. The combined STO annual debt service has a declining annual debt service schedule after fiscal 2017.

Gov. Dannel Malloy has proposed a major expansion of the state's transportation infrastructure program, called "Let's GO CT!," envisioned to cost as much as $100 billion over 30 years. The most recent session of the legislature has increased revenue flowing to the state's transportation fund in order to fund the first five years of this goal, involving $2.8 billion of bonding over the next five years. When combined with existing transportation capital plans, this would lead to what we view as a substantial $4.2 billion of additional bonding through 2020. To support this level of bonding, Connecticut has statutorily allocated a percent of the state's sales tax directly to the pledged STF, beginning in fiscal 2016. The amount will phase in over time until a full 0.5% sales tax is directed into the transportation fund by fiscal 2018. In addition, the state has dedicated directly to the pledged transportation fund the oil companies tax whose revenues had been previously transferred from the state general fund. No further state appropriation of the sales or oil company tax is necessary to receive this money. However, as a statutory law, allocations could be modified by future legislatures and it is possible that future increases in other transportation taxes could be substituted for the increased sales tax allocation, or used for additional bonding beyond 2020. The net additional revenue is expected to total $203 million in fiscal 2019.

We believe pledged revenues will remain diverse even after the phase-in of the newly pledged sales taxes. Sales tax is projected to be only about 21% of pledged revenues in 2018 when fully phased in. In our view, sales taxes 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. Estimated fiscal 2015 STF revenue, excluding transfers and refunds, includes motor fuels taxes (38% of estimated fiscal 2015 pledged revenues and 30% of 2018 revenue based on state projections); oil companies' tax payments (25% in 2015 compared with 21% in 2018); motor vehicle receipts (19% in 2015 compared with 14% in 2018); and licenses, permits and fees (11% in 2015 compared with 8% in 2018). Pledged revenues also include BAB interest subsidy payments and interest income revenues, offset by net transfers out of the pledged STF as determined by the state legislature. In fiscal 2014, the state made a one-time $76.5 million transfer to the general fund from the STF, but this was more than offset by changes in statutory law that deposited all of the state's transportation-related oil company tax 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, with a net positive effect on the STF.

Connecticut made only $6.5 million in transfers out of the STF in fiscal 2015 for the emissions enterprise fund, consistent with previous years, and $41.2 million of oil company tax transfers in; oil company taxes are now transferred directly into the STF beginning in fiscal 2016.

We calculate estimated pledged revenues collected by the state comptroller for the fiscal year ended June 30, 2015, not including pledged BAB interest subsidy or interest earnings, covered proposed future senior-lien MADS of $405.7 million occurring in fiscal 2017 after this sale by 3.34x, and combined senior- and second-lien MADS by 2.78x also in 2017.

The state projects annual DSC will remain above 2.5x through 2020, despite plans to issue $4.2 billion of STF total debt, as additional sales tax is phased into the STF. Nevertheless, this represents a small decline from the over 3x annual coverage levels the state had previously projected before the addition of the Let's Go CT! program. The governor's proposed long-term transportation infrastructure plan could involve as much as $100 billion in capital improvements over 30 years. However, the state expects that substantial bonding beyond 2020 would be met with additional pledged revenue not currently in statute, which could also potentially replace a portion of existing revenues. Currently, Connecticut expects to issue $800 million of additional STO bonds in fiscal 2017. 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.

(For more information on the state and its economy, please refer to the most recent state GO summary analysis published July 23, 2015, on RatingsDirect).

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 directed new sales tax revenue into the pledged STF to offset its recent expansion of the transportation capital program. We believe planned additional bonding will eventually lead to somewhat lower annual DSC levels beyond our two-year outlook horizon, while remaining above levels that we would consider strong. If DSC weakens significantly, or the historical state 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 capital requirements and projected debt issuance.

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.

The state 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. $)	2009	2010	2011	2012	2013	2014	2015e	2016p	2017p	2018p
Motor fuels tax	495.0	503.6	483.5	492.8	501.3	508.0	516.6	511.8	514.4	516.8
Oil companies tax	141.9	141.9	165.3	226.9	199.4	380.7	337.9	307.1	327.9	357.4
State sales tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	158.6	260.6	356.5
Motor vehicle receipts	220.8	220.7	220.1	235.4	234.5	236.1	249.5	254.8	246.6	247.4
License, permits, fees	142.4	135.0	135.5	136.0	137.3	138.4	145.0	139.3	139.9	140.5
Sales tax - DMV	57.1	67.8	71.9	76.6	79.0	82.2	83.9	84.0	85.0	85.9
Federal grants [BAB subsidy]	0.0	3.0	9.4	12.9	12.4	12.1	12.1	12.1	12.1	12.1
Interest income	15.6	6.7	5.5	2.2	4.1	6.8	6.9	7.7	8.5	9.5
Transfers from/(to) other funds	(6.6)	64.7	101.1	75.1	88.7	(83.0)	34.7	(6.5)	(6.5)	(6.5)
Transfers to Transportation Strategy Board (TSB) (eliminated in 2016)	(15.3)	(15.3)	(15.3)	(15.0)	(15.0)	(15.0)	(15.0)	0.0	0.0	0.0
Total revenues	1,050.9	1,128.1	1,177.0	1,242.9	1,241.7	1,266.3	1,371.6	1,459.9	1,588.5	1,719.6
Refunds	(8.9)	(10.2)	(9.8)	(10.0)	(9.2)	(10.6)	(11.1)	(11.0)	(11.3)	(11.5)
Total net pledged revenues	1,042.1	1,117.9	1,167.2	1,232.9	1,232.5	1,255.7	1,360.5	1,448.9	1,577.2	1,708.1
TSB projects account transfers added back in as pledged revenue	15.3	15.3	15.3	15.0	15.0	15.0	15.0	0.0	0.0	0.0
Total pledged revenues	1,057.4	1,133.2	1,182.5	1,247.9	1,247.5	1,270.7	1,375.5	1,448.9	1,577.2	1,708.1
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	1,356.5	1,429.1	1,556.6	1,686.5
Coverage of senior lien MADS alone ($406 million in fiscal 2017) without BABs	2.6	2.8	2.9	3.0	3.0	3.1	3.3	3.5	3.8	4.2
Coverage of combined senior and junior lien MADS ($488.3 million in fiscal 2017)	2.1	2.3	2.4	2.5	2.5	2.6	2.8	2.9	3.2	3.5

DMV--Department of Motor Vehicles. BAB--Build America bond. MADS--Maximum annual debt service. e--Estimated. p--Projected.

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 (21,508 miles), bridges (5,296), 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 1985-2020 is estimated at $37.5 billion and includes federal state and local funds, with the state's share estimated at $18.5 billion, of which $17.7 billion is to be financed by bonds. Connecticut expects that about $700 million of new money STO bonds in fiscal 2016, $800 million in 2017, and $900 million annually in fiscal years 2018-2020.

Financial Update

The state estimates that the STF recorded another surplus in fiscal 2015 after payment of budgeted department of transportation expenses. The STF last recorded deficits in fiscal years 2008 and 2009. Connecticut estimates the STF operating surplus for fiscal 2015 at $40.5 million, following a $4.4 million surplus in fiscal 2014. The cumulative balance in the STF at fiscal year-end 2015 is estimated by the state at $209.5 million or 16% of expenditures. 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 2009 to enhance the fund with additional transfers from the general fund. Ongoing budget pressure in the general fund subsequently reduced the amount of these 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. The only remaining transfer after fiscal 2015 is expected to be a $6.5 million ongoing annual statutory transfer to the Emission Enterprise Fund. Connecticut projects that $158.6 million of state sales tax will be newly directed into the STF in fiscal 2016, which would rise to $356.5 million by fiscal 2018.

Major revenue enhancements to the fund over the years have included:

- The allocation of a portion of Connecticut sales tax, which is expected to phase in over time until 0.5% sales tax is dedicated to the STF in 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);
- Motor vehicle fee increases in previous years; and
- A motor fuels tax increases in previous years.

The transfers and revenue enhancements that Connecticut has planned are projected to contribute to surplus operations after payment of department of transportation expenses through 2020.

Chart 1

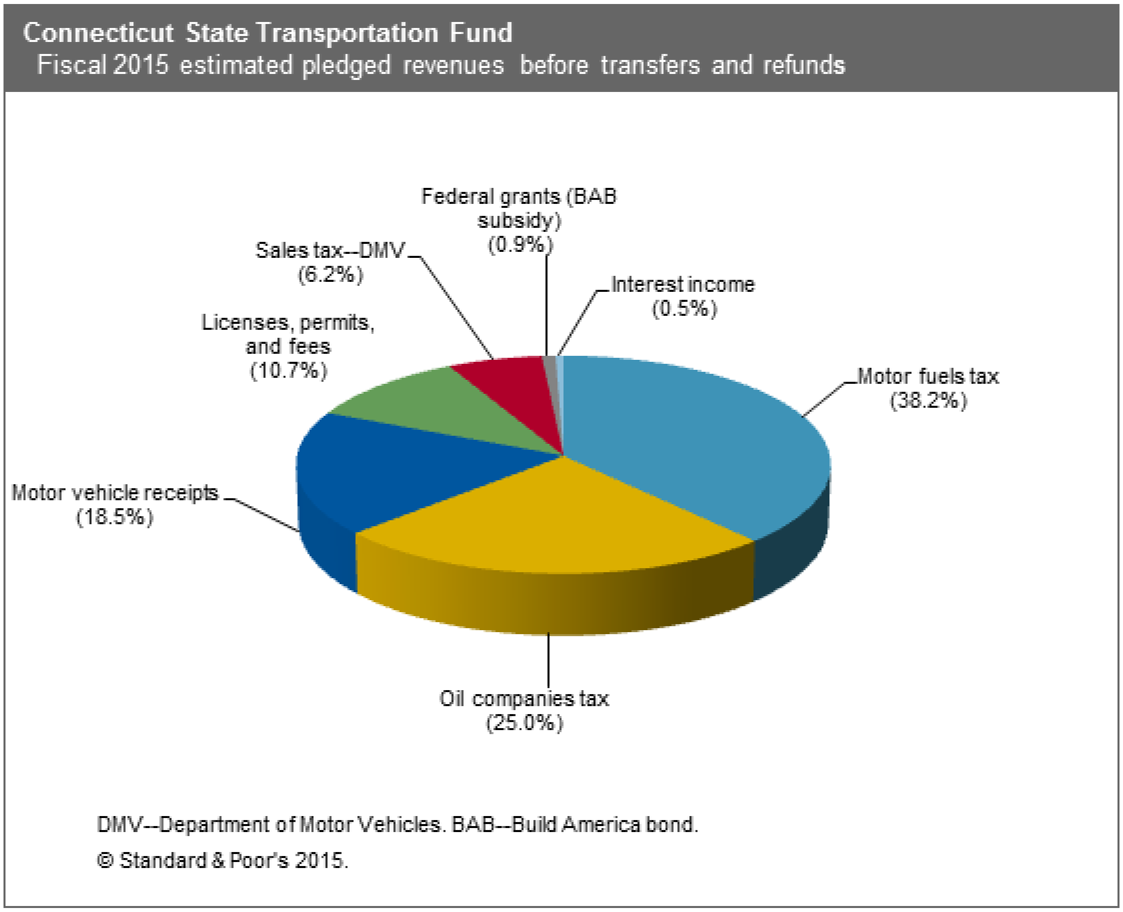
Connecticut State Transportation Fund
Fiscal 2015 estimated pledged revenues before transfers and refunds
Federal grants (BAB subsidy) (0.9%)
Sales tax--DMV (6.2%)
Interest income (0.5%)
Licenses, permits, and fees (10.7%)
Motor fuels tax (38.2%)
Motor vehicle receipts (18.5%)
Oil companies tax (25.0%)
DMV--Department of Motor Vehicles. BAB--Build America bond.
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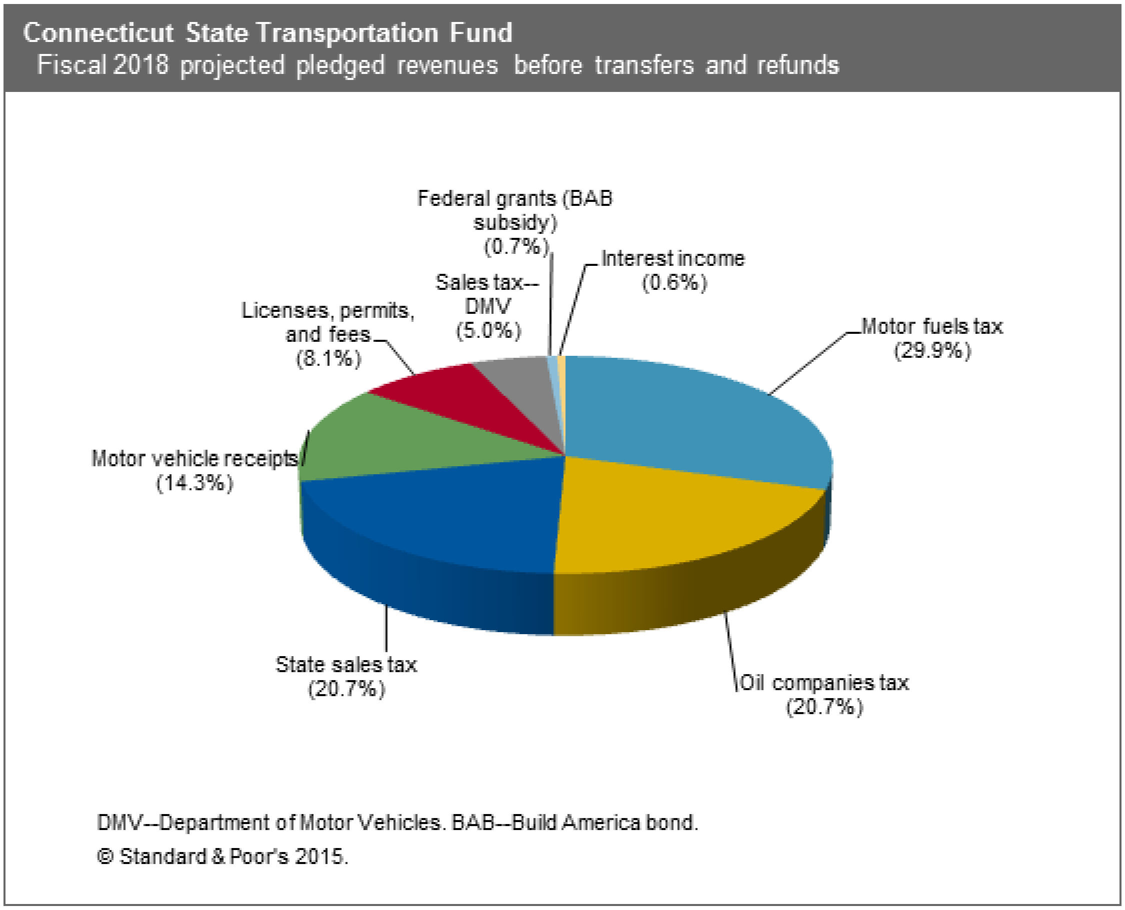
Chart 2



Related Criteria And Research

Related Criteria

- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Special Tax Bonds, June 13, 2007

Ratings Detail (As Of September 29, 2015)		
Connecticut gas (AGM) (MBIA)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut gas (AMBAC) (MBIA)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut spl tax oblig bnds		
Long Term Rating	AA/Stable	Affirmed
Connecticut spl tax oblig bnds transp infrastructure purp		
Long Term Rating	AA/Stable	Affirmed
Connecticut 2nd lien		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of September 29, 2015) (cont.)		
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.