RATING ACTION COMMENTARY

Fitch Rates Connecticut's $1 Billion Special Tax Obligation Bonds 'A+', Outlook Stable

Mon 12 Apr, 2021 - 5:09 PM ET

Fitch Ratings - New York - 12 Apr 2021: Fitch Ratings has assigned 'A+' ratings to the following State of Connecticut special tax obligation (STO) bonds:

--$875,000,000 STO bonds transportation infrastructure purposes, 2021 series A;

--$11,610,000 STO refunding bonds transportation infrastructure purposes, 2021 series B;

--$145,230,000 STO refunding bonds transportation infrastructure purposes, 2021 series C (forward delivery).

The STO bonds will be offered by negotiated sale on April 22, 2021.

In addition, Fitch has affirmed outstanding STO bonds at 'A+'.

The Rating Outlook is Stable.

Feedback

SECURITY

STO bonds are secured by a gross lien on pledged revenues and other receipts deposited to the special transportation fund (STF) prior to any other uses.

ANALYTICAL CONCLUSION

The 'A+' ratings and Stable Rating Outlook on Connecticut's STO bonds reflects very strong resiliency of the financing structure and solid debt service coverage, and considers the state's active management of the special transportation fund (STF) over time, as underlying growth prospects for revenues are otherwise slow but remain solid. Fitch caps the rating at Connecticut's 'A+' Issuer Default Rating (IDR) given the state's ability to statutorily adjust the rates of pledged taxes and fees and their distribution.

KEY RATING DRIVERS

Growth Prospects Steady: Underlying growth prospects for transportation-related revenues pledged to the bonds are likely to be flat over time. The pledge of portions of statewide sales taxes adds diversity to the pledge beyond transportation receipts and supports steadier growth over time. Trends are affected by active state management over time to augment resources for transportation capital and operating needs.

Leverage Limits and High Resiliency: Receipts are economically sensitive, but pledged revenues can absorb a significant decline and still provide sufficient coverage of debt service based on current revenue expectations. A minimum of 2x maximum annual debt service (MADS) is required for additional bonds, limiting leverage and providing a strong cushion for bondholders in the event of cyclical declines. The bonds also carry a 2x annual coverage requirement.

Rating Capped by State IDR: The credit is exposed to the operating performance of the state of Connecticut by virtue of the state's ability to statutorily adjust the rates and distribution of taxes and fees, even as a constitutional provision in place since 2018 restricts revenues, once deposited in the STF, to being spent solely on transportation purposes. This interdependence caps the STO rating at the state's 'A+' IDR.

Feedback

RATING SENSITIVITIES

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

--An upgrade of Connecticut's 'A+' IDR, given that the rating on STO bonds is capped at the state's IDR;

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

--A material and sustained erosion in pledged receipts that reduces resilience of the structure, or state actions that shift pledged revenues away from the STF or otherwise narrow the resilience of the structure;

--A downgrade of Connecticut's 'A+' IDR, given that the rating on STO bonds is capped by the state's IDR.

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.

Feedback

ECONOMIC RESOURCE BASE

Connecticut has a diverse, mature and wealthy economic base, with flat to modestly declining population trends prior to the pandemic and an aging demographic profile, consistent with many other states in the region. The state's diverse economy includes a sophisticated, defense-related manufacturing sector, important finance and insurance sectors in Fairfield County and Hartford, respectively, health and education institutions, and tourism linked in part to Native American gaming in the state's southeast.

In contrast to past economic expansions, the state's employment performance in the pre-pandemic expansion had been unusually slow, delaying the state's economic and fiscal rebound. The pandemic has had a severe effect on the state's economy as the initial lockdown has now transitioned to a gradual recovery, with ongoing weakness in the labor market. As of February 2021, the unemployment rate stood at 8.5%, well above the 6.6% rate nationally. Personal income per capita in Connecticut ranks highest among the states, at 134% of the national level in 2020.

DEDICATED TAX CREDIT PROFILE

The credit is exposed to the 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. Notwithstanding voter approval of the constitutional dedication of the STF for transportation purposes only in 2018, the legislature retains its discretion to adjust rates and/or allocations of pledged revenues prior to deposit of revenues into the STF. The state actively manages capital, debt issuance, revenues and expenditures in the STF, to identify and address cumulative deficits in the STF over the state's longer-term transportation planning window.

For additional information on Connecticut's IDR, please see Fitch's December 2020 press release " Fitch Affirms Connecticut's IDR at 'A+', Rates $800MM GO Bonds 'A+'; Outlook Stable", at 'www.fitchratings.com'.

STO bonds issued under Connecticut's longstanding transportation borrowing program are supported by a first claim on pledged revenues and other receipts deposited to the STF, consisting primarily of transportation-related taxes and fees. Monthly deposits for debt service are made on a one-sixth, one-twelfth basis, and a debt service reserve is cash-funded at MADS. All outstanding bonds are on a senior lien, with remaining issuance under a second lien having fully amortized in April 2020. Approximately $6.1 billion in borrowing under the senior lien is outstanding prior to the current sale, all of which has been issued at fixed rates and a 20-year maximum amortization. A minimum of 2x coverage of maximum annual debt service (MADS) by historical revenues is required for additional bonds, limiting leverage of pledged resources. The bonds also carry a 2x annual coverage requirement.

Pledged revenues consist of a motor fuels tax charged on gasoline, diesel and other fuels sold by distributors; a fixed portion of the statewide general sales tax; a rising share of the

Feedback

sales tax levied on motor vehicle sales; vehicle license, permit and fee revenues; a tax on gross earnings from the sale of petroleum products containing oil derivatives; and various motor vehicle registration, inspection and user fees. The motor fuels tax has traditionally been the largest component, although the phased shift of vehicle sales tax will make the sales tax the largest component of STF revenue beginning in fiscal 2022. As of fiscal 2022, 75% of vehicle sales tax will be deposited to STF, up from 25%; 100% of the vehicle sales tax will shift to the STF as of fiscal 2023.

STF forecast performance is closely managed through ongoing revenue monitoring and multiyear forecasting. After payment of debt service, receipts support the state's broad transportation needs, including expenses of the departments of transportation and motor vehicles and pay-go capital. The forecast of cumulative surpluses or deficits over time is regularly updated to reflect underlying economic and revenue trends, planned changes to taxes, fees and their distributions, operating and capital spending and state debt issuance plans.

The STF, like the general fund, is subject to the state's recent revenue cap requirement that limits appropriations relative to revenues beginning in fiscal 2020 in order to maintain a budgetary cushion. The appropriations limit began at 99.5% of expected revenue in fiscal 2020, will drop to 99% in fiscal 2022, and ultimately to 98% in fiscal 2026 and thereafter. Incorporating the remaining phase in of vehicle sales taxes and the revenue cap will leave STF available revenues nearly flat through the fiscal 2026 planning period, absent other rate or distribution changes.

RECENT PERFORMANCE

The STF has not been spared from budgetary effects of the pandemic. Early in the pandemic, stay-at-home orders severely curtailed gasoline consumption, the global crude oil price plunge affected the oil companies tax, and motor vehicle receipts, which include registration fees, were subject to a 90-day deferral. These factors and other pandemic-related weakness led to STF net revenues falling 10.2% in fiscal 2020, to $1.5 billion. An annual deficit of $152 million was absorbed by the STF's cumulative excess (fund balance), which fell to $168 million in fiscal 2020, from $320 million in fiscal 2019.

The gradual rebound in economic activity is now supporting a rebound in STF revenues, combined with the continued shift of vehicle sales taxes to the STF. As of the January 2021 consensus forecast, the state expects fiscal 2021 STF revenues to rise $174 million (11.5%) over fiscal 2020, to nearly $1.7 billion, reducing the annual deficit to $52.4 million. Rising receipts are supported by the higher allocation of the vehicle sales tax to the STF and a

Feedback

bounce back in motor vehicle receipts. The oil companies tax is forecast to decline further, although crude oil prices since the January consensus forecast have exceeded the assumptions underlying the state's January consensus forecast, suggesting stronger actual collections are likely in fiscal 2021.

The outlook for the fiscal 2022-2023 biennium brightens further, supported by the continued recovery from the pandemic and the final phased shift of vehicle sales tax to the STF. Forecast STF revenues rise $163 million (9.7%) in fiscal 2022 and $141 million (7.6%) in fiscal 2023, leaving the STF with an annual deficit of $24 million in fiscal 2022 and an annual surplus of $20 million in fiscal 2023. Including the impact of forecast changes, the STF's cumulative excess declines to $94 million in fiscal 2022, from $168 million in fiscal 2020.

Although long-term forecasts beyond the next biennium show further annual deficits gradually depleting the remaining cumulative excess, this is not inconsistent with past forecasts. The state has a longstanding practice of actively adjusting planned capital spending, debt issuance, revenues and expenses across a multiyear planning period to ensure the STF retains a cumulative surplus, including as a cushion against revenue shocks such as what was experienced during the pandemic.

The current long-term STF forecast reflects the state's January 2021 consensus revenue forecast but excludes the impact of proposed policy changes in the governor's budget for the fiscal 2022-2023 biennium. Proposals include levying a small highway user fee on trucks and making modest spending reductions, as well as recognizing savings from past federal pandemic stimulus. Altogether, the proposed changes would leave the STF with a rising cumulative balance through fiscal 2026.

The state will release an updated consensus forecast late in April, and the policy changes from the executive budget will be deliberated by the legislature and governor over the coming months. The current STF projection also does not yet reflect potential impacts of the American Rescue Plan Act of 2021, which will direct $4.4 billion to Connecticut and its local governments, including for capital.

Feedback

LIMITED GROWTH PROSPECTS FOR TRANSPORTATION RECEIPTS

Fitch views growth prospects for the diverse mix of transportation and general receipts securing the STO bonds to be relatively flat over time. Transportation-related collections in

Connecticut, similar to other states, are expected to be a flat to declining source of revenue over time in the absence of rate changes, particularly given factors such as rising fuel efficiency and the transition to alternative fuels. The deposit of sales tax is adding diversity to pledged receipts, and while a portion of sales tax derives from general economic activity in Connecticut, sales tax on motor vehicles will be a key driver of performance as well. Despite Fitch's expectation for underlying trends, the state is expected to continue to carefully manage the rates and allocations of revenues supporting the STF to ensure ample resources for transportation needs.

RESILIENCE OF PLEDGED RECEIPTS

To assess the resilience of the bond structure to potential cyclicality, Fitch considers how much cushion the structure could still provide under stress scenarios that assume full issuance to the ABT. The assessment relies on historical pledged revenue performance for these scenarios, which include stressing current revenues based on the largest actual historical decline and based on a moderate recession as provided by the Fitch Analytical Stress Test (FAST), a model which relates historical sales tax receipts over time to GDP.

Based on fiscal 2020 projected net revenues of $1.5 billion and assuming full issuance to the 2x ABT, collections could fall 50% while maintaining sum-sufficient coverage of debt service. This level of cushion is 4.9x the largest historical decline in sales taxes (a projected -10.2%, in fiscal 2021). Using the FAST model, a separate scenario assuming Fitch's standard moderate GDP decline of 1.0% produces an expected revenue decline of 4.2%; however, resilience remains very strong, with the structure's cushion at almost 12x the scenario revenue decline. Fitch views these levels of resilience as being ample. Fitch's current economic outlook for calendar year 2021 anticipates GDP rising 6.2% in the U.S. in 2021 (https://www.fitchratings.com/research/sovereigns/world-gdp-forecasts-revised-up-after-us-fiscal-stimulus-package-17-03-2021), implying the -1% decline assumption in FAST is fairly conservative.

Feedback

CRITERIA VARIATION

None identified.

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]				
• Connecticut, State of (CT) /Special Tax Oblig Trans Infr/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Douglas Offerman
Senior Director

Feedback

Primary Rating Analyst
+1 212 908 0889
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Karen Krop
Senior Director
Secondary Rating Analyst
+1 212 908 0661

Eric Kim
Senior Director
Committee Chairperson
+1 212 908 0241

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (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, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Feedback

Endorsement Policy

ENDORSEMENT STATUS

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

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its

Feedback

issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000

Feedback

(or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

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.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for

Feedback

structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance North America United States

Feedback