S&P Global
Ratings

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Connecticut; Gas Tax

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Credit Profile		
US$875.0 mil spl tax oblig bnds transp infra purp ser 2023A due 07/01/2043		
Long Term Rating	AA/Stable	New
US$340.0 mil spl tax oblig rfdg bnds transp infra purp ser 2023B due 01/01/2033		
Long Term Rating	AA/Stable	New
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to the State of Connecticut's $875 million senior-lien special tax obligation (STO) bonds, 2023 series A, and approximately $340 million STO refunding bonds, 2023 series B.
- At the same time, S&P Global Ratings affirmed its 'AA' long-term and underlying (SPUR) ratings on the state's $7.24 billion senior-lien STO bonds outstanding.
- The outlook is stable.

Security

The senior STO bonds are secured by a first-lien pledge of revenues deposited into the state transportation fund (STF) before payment of operating expenditures. In accordance with the enabling act and bond provisions, pledged revenues are appropriated and do not require further legislative approval. Pledged revenues credited to, and deposited in, the STF are derived from the statewide collection of:

- Specific portions of the general retail sales and use tax;
- Motor fuels tax (including gasoline, special fuels, and motor carrier road taxes);
- Oil companies tax;
- Motor vehicle receipts (registration fees for motor vehicles, license, permit, and fee revenue); and
- Other receipts, funds, and moneys credited to the STF.

Proceeds from the 2023 series A bonds will finance various projects of the state's transportation infrastructure program and proceeds from the 2023 series B refunding bonds will be used to refund the state's 2012 series A and 2013 series A bonds. The obligations are also secured by a debt service reserve (DSR) that had a balance of $823.9 million as of Aug. 31, 2023.

Credit overview

The rating incorporates our view of Connecticut's very strong economic fundamentals, anchored by a large statewide taxing base from which pledge revenues are collected, as well as diverse composition of pledged revenues deposited into the STF that have historically exhibited low-to-very low volatility across economic cycles. In general, Connecticut has demonstrated active management of the STF, both through the sizing of its large transportation capital program and periodically expanding revenues deposited to its STF, which we believe will continue to provide strong-to-very strong coverage near or above 2.0x. We view STO bonds as exhibiting a close linkage to the Connecticut general obligation (GO) rating, and in our view, any rating action on the state's general creditworthiness would also have a corresponding effect on the rating of the state's STO bonds.

In our opinion, Connecticut has consistently demonstrated resilient and strong-to-very strong debt service coverage (DSC). Unaudited STF pledged net revenues exceeded $2 billion in 2023, returning to a more modest, but steady rate of growth (4.0%) consistent with historical trends, after increasing 12.6% and 17.2% annually in fiscal years 2022 and 2021, respectively. Based on unaudited fiscal 2023 pledged revenues, we calculate annual DSC of approximately 2.6x in 2023 and maximum annual debt service (MADS) coverage of 2.3x, occurring in 2024. We also view Connecticut's 2x additional bonds test (ABT) provisions, and a rate covenant under the senior trust indenture to levy additional pledged revenue and other receipts to maintain 2x coverage as a credit stabilizing factor, limiting coverage dilution from future planned debt issuances.

On May 1, 2023, Connecticut fully lifted its eight-month suspension (April 1, 2022 – Dec. 31, 2022) of the statewide 25-cent per gallon motor fuels tax to provide taxpayer relief in response to inflation pressures and rising gasoline prices, while phasing in the motor fuels tax rate by 5-cent increments between Jan. 1, 2023, and April 30, 2023. However, we view this temporary tax-relief measure as credit neutral, as budget estimates indicate that growth in other STF pledged revenues above originally budgeted fiscal 2022 and 2023 levels more than compensated for the estimated $90 million and $150 million losses, respectively, of motor fuels tax revenue.

Based on the Office of Policy and Management's (OPM) out-year STF projections, Connecticut forecasts that the pledged revenue growth rate will gradually slow to 0.1% and negative 0.2% in fiscal years 2025 and 2026 from 13.1% growth in fiscal 2024, which is partially due to resuming collections of motor fuel taxes for the full year. We view these projections as reasonable given some uncertainty of macroeconomic conditions and expected adjustments to pledged revenues. Over the same period, Connecticut projects cumulative fiscal year-end surplus balances in the STF will rise to $937.3 million through the end of fiscal 2025, but structural out-year gaps could materialize between fiscal years 2026 and 2028. Assuming no revenue enhancements or adjustments to the state's $4.3 billion in prospective transportation bond financing needs over this period, OPM projects a revenue-expenditure imbalance could reduce cumulative balances to $545.7 million by the end of fiscal 2028. Therefore, a key credit consideration will be the state's ability to identify alternative and sustainable revenue sources and raise revenue when necessary to fund the state's transportation infrastructure program and maintain steady coverage levels.

Key considerations in our assessment of the credit quality of the pledged STF revenues include:

- A very strong and diverse statewide economic base of approximately 3.6 million people generating the pledged revenues, and the state's stable economic profile, which contributed to growth in overall pledged revenues following a pandemic-induced decline;
- Low-to-very low volatility of pledged STF revenues, including a history of the state increasing motor fuel tax rates, fees, and allocations of pledged revenues and its approval of new revenue streams dedicated to the STF;
- Strong to very strong coverage and liquidity, including senior-lien MADS coverage of 2.3x based on estimated debt service following these bond issuances, occurring in fiscal 2024, and unaudited fiscal 2023 revenue estimates (net of

federal payments and interest income).

- Good bond provisions and Connecticut's strong commitment to its transportation program, including a 2.0x ABT for both first- and second-lien bonds, establishment of a 2.0x rate covenant, and a fully funded DSR, which are likely to support maintenance of strong to very strong DSC as the state funds additional transportation debt issuances in its capital improvement plan.

Environmental, social, and governance

We consider Connecticut's environmental and governance factors to have a neutral influence within our credit rating analysis and are consistent with similar obligations secured by sales, motor fuels, and other related taxes. Connecticut's strong management and comprehensive long-term capital planning incorporates hardening of transportation assets and other infrastructure helps to mitigate exposure to physical risks--including severe weather events, coastal, and inland flooding risks. In addition, we consider the state's social capital risks to have neutral influence in our credit rating analysis for Connecticut, although we recognize demographic trends--including an aging population with slow growth--could present long-term social capital considerations to Connecticut's economic and budgetary performance. We believe the broad taxing base and diversity of pledged revenue, coupled with forecasting the potential effects of long-term revenue pressures and adjusting revenue to reduce volatility in the STF helps manage these risks.

Outlook

The stable outlook reflects our view of Connecticut's statewide economic base on which pledged revenues are collected and the state's demonstrated timely adjustments to taxes and fees to sustain pledged revenue growth and stave off periodic cyclical pressures. The outlook also incorporates our expectation that DSC could experience some fluctuations as Connecticut issues additional debt to support the state's substantial transportation-related capital needs, but that it will remain above levels that we consider very strong over the outlook period.

Downside scenario

As we view the STO bonds to exhibit a close linkage to the Connecticut GO rating, if we lower the state GO rating, it would likely result in a corresponding negative rating action on the STO. Alternatively, a significant or sustained deterioration of pledged revenues or a substantial increase in the STO debt burden that weakens our view of coverage, could result in lowering the rating.

Upside scenario

The application of our priority-lien tax revenue debt criteria limits the STO bonds to no more than one notch above Connecticut's general creditworthiness. Therefore, raising the STO rating would correspond with the raising of the state GO rating.

For more information regarding the state's long-term credit fundamentals, see our analysis on Connecticut, published May 18, 2023, on RatingsDirect.

Credit Opinion

Economic fundamentals: very strong

Connecticut's economic fundamentals are supported by its large, statewide economic base from which pledged revenues are derived. Very strong wealth and income levels remain a hallmark of the state's economic profile, although economic and population growth have lagged the nation. In 2022, Connecticut's per capita personal income was $84,972, or approximately 130% of the nation, ranking high among states. However, we will continue to monitor the state's long-term personal income growth trend, which has slowed since the Great Recession to a compounded annual growth rate (CAGR) of 2.6% (2009-2022). Over the past five years, Connecticut's real gross state product (GSP) growth CAGR of 0.4% compared with 2.1% for the nation. S&P Global Market Intelligence projects the state's GSP growth (2.6% increase) could continue on a slower path over the next four years compared with the national trend (6.7% increase) over the same period.

Revenue volatility: low

We believe pledged revenue securing the STO bonds will continue to exhibit low-to-very low volatility based on a broad-and-well-diversified mix of pledged transportation-related revenue that have remained resilient across economic cycles, increasing by an average annual growth rate of approximately 7.4% from 2017-2023. Fueled by robust average annual growth of 25.2% between 2019 and 2023, sales and use tax allocations to the STF (41.9% of fiscal 2023 pledged revenues) have surpassed oil consumption-based taxes, including motor fuels taxes (13.2%) and oil companies' tax payments (19.6%), as the leading pledged revenue source. In our view, sales taxes, particularly those derived from auto sales, could exhibit greater volatility over economic cycles compared with per-gallon-fuel taxes or motor vehicle license fees, but we expect growth from this revenue source will be steady for the state over the long-term. Connecticut projects a 0.3% average annual growth rate in motor fuel tax between 2024 and 2028, while sales and use tax receipts are estimated to average 2.2% growth over the same period.

Overall, we believe the outlook for highway user tax debt is stable. State highway user revenues have continued to grow following a slight dip due to the COVID-19 pandemic. As more drivers transition to electric vehicles (EVs) or other vehicles with higher fuel efficiency we expect that pledged revenues for state highway user tax revenue bonds will recognize shifts in revenue reliance over the long term, but we believe the overall sector will remain resilient in the face of this modernization. If motor fuel tax revenue losses become significant, we believe states will be motivated to consider transportation-related revenue alternatives, but to date these industry shifts have not affected our ratings.

We believe Connecticut has been proactive when enacting revenue enhancements for transportation-related purposes. In recent years, the state increased allocations or introduced new sources that have supported growth in STO-pledged revenue to long-term debt associated with its statewide transportation improvement plan. In 2016, Connecticut made a statutory dedication of a 0.5% statewide general sales tax to the STF, and the legislature added dedicated sales and use taxes collected on the sale of new and used motor vehicles, which was fully phased in during fiscal 2023. In 2021, Connecticut also approved a highway use fee (effective Jan. 1, 2023) on certain heavy, multi-unit motor vehicles based on the weight and number of miles driven on public roads in the state. The state estimated highway use fees generated approximately $45 million in 2023, but actual collections are expected to be approximately $30 million at June 30, 2023. The state currently projects an increase to $90 million during its first full year of implementation in 2024 and

3.0% annually thereafter, although it might adjust projected annual growth rates from this new source as additional use fee collection data comes available.

Coverage and liquidity: strong-to-very strong

We calculate audited actual pledged revenues for the fiscal year ended June 30, 2023--excluding pledged Build America Bonds interest subsidy or interest earnings for our DSC calculations--covered proposed future senior-lien MADS of $854.5 million, occurring in fiscal 2024, to be a strong to very strong 2.3x. MADS coverage is estimated to improve to nearly 2.6x based on projected STO-pledged revenue for fiscal 2024, supported by a 13.1% expected growth rate in sales and use tax, oil companies tax receipts, and resumed collections of the state's motor fuels tax.

The state projects annual DSC will remain at or above 2.0x, which we view as strong to very strong, through 2028. These projections incorporate modest average annual growth of 0.8% in pledged revenue and factors in potential debt issuance of $4.3 billion of new-money STO bonds over this five-year period, subject to approval by the state's Bond Commission. Projected debt financing plans could increase as both the volume of projects and inflation-driven effects push up project costs, with estimated annual STO bond issuances averaging between $1.0 billion and $1.1 billion between fiscal years 2025 and 2028. Nevertheless, we view Connecticut's rapid debt amortization schedule--with nearly 66% of existing STO principal retired within the next 10 years, frontloaded debt service requirements, and its conservative 0.8% annual average pledged revenue growth from 2024-2028 should support stable DSC in light of a potentially higher debt load. The state has no current plan to issue additional debt under its subordinate lien.

Linkage to state general creditworthiness: close

Because the state collects the pledged revenues, we view the rating on the transportation revenue bonds as linked to Connecticut's creditworthiness. In our establishment of a one-notch upward limitation on the transportation revenue bond rating compared with the state GO rating, we factored into our analysis our view that Connecticut provides critical public services. In 2018, Connecticut voters approved a state constitutional amendment that continues directing any funding sources to the STF, including motor fuels, oil company, and sales tax revenues, as long as the law authorizing the state to collect or receive them remains in existence. While the amendment added state constitutional restrictions on the use of pledged transportation revenue deposited to the STF in accordance with state statute against potential diversion of a portion of the pledged revenue stream, we believe it does not sufficiently mitigate the exposure of the STO rating from the operating risk of the state, as collector of the pledged taxes, to rate it above our one-notch upward limitation from the state rating. In addition, Connecticut does not, in our view, benefit from limited scope of operations or extraordinary expenditure flexibility, which we believe still exposes it to some operating risk in the collection and distribution of pledge revenues.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of September 28, 2023)		
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of September 28, 2023) (cont.)		
Connecticut GASTAX		
Long Term Rating	AA/Stable	Affirmed
Connecticut GASTAX (BAM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GASTAX (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.