State of Connecticut

Special Tax Obligation Bonds, Transportation Infrastructure Purposes

Issuer: State of Connecticut		
Assigned	**Rating**	**Outlook**
Special Tax Obligation Bonds, Transportation Infrastructure Purposes, 2022 Series A	AA+	Stable
Special Tax Obligation Refunding Bonds, Transportation Infrastructure Purposes, 2022 Series B	AA+	Stable
Affirmed	**Rating**	**Outlook**
Special Tax Obligation Bonds, Transportation Infrastructure Purposes	AA+	Stable

Methodology:

U.S. Special Tax Revenue Bond Rating Methodology

ESG Global Rating Methodology

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Rating Summary: The long-term rating for the Special Tax Obligation Bonds (Bonds) is underpinned by the ample coverage and growing nature of the transportation revenues pledged to repayment as well as the robust legal framework that includes a covenant for the State to provide pledged revenues in each fiscal year sufficient to provide at least 2.0x annual debt service coverage. In the event that debt service coverage does not meet the 2.0x requirement, the covenant requires that the State must pass legislation within one year adjusting pledged revenues to satisfy the coverage requirement.

Special Tax Obligation Bonds are issued to fund transportation projects within the State and are payable from a diverse and stable source of state revenues derived primarily from transportation-related activities. The pledged revenues consist of sales tax, oil companies tax, motor fuels tax, and various transportation-related fees and charges. Pledged revenues increased 13.1% in the fiscal year ending June 30, 2022 to $2.01 billion, a record level of collections, reflecting additions to pledged revenues. Unaudited debt service coverage in FY 2022 was strong at 2.71x.

Connecticut has a longstanding commitment to transportation investment. In 2015, the Special Tax Fund (STF), into which all pledged revenues are deposited and used first to pay debt service, was designated a perpetual fund by legislation. The passage of a November 2018 ballot measure amended the State Constitution to require that all monies contained in the STF be used solely for transportation purposes, including payment of debt service on debt incurred for state transportation purposes. It also requires that so long as these sources of funds are authorized by statute to be collected, they must be deposited into the STF. KBRA views the constitutional dedication of transportation revenues positively and the passage of the referendum as reflecting strong public support for transportation investment.

The State has directed substantial new funding sources to the STF in recent years. It phased in the dedication of a 0.5% portion of the 6.35% general sales tax to the STF between FY 2016 and FY 2018. The State subsequently phased in the dedication of new and used car sales tax collections beginning at 8% in FY 2019, 17% in FY 2020, 25% in FY 2021, 75% in FY 2022, and 100% in FY 2023 and all future years. In FY 2022, sales taxes dedicated to the STF (including the piece derived from motor vehicle sales) totaled $703 million, comprising 35% of total STF receipts, with this source now comprising the STF's largest funding source. The Legislature has additionally implemented a Highway User Fee that will assess a per-mile tax on commercial trucks that will scale from 2.5 cents to 17.5 cents per mile based on vehicle weight class. The tax, all proceeds of which are to be deposited to the STF, is scheduled to become effective January 1, 2023 and is projected to raise $45 million in FY 2023 and $90 million in FY 2024 (its first full year of collections), growing thereafter. A recent September 21 ruling striking down a trucks-only tolling program in Rhode Island may have negative implications with respect to the viability of the Highway User Fee. KBRA is not aware of any litigation filed to date with respect to Connecticut's soon to be implemented Highway User Fee but will monitor developments as the tax is implemented next year.

The State uses STF revenues both to pay debt service and fund transportation programs and capital outlays on a pay-go basis. The future transportation capital needs of the State are significant, and the State plans to fund much of these capital plans with additional parity bonds as well as continuing pay-go contributions. The State's projections call for parity borrowing of $1.0 billion each in FY 2024 and FY 2025, and $1.1 billion in FY 2026. Transportation investment in the State will be bolstered over the next five years by supplemental federal grant funding provided under the Infrastructure Investment and Jobs Act (IIJA). The State expects to receive a 30% increase in Federal Transportation Authority funding (~$300 million) and a 48% increase in Federal Highway Administration funding (~$1.3 billion) through FY 2027. Such funds do not flow through the STF but will be available to bolster Statewide transportation infrastructure investment.

Connecticut has a strong economy with well above average wealth levels, although growth levels have lagged the region and U.S since 2010. The State's economy continues to recover from the impacts of the COVID-19 pandemic. The seasonally adjusted unemployment rate reached a high of 11.6% in May 2020 but jobs have returned quickly. As of August 2022, Connecticut's unemployment rate has eased to 4.1%, a level which, while much lower than the 2020 high, exceeded the U.S. level of 3.7%.

The Stable Outlook reflects KBRA's expectation that debt service coverage on the bonds will remain at comfortable levels based upon the stability and expected growth of the pledged revenues and the State's demonstrated history of activity managing transportation funding levels.

Key Credit Considerations

The rating actions reflect the following key credit considerations:

Credit Positives

- Stable source of revenues provides good coverage of debt service.
- The State's commitment to transportation capital funding is strong and is buttressed by the public support for transportation purposes reflected in the passage of the November 2018 referendum.
- Legal protections are favorable including a covenant to maintain at least 2.0x annual debt service coverage.

Credit Challenges

- The State's rate of economic growth has been slower than that of the U.S. and New England region for more than a decade although wealth levels are favorable.
- Transportation needs are substantial and place pressure upon the State's ability to fund them over the longer term.

Rating Sensitivities

▪ Increased economic growth that translates into enhanced organic growth of the pledged revenue sources.	+
▪ An economic downturn that leads to a sustained decline in coverage levels and budgetary pressure on the State.	-

Highlights FYE June 30 (dollars in millions)	**2021**	**2022 Unaudited**
Pledged Revenues and Coverage		
Motor Fuels Tax	$ 475	$ 389
Oil Companies Tax	229	392
Licenses, Permits, Fees	131	134
Sales Tax - DMV	117	122
General Retail Sales and Use Tax	483	703
Motor Vehicle Receipts	321	282
Other, Net	21	(13)
Total	1,778	2,010
Combined Sen. and Sub. Lien DS	664	743
Debt Service Coverage Ratio	**2.68x**	**2.71x**
Economic Data		
Per Capita Personal Income (2021)	$82,082	
as a % of U.S.	129%	
Population (2021)	3,605,597	
Δ 2010 to 2021	0.9%	
Real GSP, Δ 2010 to 2021		
Connecticut	0.6%	
New England	15.2%	
U.S.	24.1%	
Summary Legal Provisions		
Coverage Covenant	Pledged revenues must provide 2.00x annual debt service.	
Additional Bonds Test	Historical and projected annual receipts equivalent to 2.00x pro forma MADS.	
DSRF Requirement	1.00x MADS	

Rating Determinants (RD)	
1. Legal Framework	AAA
2. Nature of Special Tax Revenues	AAA
3. Economic Base and Demographics	AA-
4. Revenue Analysis	A+
5. Coverage and Bond Structure	AAA

Updates to RD 4: Revenue Analysis and RD 5: Coverage and Bond Structure are provided below. A detailed review of each rating determinant as well as a discussion of ESG Management and KBRA's Bankruptcy Assessment can be found in prior reports, the most recent of which from November 1, 2021 can be found here.

RD 4 Update: Revenue Analysis

FY 2020 pledged revenues declined 10.2% to $1.52 billion reflecting the impact of the early stages of the COVID-19 pandemic on the underlying taxes and fees. Oil companies tax in particular declined 26.4% to $229 million as the sharp decline in both energy prices and gas consumption reduced oil company gross earnings. Licenses, permit, and fee revenues additionally declined 14.3% to $129 million due to the granting of a 90-day extension of DMV credentials in response to the pandemic.

FY 2021 pledged revenues rebounded by a sharp 17.2% YoY to $1.78 billion owing largely to an increase in the allocation of motor vehicle sales tax to the STF to 25% from 17% in the prior year resulting in receipts of $483 million. Motor vehicle receipts increased by an also notable 33% to $321 million reflecting the ending of DMV credential extensions.

FY 2022 receipts increased by a substantial 13.1% to $2.01 billion due to an again increased allocation of the motor vehicle sales tax to 75% from 25% in the prior year resulting in receipts of $703 million. Oil companies tax increased 71.2% to $392 million as firming oil prices and continued recovery in consumption supported strong oil company gross receipts. Motor fuel taxes in contrast declined 18.1% to $389 million reflecting the Legislature's implementation of $0.25 cent per gallon motor fuel tax holiday in the final four months of FY 2022 in response to surging gas prices. Motor vehicle receipts declined 12.4% to $282 million reflecting normalization following a surge in FY 2021 resulted from the expiration of the DMV credential extensions granted in FY 2021 in response to the pandemic.

Figure 1

Actual, Estimated, and Projected Debt Service Coverage
FYE June 30 (dollars in millions)

	Actual					Unaudited	Projected			
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Motor Fuels Tax	499	500	510	478	475	389	344	492	489	485
% change	*-3.8%*	*0.3%*	*2.0%*	*-6.2%*	*-0.6%*	*-18.1%*	*-11.5%*	*42.8%*	*-0.7%*	*-0.6%*
Oil Companies Tax[1]	238	313	313	230	229	392	402	380	350	323
% change	*-4.6%*	*31.1%*	*0.2%*	*-26.4%*	*-0.6%*	*71.2%*	*2.6%*	*-5.5%*	*-7.9%*	*-7.8%*
Sales Tax[2]	188	328	371	401	483	703	794	809	829	848
% change	*72.8%*	*73.8%*	*13.2%*	*8.2%*	*20.5%*	*45.7%*	*12.9%*	*1.9%*	*2.4%*	*2.3%*
Motor Vehicles Receipts	243	253	250	242	321	282	270	275	276	282
% change	*-3.4%*	*4.2%*	*-1.1%*	*-3.5%*	*33.0%*	*-12.4%*	*-4.0%*	*1.7%*	*0.5%*	*1.9%*
Licenses, Permits & Fees	144	142	150	129	131	134	142	143	144	145
% change	*0.1%*	*-1.5%*	*5.8%*	*-14.3%*	*1.6%*	*2.6%*	*6.0%*	*0.4%*	*0.6%*	*0.6%*
Sales Tax - DMV	85	86	87	73	117	122	106	99	100	101
Highway Use Fee	-	-	-	-	-	-	45	90	94	98
Federal Payments	12	12	12	12	12	11	10	9	8	7
Interest Income	9	18	37	22	2	4	3	5	6	7
Transfers	(7)	(6)	(6)	(36)	25	(6)	(6)	(6)	(6)	(6)
Refunds	(17)	(15)	(37)	(35)	(17)	(22)	(19)	(20)	(21)	(21)
Total Net Revenues	**1,395**	**1,630**	**1,688**	**1,517**	**1,778**	**2,010**	**2,093**	**2,276**	**2,270**	**2,269**
% change	*3.1%*	*16.9%*	*3.6%*	*-10.2%*	*17.2%*	*13.1%*	*4.1%*	*8.7%*	*-0.3%*	*0.0%*
Debt Service[4]	**542**	**574**	**642**	**651**	**664**	**743**	**842**	**891**	**955**	**1,039**
Debt Service Coverage	***2.57x***	***2.84x***	***2.63x***	***2.33x***	***2.68x***	***2.71x***	***2.59x***	***2.55x***	***2.38x***	***2.18x***

Source: POS Table 8 for revenues and Table 9 for debt service and coverage.

[1]All oil companies tax collections deposited to STF beginning FY2016.

[2]The State phased in the dedication of a 0.5% portion of the 6.35% general sales tax to the STF between FY 2016 and FY 2018. The State subsequently also phased in the dedication of new and used car sales tax collections beginning at 8% in FY 2019, 17% in FY 2020, 25% in FY 2021, 75% in FY 2022, and 100% in FY 2023 and all future years.

[3]Sales tax collected by the DMV on sales between individuals (non-dealer sales) when the vehicle is being registered for the first time by the new owner.

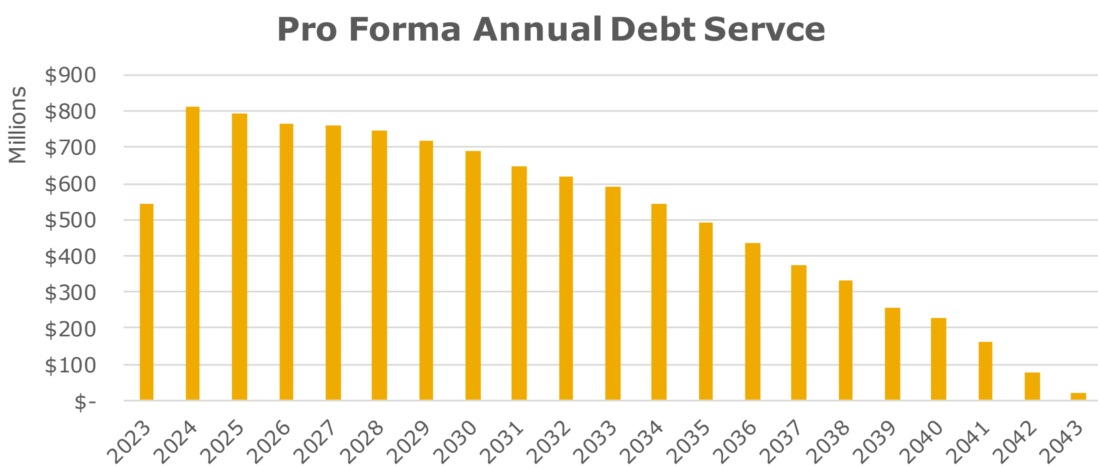
[4]Includes existing debt service requirements plus anticipated debt service on projected annual issuance through FY 2026.

The State projects that FY 2023 receipts will increase 4.1% YoY to $2.09 billion. Motor vehicle sales tax receipts are projected to increase 12.9% to $794 million reflecting completion of the phase-in of the allocation of the motor vehicle sales tax receipts this year to the STF to 100% from 75% in the prior year. Motor fuel taxes are projected to decline by another 11.5% to $344 million due to the Legislature's extension of the $0.25 per gallon gas tax holiday through November 1, 2022. The State's legislative leaders are reportedly considering a special legislative session after the November election to consider extension of the gas holiday beyond November 1. While such an extension could reduce revenues available for debt service, KBRA anticipates no materially adverse credit impact given the State's explicit covenant to maintain pledged revenues sufficient provide a minimum of 2.00x annual debt service requirements.

RD 5 Update: Coverage and Bond Structure

Historic and projected pledged revenues provide ample debt service coverage comfortably exceeding 2.00x, which together with the entirely fixed rate nature and front-loaded amortization schedule of pro forma debt are supportive of the rating level.

Figure 2



Source: State of Connecticut

State revenue projections through FY 2026 included in the preliminary official statement are based upon the consensus revenue forecast dated May 2, 2022 with adjustments made by the Office of Policy and Management to account for the estimated impact of subsequent legislative changes. Annual debt service costs reflect annual debt service for bonds outstanding plus the State's expected issuance through 2026. Coverage remains comfortable, although the annual debt service requirements for the STF bonds increase by about 40% by FY 2026. As shown in Figure 6, debt service coverage was 2.71x in 2022 and is projected to decline to 2.18x in 2026, though KBRA notes that State projections have generally proven conservative.

Figure 3

Debt Service Coverage Historic and Projected
FYE June 30 (dollars in millions)

	2021 Actual	2022 Unaudited	2023 Projected	2024 Projected	2025 Projected	2026 Projected
Motor Fuels Tax	$ 475	$ 389	$ 344	$ 492	$ 489	$ 485
Oil Companies Tax	229	392	402	380	350	323
Sales and Use Tax	483	703	794	809	829	848
Motor Vehicle Receipts	321	282	270	275	276	282
License, Permits, Fee Revenues	131	134	142	143	144	145
Sales Tax-DMV	117	122	106	99	100	101
Other	21	(13)	34	78	82	86
Total Net Revenues	**1,778**	**2,010**	**2,093**	**2,276**	**2,270**	**2,269**
Debt Sevice[1]	664	743	842	891	955	1,039
Debt Service Coverage	**2.68x**	**2.71x**	**2.59x**	**2.55x**	**2.38x**	**2.18x**

Source: POS Table 8.

[1]Includes existing debt service requirements plus anticipated debt service on projected annual issuance of $830 million in FY 2023, $1 billion in FY 2024, $1 billion in FY 2025, and $1.1 billion in FY 2026.

Coverage Sensitivity

Based on projected FY 2022 net revenues of $2.01 billion and pro forma MADS of $813 million in FY 2024 following issuance of the currently offered bonds, pledged revenues could decline by 19.1% before reaching the 2.00x MADS coverage additional bonds test or by 59.6% before reaching 1.00x coverage. KBRA anticipates that the Legislature will manage the dedication of funds to the STF as needed to comply with its 2.00x coverage covenant and to accommodate continuing borrowing needs.