

CREDIT OPINION

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Connecticut (State of)

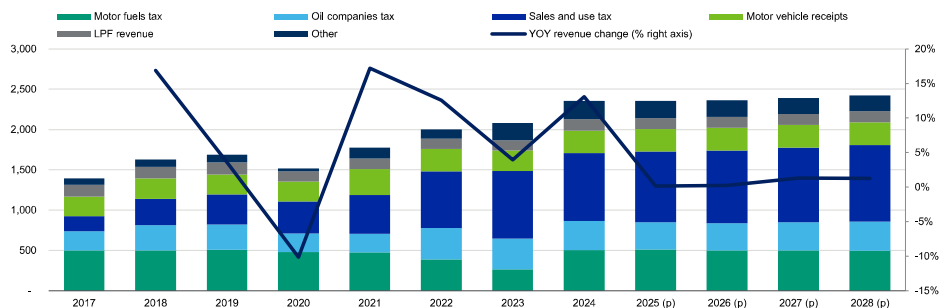
Update to credit analysis of special tax obligation bonds

Summary

Connecticut's (Aa3 positive) Special Tax Obligation (STO) Bonds have been used to finance infrastructure improvements across the state, including some of the state's major transportation related capital projects. The bonds benefit from strong legal covenants, a diversified stream of pledged revenue with some sensitivity to economic fluctuations and policy changes, and satisfactory debt service coverage. The credit profile also includes challenges resulting from the state's lagging economic and demographic trajectory relative to the nation as a whole.

Exhibit 1

Sales tax becoming more prominent in diverse pledged revenue stream



Declines in motor fuels tax in 2021 and 2022 due to tax holiday
Source: State of Connecticut

Credit strengths

- » Diversified stream of dedicated transportation and retail sales tax revenues
- » Strong legal protections including a two times coverage covenant and constitutional protection of the STF
- » Cash funded debt service reserve fund on pre-2024 parity debt; ample fund liquidity

Credit challenges

- » Some revenue sensitivity to economic fluctuations

Rating outlook

Connecticut's positive outlook reflects the expectation that state's trend of positive financial performance will continue under its extended fiscal guardrail framework, enabling it to proactively pay down its high pension liability.

Factors that could lead to an upgrade

- » Upgrade of state issuer rating

Factors that could lead to a downgrade

- » Downgrade of the state's issuer rating
- » Revenue declines resulting in lower debt service coverage
- » Materially weakened legal covenants

Key indicators

Exhibit 2

Connecticut Special Tax Obligations

Credit background

Pledged revenues Motor fuels tax, oil companies tax, sales and use taxes, motor vehicle receipts, licenses, permits and fees, DMV sales tax federal payments

Legal structure

Additional Bonds Test 2.0x aggregate debt service

Open or Closed Lien Open

Debt Service Reserve Fund requirement MADS for bonds issued before 2023, none for bonds issued 2024 or later

Trend analysis

Fiscal year	2019	2020	2021	2022	2023
Debt outstanding (\$mil)	\$ 5,706	\$ 6,161	\$ 6,959	\$ 7,054	\$ 7,433
Pledged revenue (\$mil)	\$ 1,688	\$ 1,516	\$ 1,778	\$ 2,001	\$ 2,069
Pledged revenue % change	3.6%	-10.2%	17.3%	12.6%	3.4%
Maximum annual debt service coverage	2.6	2.3	2.7	2.7	2.6

Source: State of Connecticut, Moody's Ratings

Profile

The State of Connecticut has a population of 3.6 million people, and is located in the coastal northeastern US, bordered by Rhode Island (Aa2 stable), Massachusetts (Aa1 stable) and New York state (Aa1 stable) with 618 miles of shoreline, according to the National Oceanic and Atmospheric Administration (NOAA). The state has a large and diverse economy with a gross state product of \$340.2 billion in 2023. It is the second wealthiest state in the country with per capita income of nearly 130% of the US average.

Detailed credit considerations

Tax base and nature of pledge

Connecticut's special tax obligation bonds are payable from multiple pledged revenues credited to the special transportation fund (STF), including motor fuels tax, oil companies tax, general retail sales taxes, motor vehicle receipts, licenses, permits and fees, and DMV sales taxes. The state has from time to time adjusted the allocations of revenue streams to the STF. In fiscal 2015, the legislature enacted a law directing the deposit of a portion of state general sales tax revenue into the STF and the deposit of oil companies tax revenue directly to the STF beginning in fiscal 2016. Previously, oil company revenue had been transferred from the general fund. The law provided that deposits to the STF of sales and use tax on motor vehicles would be phased in over 5 years, which is complete as of fiscal 2023.

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The addition of sales tax to the revenue stream has helped buffer the impacts of long-term stagnation and decline in driving and fuel usage on the STF. Following the addition of sales taxes, the dependence of the STF on motor fuels tax fell from 40% in fiscal 2014 to 21% in fiscal 2024. Over the next several years, the share of gas taxes is projected to remain about 20% of pledged revenues. The sales tax has also softened the effects of declining crude oil prices on oil company taxes: the share of oil company tax revenue of total STF revenue has similarly fallen to 15% in fiscal year 2024 from over 32% in 2014.

Debt service coverage and revenue metrics

Pledged revenues are volatile because of fundamental trends in the tax base, changes in state allocations to the STF and changes in tax policy. However, the average growth rate of pledged revenue was over 8% from 2017 through 2023, which reflects the impacts of the coronavirus pandemic, a gas tax holiday, and the increasing share of sales taxes in pledged revenue.

Debt issuance has outpaced revenue growth, resulting in current coverage of debt service drifting down from 3.0x in fiscal 2015 to a projected 2.6x for fiscal 2025. With planned additional bond issuances of about \$5.6 billion through 2029, coverage is projected to continue to decline and approach the 2.0x coverage covenant by fiscal 2029. However, projected revenue assumptions are conservative, and the state has historically managed coverage by either reducing issuance or adding sources of pledged revenue as needed. Most recently the state added a weight-based highway fee applied to commercial vehicles. The fee commenced in January 1, 2023, and adds a little over \$60 million to pledged revenue annually.

Based on current estimates, maximum annual debt service (MADS) of about \$910 million comes due July 2025. Estimated 2024 revenue would provide 2.6x coverage of MADS on outstanding bonds, including the 2024 issuance.

Liquidity

The 2024 bonds will not be secured by a debt service reserve fund, unlike previous STO issuances. All of the STO debt, including the 2024 bonds, have a parity claim to the pledged revenue. The state transportation fund maintains ample liquidity supporting the debt program.

During the 2024 legislative session, the state legislature appropriated a one-time use of the balance in the State Transportation Fund in excess of 18% of fiscal 2025 appropriations be applied to redeeming debt. The fiscal year 2024 balance was \$968 million, of which \$441 million was reserved, leaving \$527 million available to redeem STO bonds.

Debt and legal covenants

Connecticut funds its portion of the state's transportation infrastructure program primarily with debt, which is supplemented with federal funds to invest in highway, transit and aviation projects. The state projects that it will issue \$1.4 billion annually from fiscal years 2026 through 2029.

The STO bonds benefit from strong state constitution provisions and legal covenants. The state covenants to provide pledged revenue in each fiscal year equal to at least 2.0x aggregate principal and interest requirements on senior lien and second lien bonds. In addition, there is an additional bonds test of 2.0x aggregate senior lien debt service coverage for current and all succeeding years on outstanding and additional bonds. The indenture was amended to remove the debt service reserve requirement for future parity debt.

In fiscal 2015, Connecticut enacted significant legislative changes that enhanced the STO program including a new sales tax pledge and new statutory lockbox. The lockbox established the STF as a perpetual fund, the resources of which shall be expended solely for transportation purposes, which include the payment of debt service on obligations of the state incurred for transportation purposes. In 2018, voters approved the incorporation of these protections into the state constitution.

Debt structure

After fiscal year 2024 bond issuance is completed, there will be approximately \$8.25 billion of senior lien special tax obligation bonds outstanding. While allowed by the indenture, there is no longer any subordinated lien debt outstanding; however the second lien is not closed. All of the debt is fixed rate and approximately 60% of STO principal will amortize over the next 10 years.

Debt-related derivatives

There are no derivatives associated with the special tax obligation bonds.

Pensions and OPEB

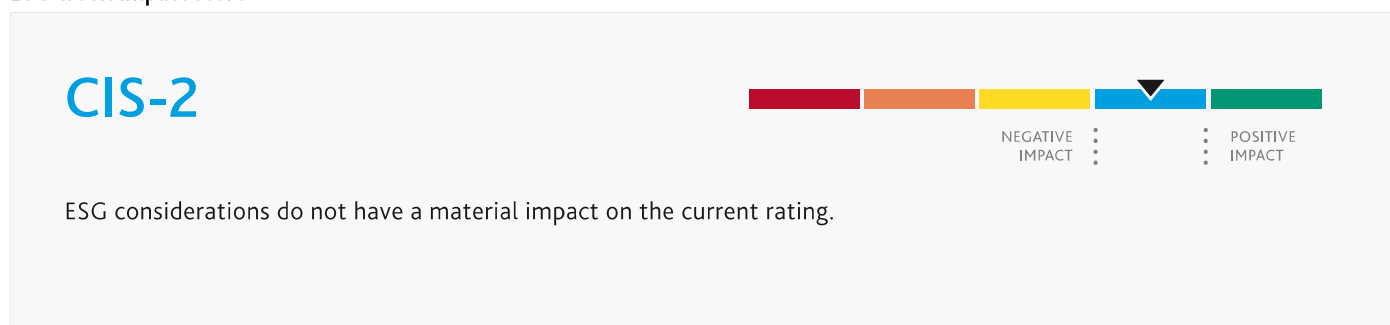
Connecticut's pension and OPEB liabilities are among the highest in the state sector and key credit factors of the state's issuer rating. Funding these liabilities puts pressure on the state's budget and tax base, constraining resources available for other purposes, including transportation spending. Connecticut has prioritized pension funding and has contributed funds well in excess of the actuarially determined contribution over the last several years in order to bring down the net pension liability. Please see our most recent State of Connecticut [credit opinion](#) for a discussion of these liabilities.

ESG considerations

Connecticut (State of)'s ESG credit impact score is CIS-2

Exhibit 3

ESG credit impact score

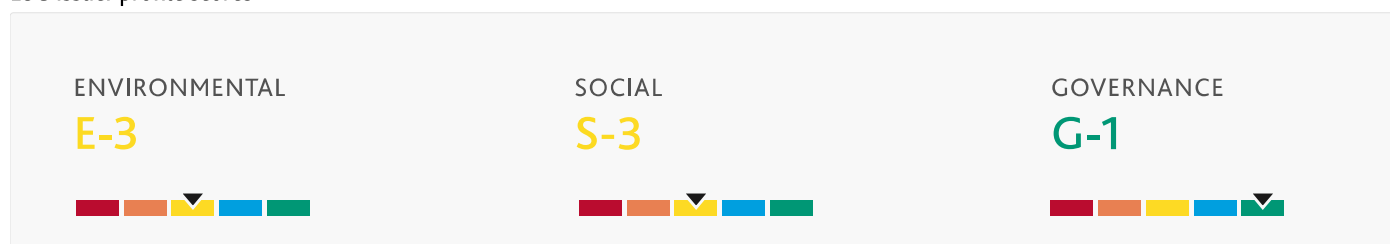


Source: Moody's Ratings

Connecticut's ESG Credit Impact Score (**CIS-2**) indicates that the state's environmental, social and governance characteristics have an overall neutral impact on the rating.

Exhibit 4

ESG issuer profile scores



Source: Moody's Ratings

Environmental

Connecticut's E issuer profile score is moderately negative (**E-3**). Due to its coastline along the Long Island Sound, Connecticut is more exposed than most states to climate risks. According to Moody's ESG Solutions, the state faces risks across several climate factors, including hurricanes, rising temperatures and water stress. The state is working to develop a systematic climate resiliency plan. The state's utilities regulatory authority has authorized funding for substation mitigation and other storm-hardening initiatives and the state is developing plans to reduce statewide greenhouse gas emissions.

Social

Connecticut's S issuer profile score is moderately negative (**S-3**), reflecting its negative net migration trends and very high income inequality. Those trends will intensify social spending for items such as access to health care and other demands on the social safety net. Connecticut is a wealthy state, with per capita personal income among the highest in the US. However, during the nation's long economic expansion the state's population declined from its peak in 2013, aligning with an underperforming housing market and lagging labor force growth. Population trends reversed during the pandemic as some city-dwellers sought out more spacious residential

accommodations. The workforce is highly educated, with almost 40% of the population aged 25 or more possessing a bachelor's degree or higher compared to the nationwide rate of just less than 33%.

Governance

Reflecting its very strong financial management, Connecticut's G issuer profile score is positive (**G-1**). Annual multiyear Fiscal Accountability reports are produced by both the governor's budget office and the legislative office of fiscal analysis, and the state releases monthly budgetary updates. The state constitution requires a balanced budget, given greater force by the state's adoption of GAAP-basis budgeting. In addition, the state is not constrained by supermajority requirements to enact tax increases, mandated initiatives or voter referenda. The governor's executive authority to cut expenses mid-year without legislative approval is limited to 5% of an individual appropriation not to exceed 3% of any fund providing only moderate flexibility. We consider strong executive flexibility to make mid-year spending adjustments a plus. If a deficit exceeding 1% of the general fund is projected by the comptroller in that office's monthly financial statement, the governor is required to submit and implement a deficit mitigation plan. Historically, some of the state's financial provisions were not highly effective, as the state has accumulated high debt levels and did not make a constitutional spending cap operative until 2018. The state has taken action to address some of its most pressing long-run financial challenges in recent years by implementing pension and OPEB reforms and committing to moving pension contributions to a more adequate level, although the state's long-term obligations remain formidable. In addition, in recent years the state legislature enacted a number of measures designed to curtail spending and debt growth, rebuild the state's rainy day fund, and more frequently assess the condition of its pension funds. Following some of these provisions will now be required by bond covenants and constitutional amendments. While the required practices strengthens the state's long term credit profile, covenanting to follow them reduces budgetary flexibility.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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