

## CREDIT OPINION

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New Issue

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## Connecticut (State of)

New Issue - Moody's Assigns Aa3 to Connecticut \$1.0B Special Tax Obligation Bonds, 2016 Series A & B; Outlook Negative

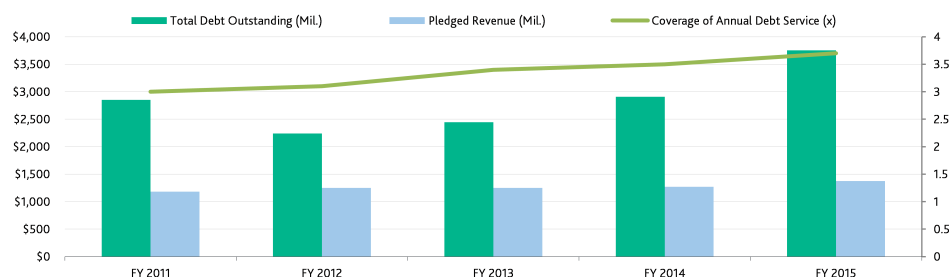
### Summary Rating Rationale

Moody's Investors Service has assigned a Aa3 rating to the State of Connecticut's \$800 million Special Tax Obligation (STO) Bonds Transportation Infrastructure Purposes, 2016 Series A and \$200 million STO Refunding Bonds Transportation Infrastructure Purposes, 2016 Series B. The state plans to sell the senior lien bonds the week of September 12.

The Aa3 rating incorporates the strong legal covenants, including a two times additional bonds test and a combined senior and second lien debt service reserve funded at maximum aggregate annual debt service; the diversified stream of pledged revenues with some sensitivity to economic fluctuations; and satisfactory debt service coverage.

Exhibit 1

### Coverage on Connecticut Special Tax Obligations Has Improved Since Fiscal 2011



Coverage and Total Debt Outstanding reflect senior lien bonds only  
 Source: Connecticut CAFRs FY11-FY15; Moody's Investors Service

### Credit Strengths

- » History of stable aggregate debt service coverage of at least two times by diversified stream of dedicated transportation-related revenues
- » Effective management of Connecticut's Special Transportation Fund (STF)
- » Legal rate covenant to provide pledged revenues in each fiscal year equal to two times aggregate principal and interest requirements on senior lien and second lien bonds
- » Structural enhancements to the STF that diversify the pledged revenues of the fund, eliminate general fund transfers, and establish the STF as a perpetual fund, the resources of which will remain in the STF

## Credit Challenges

- » Some revenue sensitivity to economic fluctuations
- » Sizeable future borrowing plans at \$3.5 billion through 2020

## Rating Outlook

The bonds carry the negative outlook of Connecticut's GO rating, which reflects a lagging economy and weakening demographics that have led to budgetary strain. While we expect the state to solve the budgetary gaps with recurring solutions, we believe that economic trends will place negative pressure on the state's finances in the next few years, while the very high fixed costs reduce flexibility.

## Factors that Could Lead to an Upgrade

- » Stronger debt service coverage

## Factors that Could Lead to a Downgrade

- » Revenue declines resulting in lower debt service coverage
- » Weakened legal covenants

## Key Indicators

Exhibit 2

### State of Connecticut

#### Connecticut Special Tax Obligation Transportation Infrastructure Purpose

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Coverage of Annual Debt Service (x)	3.0x	3.1x	3.4x	3.5x	3.7x
Total Debt Outstanding (Mil.)	\$2,850	\$2,241	\$2,444	\$2,910	\$3,755
Pledged Revenue (Mil.)	\$1,183	\$1,248	\$1,248	\$1,271	\$1,376
Pledged Revenue Annual Change	4.4%	5.5%	0.0%	1.8%	8.3%
Additional Bonds Test (x)	2.0x	2.0x	2.0x	2.0x	2.0x

Total Debt reflects senior lien bonds only; pledged revenues include TSB revenues  
 Source: Connecticut CAFRs FY11-FY15; Moody's Investors Service

## Recent Developments

Recent developments are incorporated into the detailed rating considerations below.

## Detailed Rating Considerations

### Tax Base and Nature of Pledge: Bonds Supported By Diverse Stream of Pledged Revenues

Connecticut's special tax obligation bonds are payable from multiple pledged revenue streams credited to the STF. These revenues include motor fuels tax, oil companies tax, general retail sales taxes, motor vehicle receipts, licenses, permits and fees, and DMV sales taxes. In the past, the majority of pledged revenues have been derived from motor fuel taxes, which totaled approximately 38% in fiscal 2015 revenues. However, in fiscal 2015 the state enacted new laws that provided for a specific portion of state general sales tax revenues be deposited directly into the STF. In addition, oil companies tax revenues, previously transferred from the general fund, will be deposited directly to the STF beginning in fiscal 2016, and general fund transfers were eliminated.

Following this shift, the dependence on motor fuels tax is expected to fall. Sales taxes will be phased in, period beginning Oct. 1, 2015, of 0.3%, increasing to 0.4% on Oct 1, 2016, and to 0.5% beginning July 1, 2017. Following this phase in, motor fuels taxes are expected to fall from 38% of revenues in fiscal 2016 to an estimated 30% in fiscal 2018. Additionally, sales taxes are estimated to grow from 8% of revenues in fiscal 2016 to 21% in fiscal 2018.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody.com](http://www.moody.com) for the most updated credit rating action information and rating history.

### Debt Service Coverage and Revenue Metrics: Debt Service Coverage Remains Healthy

Pledged revenues have grown each year since 2009, increasing by 8.4% in fiscal 2015. Revenue volatility has been limited and revenue increases implemented in the 2011 and 2015 legislative sessions helped maintain average annual senior lien debt service coverage at three times during the recent recession and recovery period.

In fiscal 2015, senior lien debt service coverage stood at 3.7x, which is the highest in the last five years, with second lien coverage at 3.0x. Preliminary fiscal 2016 results indicate senior lien debt service coverage stood at 3.4 times, reflecting both an increase in debt service and a slight -0.5% decline in pledged revenues. Using fiscal 2016 estimated revenues of nearly \$1.4 billion, senior lien MADS coverage is projected at 2.86 times in fiscal 2022. Across all liens, MADS occurs in fiscal 2017 with coverage estimated at 2.49 times.

### LIQUIDITY

Unlike most transportation programs, Connecticut's STO bond indenture also requires a combined debt service reserve account equal to maximum annual debt service. The reserve is currently cash funded with a balance of \$492.9 million.

### Debt and Legal Covenants: Reserve Fund and Leverage Constraints Bolster Credit Profile

The bonds benefit from strong legal covenants and recent legislative changes ensure the resources of the STF will be expended solely for transportation purposes. The state covenants to provide pledged revenues in each fiscal year equal to at least two times aggregate principal and interest requirements on senior lien and second lien bonds. In addition, there is an additional bonds test of 2.0x aggregate senior lien debt service coverage for current and all succeeding years on outstanding and additional bonds. The indenture contains a reserve requirement whereby maximum annual aggregate debt service is fully funded with cash and held with a trustee.

In fiscal 2015, Connecticut enacted significant legislative changes that enhanced the STO program including a new sales tax pledge and new statutory lockbox that establishes the STF as a perpetual fund. The new statutory lockbox establishes the STF as a perpetual fund, the resources of which shall be expended solely for transportation purposes, which include the payment of debt service on obligations of the state incurred for transportation purposes.

### DEBT STRUCTURE

As of August 1, 2016 there was \$4.5 billion of special tax obligation bonds outstanding, of which \$4.2 billion are senior lien and \$260 million are second lien. All of the debt is fixed rate and approximately 59% of STO principal will amortize over the next ten years.

### DEBT-RELATED DERIVATIVES

There is no derivative exposure.

### PENSIONS AND OPEB

Connecticut's adjusted net pension liability (ANPL), our measure of the government's pension burden, is significantly above the 50-state median. As of 2014, the three-year average ANPL was 225% of total governmental revenue, the second highest among the states. The state participates in 3 pension systems, of which the most significant are the State Employees Retirement System and the Teachers Retirement System. Connecticut is among the handful of states that take responsibility for directly funding teacher pensions. Moody's ANPL reflects certain adjustments made to improve comparability of reported pension liabilities. The state contributes the full amount of its actuarially determined contribution, about \$2.2 billion in fiscal 2015.

Connecticut also has a very high OPEB liability. As of the 2013 valuation, the liability stood at \$19.5 billion. The state is responsible for the \$2.4 billion Teachers' OPEB liability. The OPEB trust fund contained \$229.6 million in net assets as of June 30, 2015.

Pensions and OPEB are not factors in the special tax methodology.

### Governance: State Utilizes Strong Governance Practices

The state has a constitutional balanced budget requirement, strong, binding consensus revenue process supported by nonpartisan and objective economic analysis that is conducted three times a year (January, April and November) or can be scheduled more frequently during times of revenue shortfalls or economic distress. There is a constitutional cap on spending, however, the Attorney General opined in November 2015 that it is not operative until the General Assembly adopts definitions. There is a statutory limit on debt payable from the general fund. The state is not subject to mandated initiatives or voter referenda. The Governor has limited executive authority to cut expenses by up to 5% of an individual appropriation, not to exceed 3% of any fund, without legislative approval, and if a deficit exceeds 1% of the general fund, there are requirements for a timely deficit mitigation plan to be developed. A supermajority

is not required for tax increases or legislatively enacted budget adjustments. There is monthly budget reporting by both the Governor's budget office and the State Comptroller and budget adoption has been timely.

The state does not conduct a debt affordability analysis; however, both the Governor's budget office and the Office of Fiscal Analysis prepare Fiscal Accountability reports that include multiple-year financial planning including projections of debt issuance, debt levels and debt cost. The state has frequently maintained a rainy day fund over the years, and there are statutory requirements that all budget surplus funds be deposited to the rainy day fund at year-end.

The Department of Transportation (DOT) is an agency of the state that has a budget approved by the state Office of Policy and Management. The same reporting guidelines apply to the DOT through the Connecticut Office of Policy and Management.

### **Legal Security**

The bonds are secured by a gross pledge of motor fuels tax, oil companies tax, general retail sales taxes, motor vehicle receipts, licenses, permits and fees and sales taxes. The security was recently diversified with the inclusion of a portion of sales taxes and the pledged revenues are credited to the STF.

### **Use of Proceeds**

Proceeds of the Series A new money bonds will be used for infrastructure improvements across the state, including some of the state's major capital projects. The Series B bonds will refund existing Series 2008A special tax obligation bonds.

### **Obligor Profile**

The State of Connecticut has a population of almost 3.6 million people. The state, located in the northeastern US, has a large and diverse economy with a gross state product of \$253 billion. It is the wealthiest state in the country with per capita income of 141% of the US average.

The state infrastructure program was established in 1984 and is a continuous program that finances the ongoing requirements of the state for the planning of infrastructure. The state's biennial budget included a five-year transportation improvement program that provides initial funding for the 30-year "Let's Go CT" capital investment plan.

### **Methodology**

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in January 2014. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Ratings

Exhibit 3

### Connecticut (State of)

Issue	Rating
Special Tax Obligation Bonds Transportation Infrastructure Purposes, 2016 Series A	Aa3
Rating Type	Underlying LT
Sale Amount	\$800,000,000
Expected Sale Date	09/12/2016
Rating Description	Special Tax: Transportation-Related
Special Tax Obligation Refunding Bonds Transportation Infrastructure Purposes, 2016 Series B	Aa3
Rating Type	Underlying LT
Sale Amount	\$200,000,000
Expected Sale Date	09/12/2016
Rating Description	Special Tax: Transportation-Related

Source: Moody's Investors Service

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