FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Connecticut's $1.1 Billion STO Bonds 'AA-'; Outlook Stable

Mon 03 Oct, 2022 - 1:51 PM ET

Fitch Ratings - San Francisco - 03 Oct 2022: Fitch Ratings has assigned a 'AA-' rating to the State of Connecticut's $1.145 billion special tax obligation (STO) bonds, consisting of:

--$830,000,000 special tax obligation bonds transportation infrastructure purposes 2022 series A;

--$315,000,000 special tax obligation refunding bonds transportation infrastructure purposes 2022 series B.

Par amounts are subject to change pending final sale.

The STO bonds will be offered by negotiated sale the week of Oct. 17, 2022.

In addition, Fitch has affirmed the rating on Connecticut's outstanding STO bonds at 'AA-'.

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 'AA-' ratings and Stable Outlook on Connecticut's STO bonds reflect very strong resiliency of the financing structure, the state's active management of STF revenues, and the otherwise slow underlying growth prospects for transportation revenues, similar to other states.

The rating on the STO bonds remains capped at the state's 'AA-' IDR, given its ability to statutorily adjust the rates of pledged taxes and fees and their distribution. The new bonds and all outstanding bonds have been issued under a senior lien, with no second lien bonds outstanding or contemplated.

KEY RATING DRIVERS

Growth Prospects Slow: Slow underlying growth prospects for transportation-related revenues pledged to the bonds are similar to other states and reflective of a 'a' assessment. The pledge of portions of statewide sales taxes adds diversity to the pledge beyond transportation receipts and supports expectations for steadier growth over time. Revenue trends are affected by active state management 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 supporting a 'aa' assessment for resilience. A 2x maximum annual debt service (MADS) additional bonds tests provides a strong cushion for bondholders in the event of cyclical declines.

Rating Capped by State IDR: The credit is exposed to the operating performance of the state of Connecticut given the state's ability and demonstrated willingness to alter the flow of revenues to the transportation fund. This interdependence caps the STO rating at the state's 'AA-' IDR.

RATING SENSITIVITIES

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

--An upgrade of Connecticut's IDR and maintenance of resilience and revenue growth prospects, absent state actions, at least in line with recent trends.

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 reduce pledged STF revenues or otherwise narrow the resilience of the structure;

--A downgrade of Connecticut's 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.

ECONOMIC RESOURCE BASE

Connecticut's economy is anchored by 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 southeast.

Population growth in Connecticut, like much of the northeast, has been well below the U.S. average in recent decades. 2021 census data points to a modest, 0.9% uptick since the 2010 census, stronger than recent annual estimates although below neighboring states and national trends.

DEDICATED TAX CREDIT PROFILE

The 'AA-' rating reflects the underlying credit quality of the bonds' structure and its linkage to the state's overall credit quality, reflected in the state's 'AA-' IDR. 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. Voters approved a constitutional dedication of revenues held in the STF for transportation purposes in 2018, though the legislature retains discretion to adjust rates and/or allocations of pledged revenues prior to deposit into the STF. There is otherwise no annual appropriation requirement.

Some of these adjustments constrain resilience, while some enhance resilience. This has been demonstrated in the fiscal 2020-2021 biennium, when the scheduled phase-in of expanded sales tax deposits to the STF was modified to support the general fund, and in the fiscal 2022-2023 biennium, with the passage of a highway use fee on truck traffic as of Jan. 1, 2023. Connecticut is also one of a handful of states implementing a gas tax holiday, currently spanning portions of fiscal 2022 and 2023, although an extension has been considered by the legislature. The gas tax holiday is estimated to reduce STF revenues $90 million in fiscal 2022 and $150 million in fiscal 2023.

For additional information on Connecticut's IDR, please see Fitch's May 2022 press release "Fitch Rates Connecticut's $1.1 Billion GO Bonds 'AA-'; 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.

After issuance of the bonds, approximately $7.6 billion will be outstanding under the senior lien, all of which has been issued at fixed rates and a 20-year maximum amortization. Leverage of pledged resources is limited by minimum required coverage of 2x maximum annual debt service (MADS) in any 12 consecutive months of revenues in the 18 months prior to issuance of additional bonds, as well as all years for which bonds will remain outstanding. The bonds also carry a rate covenant requiring 2x annual coverage.

Unaudited pledged revenues of $2.0 billion in fiscal 2022 were a 13.1% increase over fiscal 2021, as statutory increases to the share of state sales taxes pledged to bondholders and increased receipts from taxes on oil companies more than offset sizeable decreases to motor fuels tax charged on gasoline, diesel largely due to a gas tax holiday.

Fiscal 2022 pledged revenues consisted of a fixed portion of the statewide general sales tax ($703 million, 35% of the total); a motor fuels tax charged on gasoline, diesel and other fuels sold by distributors ($390 million, 19%); various motor vehicle registration, inspection and user fees ($282 million, 14%); a tax on gross earnings from the sale of petroleum products containing oil derivatives ($393 million, 19%); vehicle license, permit and fee revenues ($134 million, 7%); and a rising share of the sales tax levied on motor vehicles ($122 million, 6%).

The motor fuels tax has traditionally been the largest component, although the phased shift of vehicle sales tax made the sales tax the largest component of STF revenue beginning in fiscal 2021. In fiscal 2022, 75% of vehicle sales tax were deposited to STF, up from 25%. Beginning fiscal 2023, 100% of the vehicle sales tax will shift to the STF, bringing in an estimated $776 million of the projected $2.1 billion in total pledged revenues.

Fiscal 2023 revenues will also benefit from implementation of a highway use fee on truck traffic in the state, which will generate $45 million, rising to $90 million in fiscal 2024. The state plans to more than offset lost STF revenues with larger-than-anticipated revenues in related streams, especially Gross Receipts Taxes on Oil Companies, which will remain robust amidst elevated petroleum prices. The nine-month gasoline tax break projected to reduce STF revenue by a combined $240 million in fiscal 2022 & 2023. While affordable, this gas tax holiday nonetheless results in less funds available for transportation needs.

STF revenues are closely monitored, with monthly updates by the state budget office and comptroller, and updates of a multiyear outlook at each state consensus forecast. 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.

Multi-year STF forecasts have typically shown narrowing surpluses or deficits later in the state's 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 state has a longstanding practice of actively adjusting planned capital spending, debt issuance, revenues and expenses across a multiyear planning period. State projections anticipate small surpluses in the fiscal 2022-2023 biennium as the economic recovery continues and the new revenue streams flow to the STF.

LIMITED TRANSPORTATION RECEIPTS GROWTH PROSPECTS

Fitch views growth prospects for the diverse mix of transportation and general receipts securing the STO bonds to be relatively flat over time, although the recent addition of new sales tax inflows and future collections from highway use fees could over time result in stronger growth to offset expected declines in fuels-based revenues. The dedicated revenue stream through fiscal 2021 had a 10-year CAGR of 3.9%, but this CAGR reflects substantial rate changes and other state actions that increase receipts flowing to the STF, such as the deposit of vehicle-related sales taxes.

Transportation-related collections in Connecticut, similar to other states, are likely to be a flat-to-declining source of revenue in the absence of rate changes, particularly given factors such as rising fuel efficiency and the transition to alternative fuels.

VERY STRONG 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 pledged revenue over time to GDP.

Based on fiscal 2021 net revenues of $1.7 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 about 5x the largest historical decline in pledged revenues (-10.2%, in fiscal 2020). Using the FAST model and revenue data through fiscal 2021, a separate scenario assuming Fitch's standard moderate GDP decline of 1.0% produces an expected revenue decline of 3.7%. This constitutes a very strong level of resilience, with the structure's cushion at more than 13x the scenario revenue decline.

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	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Bryan Quevedo
Director
Primary Rating Analyst
+1 415 732 7576
bryan.quevedo@fitchratings.com
Fitch Ratings, Inc.
One Post Street, Suite 900 San Francisco, CA 94104

Douglas Offerman
Senior Director
Secondary Rating Analyst
+1 212 908 0889
douglas.offerman@fitchratings.com

Michael Rinaldi
Senior Director
Committee Chairperson
+1 212 908 0833
michael.rinaldi@fitchratings.com

MEDIA CONTACTS

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

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (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, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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

DISCLAIMER & DISCLOSURES

All Fitch Ratings (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. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the

Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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 or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) 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.

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

US Public Finance North America United States
