FitchRatings

Fitch Rates Connecticut's $730MM Special Tax Obligation Bonds 'AA' Ratings Endorsement Policy

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Fitch Ratings-New York-25 September 2014: Fitch Ratings assigns an 'AA' rating to the following State of Connecticut special tax obligation (STO) bonds:

--$600,000,000 STO bonds transportation infrastructure purposes, 2014 series A;
--$130,000,000 STO refunding bonds transportation infrastructure purposes, 2014 series B.

The bonds are expected to sell via negotiated sale on Oct. 1. In addition, Fitch affirms the following ratings:

--$3.34 billion in outstanding STO senior lien bonds at 'AA';
--$399 million in outstanding STO second lien bonds at 'AA'.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a gross lien on pledged revenues and other receipts deposited to the state's special transportation fund prior to any other uses.

KEY RATING DRIVERS

SOUND COVERAGE: The bonds benefit from sound coverage of debt service for senior and second lien STO bonds by pledged revenues, with a 2 times (x) annual coverage requirement and a 2x maximum annual debt service (MADS) test for additional bonds.

ESTABLISHED, STABLE PROGRAM: The STO bond program is a well-established part of a comprehensive and legislatively authorized long-term transportation infrastructure program.
CONSERVATIVE FORECASTING: Revenue forecasting and budgeting is conservative, although rising debt service and higher transportation needs present ongoing challenges. The state has the flexibility to slow capital spending if necessary.

TRANSPORTATION FUND AFFECTED BY STATE'S GENERAL FUND CONDITION: Interdependence with general fund operations has led to periodic revenue and cost shifts.

GENERALLY STABLE REVENUE STREAM WITH LIMITED GROWTH POTENTIAL: The bonds are secured largely by motor fuel and various other transportation-related revenues that have shown stability over time, with modest losses during the recession. However, Fitch believes the revenue stream has limited growth potential.

RATING SENSITIVITIES

CONDITION OF THE TRANSPORTATION FUND: The rating is sensitive to consistent performance of revenues and to ongoing management actions that sustain sizable coverage on the bonds. Any future action that results in increased exposure of the transportation fund to general fund fiscal pressure would exert negative rating pressure.

CREDIT PROFILE
Connecticut's STO bonds are issued under a senior and second lien, and are secured by pledged revenues deposited to the state special transportation fund (STF). Pledged revenues include taxes and fees on motor vehicle fuel, casual vehicle sales, licenses, as well as transfers from the state's general fund of taxes collected on oil companies' gross earnings and other statutory transfers.

The 'AA' rating for bonds on both senior and second liens reflects an additional bonds test requiring 2x coverage of aggregate principal and interest. Moreover, the state covenants under the second lien that any senior issuance must meet all second lien requirements, both senior and second lien bonds are subject to an annual 2x debt service coverage test, and the bonds are backed by an aggregate debt service reserve funded at maximum annual debt service.

At present, $3.34 billion in senior lien bonds and $399 million in second lien bonds are outstanding. Senior lien bonds have been issued periodically under a 1984 indenture to fund statewide transportation capital, with second lien bonds issued since 1990 for new money and refunding purposes.

Pledged revenues are available first for senior lien debt service and reserves, followed by second lien debt service and reserves. Thereafter, pledged revenues are available for transportation-related general obligation bond debt service and operating expenses of the departments of transportation and motor vehicles.

The state actively manages the STF through a five-year forecast period to maintain ample resources for projected debt service, capital program needs and operating expenses. The STO bond program is very well established, with conservative forecasting and budgeting, 20-year final maturity and flexibility to slow capital projects as necessary. Offsetting these strengths are forecast debt service that generally rises faster than pledged revenues, interdependence with the state general fund that has led to revenue or cost shifts during periods of general fund fiscal stress, and large planned spending for transportation capital.

In recent years the state has made frequent changes to statutory flows of revenues between the general fund and the STF. The 2013 legislative session adopted a significant increase in oil companies' tax deposits to the STF through the FY 2018 forecast plan period to augment funds available for capital, even as FY 2014 and 2015 statutory transfers were adjusted to provide near-term gap-closing resources for the general fund. Including various reductions in planned STF expenditures, the net impact of the changes resulted in a small reduction in net STF resources in FY 2014, followed by significant expansion in FY 2015 and beyond.

Recent underlying revenue collection trends have reflected the state's economic experience, with a slow and uneven economic recovery resulting in only slow baseline gains to transportation tax collections. Motor fuels taxes, the largest source of pledged receipts, rose 1.7% and 1.4% in FY 2013 and FY 2014, respectively, despite a decline in demand over the period for gasoline. Collections of motor fuels taxes are forecast to fall 0.8% during FY 2015, and the state prudently forecasts subsequent slight declines through the FY 2018 forecast period reflecting greater vehicle fuel efficiency and shifts in consumption patterns.

Estimated FY 2014 STF revenue performance was steady, with net revenues up 1.9% from FY 2013 and the cumulative fund excess rising to $173.7 million, or about 13.8% of net revenues. Pledged revenues covered combined outstanding FY 2014 senior and second lien debt service by 2.8x. Including the current sale, Fitch calculates that FY 2014 pledged revenues cover projected MADS in FY 2015 by 2.7x.

The state's multi-year forecast assumes $600 million in additional bond issuance annually through the forecast period, under which annual coverage would drop to 2.6x in FY 2018. Over the forecast period through FY 2018, revenues would grow modestly as a result of the statutory revenue changes noted earlier, even as annual coverage remains ample.

Contact:

Primary Analyst
Douglas Offerman
Senior Director
+1-212-908-0889
Fitch Ratings
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Marcy Block
Senior Director
+1-212-908-0239

Committee Chairperson
Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria', dated Aug. 14, 2012;
--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 14, 2012.

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Additional Disclosure
Solicitation Status