FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Connecticut's $850 Million STO Bonds 'A+'/Stable

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Fitch Ratings - New York - 15 May 2020: Fitch Ratings has assigned an 'A+' rating to the following obligations of the state of Connecticut:

--$850 million special tax obligation (STO) bonds, transportation infrastructure purposes (2020 series A).

The STO bonds will be offered by negotiated sale the week of May 18, 2020.

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

The Rating Outlook is Stable.

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 reflect ample resiliency of the financing structure and strong debt service coverage, and considers the support provided by state policy actions on taxes, debt and capital to manage the fund over time, as growth prospects for revenues are otherwise slow yet still solid. The new bonds and all outstanding bonds have been issued under a senior lien, with no second lien bonds outstanding.

Pledged revenues are expected to remain economically sensitive and future allocation of portions of statewide sales tax to the STF is likely to benefit the fund, providing firmer future growth prospects than would be provided if the STF were funded solely by transportation-related receipts. Although coronavirus-related revenue declines will affect the fund in fiscal years 2020 and 2021, the state projects a rebound over several years through fiscal 2023, aided by the additional sales tax revenue allocations, with a return to flatter growth anticipated in fiscal 2024.

The security is exposed to the state's ability to statutorily adjust both the rates of pledged taxes and fees and their distribution among its funds, despite the passage of a constitutional amendment in 2018 that requires revenue, once deposited in the STF, to be spent on transportation purposes. This exposure places a cap on the STO rating at the state of Connecticut's 'A+' Issuer Default Rating (IDR).

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 a portion of statewide sales taxes adds diversity to the pledge beyond transportation receipts and supports more steady growth over time. Receipts are economically sensitive, and trends are affected by state actions to shift receipts to support transportation capital and operating needs.

Leverage Limits and High Resiliency: Pledged revenues can absorb a significant decline and still provide sufficient coverage of debt service based on current revenue expectations. A minimum of 2.0x maximum annual debt service (MADS) is required for additional bonds, limiting leverage of pledged resources. The bonds also carry a 2.0x annual coverage requirement.

Linkage with State: The credit is exposed to 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, despite a constitutional amendment that requires revenue once deposited in the STF to be spent solely on transportation purposes. This interdependence caps the STO rating at the state of Connecticut's 'A+' IDR.

RATING SENSITIVITIES

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

--Upgrade in State's IDR: an upgrade of Connecticut's 'A+' IDR could result in an upgrade in the STO bonds' rating, given the linkage of the rating on STO bonds to the state's IDR.

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

--Lower Resilience of Pledged Revenues: an extended economic contraction beyond Fitch's current baseline scenario that substantially impairs pledged receipts and reduces their resiliency relative to MADS could lead to a downgrade.

--Revenue Changes that Narrow Coverage: the rating assumes continued active management by the state of pledged revenues to support transportation needs over time. State actions that shift pledged revenues away from the STF or otherwise lead to narrower coverage would reduce resilience and lead to a downgrade.

--Downgrade in State's IDR: a downgrade of Connecticut's 'A+' IDR would result in a downgrade in the rating on STO bonds, given the linkage of the rating on STO bonds to the state's IDR.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance 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.

CURRENT DEVELOPMENTS

Sectorwide Coronavirus Implications

The recent outbreak of the coronavirus and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. As severe limitations on economic activity only began recently, most state governments' fiscal and economic data do not fully reflect credit impairment. Material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward looking, and Fitch will monitor developments in state and local governments related to the severity and duration of the virus outbreak, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in the first half of 2020 at a speed and depth unprecedented since World War II. Recovery begins from the third quarter of 2020 onward as the health crisis subsides after a short but severe global recession. GDP remains below its fourth-quarter 2019 level until mid-2022. A severe but plausible downside scenario includes a prolonged health crisis and negative economic shock. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update," at www.fitchratings.com.

Coronavirus - Connecticut STF Budget and Liquidity Update:

Budgetary and liquidity impacts of the pandemic and lockdown are not sparing the STF, although bondholders are protected by a first lien on deposits to the fund, monthly deposits for debt service on a one-sixth, one-twelfth basis, and a debt service reserve funded at MADS.

Gasoline consumption is well below typical levels given stay-at-home orders, oil companies tax are well below recent levels due to the drop in global crude oil prices, and motor vehicle receipts, which include registration fees, have been subject to a 90-day deferral. As of its April 2020 consensus update, the state forecasts fiscal 2020 STF revenues falling $183 million, or 10.5%, from the level projected in the enacted budget, resulting in an annual deficit of $152 million, compared with a $39 million surplus at budget enactment. The outlook for fiscal 2021 is similar, with forecast STF revenues falling $204 million, or 10.8%, from earlier forecast levels, leaving the STF with an annual deficit of $140 million.

Including the impact of forecast changes, the STF has a cumulative surplus forecast at $168 million in fiscal 2020, diminishing to $29 million in fiscal 2021. Although long-term forecasts beyond fiscal 2021 show deficiencies in the fund, this is not inconsistent with past forecasts, with the state's practice of actively revisiting capital, debt, revenue and expense policy decisions to ensure transportation needs are met.

ECONOMIC RESOURCE BASE

Connecticut has a diverse, mature and wealthy economic base, with flat to modestly declining population trends 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 Indian gaming in the state's southeast.

In contrast to past economic expansions, the state's employment performance in the expansion that recently ended had been unusually slow. Economic impacts of the pandemic and lockdown have unfolded rapidly, with Fitch calculating that based on first-time claims since mid-March, jobs lost as a percentage of the labor force equals a steep 31%, more severe than the 19.3% median for all U.S. states. The state's unemployment rate has historically run below the U.S. rate but exceeded the nation for much of the recovery; the unemployment rate was 4.1% in 2019, compared with

3.9% for the U.S. Personal income per capita ranks highest among the states, at 140% of the national level, although annual growth in aggregate personal income has been below the nation's since 2011.

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.

STO bonds are secured by a gross lien on pledged revenues and other receipts deposited to the STF prior to any other uses. All outstanding bonds are on a senior lien, with debt outstanding under a second lien called in April 2020. Pledged revenues consist of a motor fuels tax charged on gasoline, diesel and other fuels sold by distributors; vehicle license, permit and fee revenue; a tax on gross earnings from the sale of petroleum products containing oil derivatives; portions of the general statewide sales tax and the sales tax levied on new automobile purchases; various motor vehicle registration, inspection and user fees; and a department of motor vehicle (DMV) sales tax levied on the casual sale of non-commercial motor vehicles, aircraft, vessels and snowmobiles.

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 stable over time. STF revenues are derived primarily from economically-sensitive transportation-related collections, although recently boosted allocations of statewide sales tax revenue add diversity and reduce exposure to transportation-related activity. Over time, the mix of dedicated revenue sources compensates for expected slower growth in transportation-related revenue sources. Notwithstanding the coronavirus-driven decline beginning in fiscal 2020, Fitch expects longer term collections to recover and remain sound in the absence of further revenue changes by the state. Total fiscal 2019 net revenues grew 3.6%, and longer-term growth prospects are flat but supported by the additional sales tax revenue flowing to the STF. The state's April 2020 consensus revenue forecast projects a 7.2% decline in available net revenue in fiscal 2020 and an increase of 7.1% in fiscal 2021.

Motor fuels taxes increased 2% YOY in fiscal 2019 as a $0.026 increase in the diesel fuel tax rate, to $0.465 per gallon, boosted receipts. Going forward, the state forecasts a relatively sharp decline in 2020 collections due to a coronavirus-related consumption decline, followed by a bounce-back and return to relatively flat collections through fiscal 2024. Motor vehicle-related (MV) receipts, along with license, permit and fee (LPF) revenues, will continue to demonstrate the variability associated with annual customer transactions. MV receipts are expected to rise modestly in 2020, followed by a surge in fiscal 2021 given 90-day delays in registration deadlines tied to the coronavirus lockdown, before returning to relatively slow levels of growth.

Volatility in oil companies tax collections reflects broader crude oil price trends. The tax fell for three consecutive years, from fiscal 2015 through 2017, but grew rapidly in fiscal 2018 with gains in oil prices. Going forward, oil companies tax is expected to fall in fiscal 2020 and 2021 due to the plunge in oil prices, followed by a gradual increase. General statewide sales tax deposited to the STF was approximately $371 million in fiscal 2019 and is currently forecast to grow to $693 million in fiscal 2024 due to the car sales tax phase-in through fiscal 2023, inflation, and economic growth; this is a slower rate of growth compared to recent forecasts. On a per penny basis, sales tax revenue is expected to grow slightly above the rate of inflation. Sales tax revenue is expected to become the largest component of the STF at 32% in fiscal 2022.

The STF, like the general fund, is subject to the state's revenue cap that limits appropriations relative to revenues beginning in fiscal 2020. The appropriations limit begins at 99.5% of expected revenue in fiscal 2020 and phases in to 98% in fiscal 2026 and thereafter. Looking ahead to fiscal 2024, once the full allocation of automobile sales tax is complete and netting the impact of the revenue cap, the state projects only 2.4% growth in available net revenues in the STF, a modest level absent additional tax policy action.

RESILIENCE OF PLEDGED RECEIPTS

STF forecast performance is closely managed, with an annual coverage and a balanced budget requirement, ongoing revenue monitoring and frequent forecast updates that allow the state to quickly identify weakness in STF resources. Based on forecast cumulative surpluses in the STF, the scope of state transportation capital and operating needs, the shifting appetite for transportation borrowing and the periodic need for general fund relief, legislative action on a one-time or multi-year basis has resulted in tax rates changes, taxable base adjustments and statutory diversions.

In the current environment, Fitch is assessing resilience of dedicated tax receipts using a severe shock scenario informed by the Fitch Global Infrastructure Group's scenarios for passenger and truck traffic which assumes significant traffic losses in year one and a recovery in year two. For receipts pledged to the STO bonds, the corresponding revenue impact would equal 34% decline in year one, with a slower recovery in year two and a return to the state's assumptions thereafter. This stress scenario assumption for the STO bonds is more conservative than the state's forecast declines and is also more conservative than the differences in economic sensitivity for each of the pledged receipts noted above would imply.

Based on this severe shock scenario, Fitch views the bonds as still having a robust level of resilience. Coverage of MADS (in fiscal 2023), including the new bonds, by stressed fiscal 2020 receipts would still be 1.7x, a level below the ABT but well above the level necessary to provide sum-sufficient coverage of debt service. Fiscal 2020 stressed revenues could still tolerate a 41% decline while still providing coverage of MADS. Although these results imply a lower level of resilience in the current environment, Fitch views the continued active monitoring of the fund and frequent adjustments to pledged receipts as further mitigating the risk posed by the current economic shock.

Fiscal 2020 estimated revenues cover MADS on outstanding senior bonds and the new bonds at 2.4x. Although state debt issuance has declined in recent years, projections include continual borrowing to address significant transportation needs, which is forecast to result in narrower coverage over the forecast period.

For additional information on the state of Connecticut's IDR, see "Fitch Affirms Connecticut's IDR at 'A+', Rates $900MM GO Bonds 'A+'; Outlook Stable," available at www.fitchratings.com.

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

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING
Connecticut, State of (CT) [General Government]	

ENTITY/DEBT	RATING		
• Connecticut, State of (CT) /Special Tax Oblig Trans Infr/1 LT	LT	A+	Affirmed

VIEW ADDITIONAL RATING DETAILS

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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 States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Connecticut, State of (CT)	EU Endorsed

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