FITCH RATES CONNECTICUT'S $840MM SPECIAL TAX OBLIGATED BONDS 'AA'

Fitch Ratings-New York-23 September 2015: Fitch Ratings has assigned an 'AA' rating to the following State of Connecticut special tax obligation (STO) bonds:

--$700,000,000 STO bonds transportation infrastructure purposes, 2015 series A;
--$140,000,000 STO refunding bonds transportation infrastructure purposes, 2015 series B.

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

--$3.7 billion in outstanding STO senior lien bonds at 'AA';
--$334 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 2x 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.

STATE STEPS TO INSULATE TRANSPORTATION FUND: Interdependence with general fund operations has led to periodic revenue and cost shifts in the past, although recently the state has taken steps to insulate transportation fund revenues.

GENERALLY STABLE REVENUE STREAM: The bonds are secured by motor fuel and various other transportation-related revenues that are generally stable over time but have limited growth potential. Pledged revenues have recently been expanded to include a portion of the statewide sales tax and all oil companies' tax.

RATING SENSITIVITIES

CONDITION OF THE TRANSPORTATION FUND: The rating is sensitive to the consistent performance of revenues and to ongoing management actions that sustain sizable coverage on the bonds.

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).

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.

Pledged revenues include taxes and fees on motor vehicle fuel, casual vehicle sales and licenses. The legislature expanded pledged revenues in its 2015 session as part of a broader initiative, called 'Let's Go CT!,' to accelerate transportation capital spending and insulate the STF from the state general fund. Past legislative action has often resulted in revenue or spending shifts unfavorable to the STF during periods of general fund stress.

Going forward, all taxes on oil companies' gross earnings and a designated portion of the statewide sales tax are being deposited directly to the STF and pledged to bondholders. The inclusion of sales taxes in pledged revenues broadens the base of economic activity from which collections derive beyond solely transportation, linking future STF collection trends more closely to underlying state economic trends. Oil companies' tax collections are also correlated to broader energy market trends, which may expose the STF to more heightened cyclicality in the future.

At present, $3.7 billion in senior lien bonds and $334 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.

MULTI-YEAR PLANNING

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, a 20-year maturity for each series and flexibility to slow capital projects as necessary. Offsetting these strengths are forecast debt service that generally rises faster than pledged revenues, and large planned spending for transportation capital.

Connecticut announced a major expansion of transportation capital spending in 2015, the 'Let's Go CT!' initiative, intended as a multi-decade effort to address longstanding transportation needs beyond those already funded through the existing capital program. The initiative applies the newly-pledged revenues noted earlier to support expanded STO authorization, beginning with $275 million in fiscal 2016 and rising to $706 million by fiscal 2020. Even with new authorization, Fitch notes the state has actively managed the pace of borrowing in the past to conform to available STF resources, including reducing issuance during periods of revenue weakness. Under the initiative a separate panel is also assessing additional sources of revenue to fund state transportation capital beyond the first five years of the program.

NEW LIMITS ON GENERAL FUND SHIFTS

In the past, interdependence with the state general fund has led to revenue or cost shifts during periods of general fund fiscal stress. As part of the 'Let's GO CT!' initiative, the legislature in 2015 statutorily designated the STF as a perpetual fund, limiting the use of resources only for transportation. Although less restrictive than a constitutional measure, Fitch views the new statutory protection as potentially addressing a longstanding credit concern. Past diversions typically took the form of adjustments to the transfer of oil companies' tax (which until the 2015 changes was collected in the general fund) and a separate, undesignated general fund transfer.

Recent STF revenue trends have reflected underlying economic factors affecting transportation as well as frequent statutory adjustments to transfers noted earlier. Estimated FY 2015 STF revenue performance was steady, with net revenues rising 8.3% from FY 2014 reflecting both underlying revenue trends and the impact of a statutory transfer back to the general fund in fiscal 2014.

Motor fuels tax, the largest source of STF resources, has been very slowly growing given consumption trends and the broader slow pace of economic growth in the state. Motor fuels taxes rose an estimated 1.7% in FY 2015, a pace relatively unchanged in recent years. By contrast, motor vehicle receipts and license, permit and fee revenues have risen faster in FY 2015 than in recent years, an estimated 5.7% for motor vehicle receipts and 4.8% for license, permit and fee revenues.

Fiscal 2015 is estimated to have ended with a cumulative fund surplus of $209.5 million, or about 15.4% of net revenues. Pledged revenues covered combined outstanding FY 2015 senior and second lien debt service by 3x. Including the current sale, Fitch calculates that FY 2015 pledged revenues cover projected MADS in FY 2017 by 2.8x.

HIGHER FORECAST GROWTH WITH NEW REVENUES

Future collections trends are likely to reflect both the slow-growing nature of pledged transportation receipts that have long been deposited to the STF, as well as the impact of new receipts being deposited to the STF under the 2015 legislation. Motor fuels taxes are forecast to fall 0.9% during FY 2016, and the state prudently forecasts growth through the FY 2020 forecast period well below 1% annually. Oil companies' tax collections are tied to broader baseline oil price trends; fiscal 2016 collections are forecast to decline 9.1% and rise gradually thereafter. The portion of the 6.35% statewide sales taxes deposited to the STF will be phased in, with 0.3% beginning on Oct. 1, 2015, rising to 0.4% on Oct. 1, 2016 and finally 0.5% on July 1, 2017.

The state's multi-year forecast assumes annual bond issuance rising to $900 million annually by FY 2018 and remaining at that level through FY 2020, the end of the forecast period. Based on these assumptions, annual coverage of outstanding senior and second lien bonds would drop to 2.3x in FY 2020. Over the forecast period through FY 2020, pledged revenues would grow at an average pace of 5.1% annually given underlying economic trends and newly-pledged revenues noted earlier, ahead of the 3.9% average pace of growth during the FY 2011-2015 period.

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Fitch recently published an exposure draft of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015). The draft includes a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to fewer than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published by Jan. 20, 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

Applicable Criteria
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033