

16 MAY 2023

Fitch Rates Connecticut's \$700 Million GO Bonds 'AA-'; Outlook Stable

Fitch Ratings - San Francisco - 16 May 2023: Fitch Ratings has assigned a 'AA-' rating to \$700 million in State of Connecticut general obligation (GO) bonds, consisting of:

--\$100 million GO Bonds (2023 Series A);

--\$250 million GO Bonds (2023 Series B) (Refunding);

--\$350 million GO Bonds (2023 Series A) (Taxable).

Par amounts are subject to change pending final sale.

The bonds are expected to be offered by negotiated sale the week of May 29, 2023.

The Rating Outlook is Stable.

SECURITY

The GO bonds are supported by the full faith and credit of the state pledged to payment of principal and interest.

ANALYTICAL CONCLUSION

Connecticut's 'AA-' Issuer Default Rating (IDR) reflects its superior gap-closing capacity, as well as its wealthy and diverse, yet slow-growing economic profile. The rating also incorporates the state's elevated liability burden, carrying costs and expenditure growth trends, which are likely to remain comparatively high over time.

Economic Resource Base

Connecticut has a diverse and mature economic base anchored by a large finance sector and important manufacturing and education and health sectors. Post-pandemic economic growth trails national trends. Connecticut has the highest per capita personal income of any state, though income growth slowed in the prior decade.

KEY RATING DRIVERS

Revenue Framework: 'a'

The state's largest tax revenue source, personal income tax (PIT), is subject to considerable cyclicity, although the state instituted measures to shield the general fund from its volatility. Sales and corporate income taxes further diversify the revenue base. Absent tax policy changes, underlying revenues are

expected to grow only modestly over time, consistent with the state's wealthy and diverse but slow-growing economic profile. The state has unlimited legal ability to levy taxes.

Expenditure Framework: 'aa'

Connecticut's natural pace of spending growth is expected to outpace revenues, requiring ongoing budget controls. The state has consistently demonstrated the ability to cover its comparatively high fixed costs, including making full actuarial contributions to pensions for more than a decade, and it benefits from the large degree of budget autonomy common to states.

Long-Term Liability Burden: 'a'

The state's long-term liability burden is elevated and among the highest for U.S. states, but still considered moderate relative to personal income. Long-term debt consists primarily of GO and transportation borrowings, with much of GO borrowing undertaken on behalf of local schools. Net pension liabilities are a more significant burden, with the state carrying obligations for state retirees as well as for local school teachers. OPEB is also a significant liability, although one the state has been able to modify.

Operating Performance: 'aaa'

Resilience is bolstered by strong mechanisms that set aside in the budget reserve fund (BRF) volatile revenue collections over specific thresholds and a required excess margin of revenues over budgeted spending, enabling rapid accumulation of balances. Budget management powers and strong fiscal monitoring, including frequent revenue and budget forecasting, allow the state to identify budget under-performance and address emerging gaps.

RATING SENSITIVITIES

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

- Consistent economic and revenue growth at or above Fitch's long-term expectations for national inflation over the medium term, raising Fitch's assessment for revenue growth prospects;
- Material and sustained success in gradually lowering its elevated liability burden to less than 10% of personal income, while actively managing a comparatively high fixed cost burden.

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

- Weakening of budget management policies and practices that materially amplify structural challenges;
- Actions that elevate the state's liability burden closer to or above 40% of personal income.

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>.

CURRENT DEVELOPMENTS

Connecticut Budgetary Update

Strong budgetary management policies, including relatively recent mechanisms that accelerate deposits to the budget reserve fund (BRF), and robust revenue performance have facilitated marked improvement to the state's financial position. Specific tools include a volatility cap that shifts non-withholding PIT and pass-through entities tax receipts above a threshold to the BRF, and a revenue cap mechanism that shifts a required excess of budgeted revenues over spending to the BRF.

State revenue collections have exceeded prudent budgetary expectations since the pandemic's onset. The state ended fiscal 2022 with a \$4.3 billion surplus, around 20% of fiscal 2022 general fund appropriations. The state added \$200 million to the BRF balance in fiscal 2022, bringing it to the full cap of 15% of appropriations (\$3.3 billion). In fiscal 2022, the state also transferred an additional \$5.5 billion in revenues above the volatility and revenue caps to state teacher and employee pensions to lower the state's liabilities: \$3.4 billion in fiscal 2022 and \$2.1 billion in fiscal 2023. Higher baseline spending for debt service, pensions and healthcare, among other needs, are partly offset by administrative efficiencies from a fiscal 2022 wave of state employee retirements.

Connecticut's fiscal 2023 budget includes some sizable one-time and recurring tax cuts totaling \$643 million in fiscal 2023. One-time policies include a \$250 child tax credit funded from fiscal 2022 surplus (\$125 million), as well as expansions to the state earned income tax credit (\$43 million) and reductions to state unemployment insurance taxes (\$40 million). Recurring tax cuts include expended property tax credits (\$60 million per year) and reduced car tax mill rates (\$100 million per year).

Connecticut is also one of a handful of states that implemented a gas tax holiday. The nine-month gasoline tax break is projected to reduce Special Transportation Fund (STF) revenue by a combined \$240 million in fiscal 2022 and 2023. Lost gas tax revenues were offset by larger-than-anticipated revenues in other streams, especially Gross Receipts Taxes on Oil Companies, which rose sharply amidst elevated petroleum prices. While affordable, this gas tax holiday nonetheless results in less funding available for transportation needs.

Connecticut Economic Update

Connecticut has seen uneven post-pandemic labor recovery. Connecticut's labor market suffered a somewhat larger decline than the nation in March and April of 2020, recording a 17% contraction in payrolls. The state's employment recovery through March 2023 nearly matched the national recovery with Connecticut having recouped almost all of 2020's payroll job losses. Connecticut's total non-farm employment was 0.6% below February 2020 levels in March -- less than the national employment recovery of 2.2% for the same period.

Connecticut's unemployment rate has nonetheless improved to near all-time lows. The monthly unemployment rate for March 2023 was 4.0% versus the 3.3% national rate. The state's employment-to-population ratio (EPOP) of 61.9% in March 2023 is almost three percentage points below its pre-pandemic ratio of 64.6% in February 2020. Connecticut's March 2023 EPOP is still somewhat higher than the national EPOP of 60.4%.

CREDIT PROFILE

For additional information on the state of Connecticut's IDR, see "Fitch Rates Connecticut's \$900 Million GO Bonds 'AA-'; Outlook Stable," published on Nov. 22, 2022, available at www.fitchratings.com.

Date of Relevant Committee

21 November 2022

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.

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Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
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ENTITY/DEBT	RATING	RECOVERY	PRIOR
Connecticut, State of (CT) [General Government]			
<ul style="list-style-type: none"> Connecticut, State of (CT) /General Obligation - Unlimited Tax/1 LT 	LT	AA- 	Affirmed
			AA- 

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

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

[Solicitation Status](#)

Endorsement Status

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

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