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Ratings

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Connecticut; Gas Tax

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Credit Profile		
US$800.0 mil spl tax oblig bnds transp infratructure purposes ser 2018A due 01/01/2038		
Long Term Rating	AA/Stable	New
Connecticut transp infrasturcture sr lien		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA' long-term rating, and stable outlook, to the State of Connecticut's $800 million series 2018A special tax obligation (STO) bonds for transportation infrastructure purposes. At the same time, S&P Global Ratings has affirmed its 'AA' rating on the state's STO parity senior bonds ($4.6 billion) and second-lien bonds ($186.5 million). The outlook is stable.

The series 2018A and parity senior STO bonds are secured by a first-lien pledge of revenues to the Special Transportation Fund (STF). According to bond counsel, the funds are deemed to be appropriated at time of issuance and no further legislative approval is required.

We base our ratings on our assessment of the following factors:

- A currently diverse mix of pledged revenues, in our view, that are levied on a large statewide economic base (population: 3.6 million), although the state has recently been experiencing small population declines;
- Connecticut's history of adding to pledged revenues when it has increased the size of its transportation capital program, as evidenced by increased allocation of state sales tax beginning in fiscal 2016 and scheduled in 2021, as well as the absence of transportation fund reductions in the state's enacted 2018-2019 biennium budget, despite recent general fund budget stress;
- Strong 2.55x coverage on future senior-lien maximum annual debt service (MADS) alone after this issuance by fiscal 2017 pledged revenues, and 2.34x MADS coverage on combined senior- and second-lien bonds, excluding Build America bonds (BABs) interest subsidy and fund interest earnings;
- State projections for annual debt service coverage (DSC) of at least 2.4x for senior-lien bonds, and 2.3x annual DSC on combined senior- and second-lien bonds, after expected future debt issuances, through at least fiscal 2022, including BAB subsidies and interest earnings; and
- Strong bond provisions, including a 2.0x additional bonds test (ABT) for both first- and second-lien bonds, coupled with a fully funded debt service reserve account, and a 2.0x rate covenant.

Credit risks include what we consider:

- A sizable, but well-defined, capital improvement program that includes $2.85 billion of planned additional new money bonds through fiscal 2022, and the potential for greater bonding to the extent pledged revenue is increased, as proposed by Gov. Dannel Malloy; and
- A pledged revenue stream that is somewhat susceptible to economic conditions related to changes in the price and availability of motor vehicle fuel and motor vehicle sales, or potential changes in statutory funding formula. In fiscal 2016, the state delayed the deposit of pledged sales tax to the STF for two months ($35.2 million) to help balance

state general fund operations, and reduced the sales tax deposit by $50 million in fiscal 2017, equal to about 3% of total pledged STO revenue. However, the most recent fiscal 2018-2019 biennium budget maintained its commitment to transportation funding.

We understand that proceeds from series 2018A will be used to fund various capital projects included in Connecticut's long-term transportation infrastructure program.

The senior-lien bonds are secured by a first-lien pledge on funds deposited in the STF and paid before operating expenditures. The second-lien bonds are payable after required payments on the senior-lien bonds, in advance of funding operations. The indenture also requires that as long as the second-lien bonds are outstanding, after deducting for required reserves, pledged revenues for both liens must equal at least 2x annual debt service requirements. Because the structure of the second-lien bonds is the same as the senior-lien bonds, except for the flow of funds, and debt service coverage (DSC) is strong, in our view, we do not make a rating distinction between senior- and second-lien bonds outstanding. All STO bonds are fixed rate.

The state has made changes in its allocation of pledged revenue to the STF in recent years that in general has increased the overall amount of STO-pledged revenue, which has supported an expansion of its transportation capital plan.

Beginning in fiscal 2016, Connecticut made a statutory dedication of a 0.5% statewide general sales tax to the STF to be fully phased in during fiscal 2018, while the 2017 legislative session added additionally dedicated sales and use taxes collected on the sale of new and used motor vehicles, to be phased in over five years beginning in fiscal 2021. Sales tax is projected to be about 32% of pledged revenues in 2021. In our view, sales taxes, particularly derived from auto sales, have the potential to show more variation over the economic cycle than per gallon fuel taxes or motor vehicle license fees, but they are also likely to grow faster over time.

We do not view the governor's recent statements indicating future operating shortfalls in the transportation fund as a significant credit concern because pledged gross revenue continues to grow and historical DSC on STO MADS will remain high after this sale. We believe such statements reflect political policy preference for expanded capital investment for transportation purposes and pertain rather to the ability to issue additional future debt under restrictive bond covenants. However, such capital financing expansion is unlikely to occur without new legislative action to boost pledged revenue.

Estimated actual fiscal 2017 STF revenue currently comprises what we view as a diverse mix of motor fuels taxes (35% of fiscal 2017 pledged revenues); oil companies' tax payments (17%); motor vehicle receipts (primarily vehicle registration fees; 17%); licenses, permits, and fees (10%); general fund sales tax allocations (13%); and sales tax from sales between individuals (6%); with these percentages not including the effects of legislative net fund transfers and refunds. The proportion derived from sales tax will increase when the new car sales tax allocation begins to be phased in starting in fiscal 2021. Pledged revenues also include BAB federal interest subsidy payments and fund interest income, which we do not include in our DSC calculations.

While we expect revenues overall to increase with the additional allocation of sales tax, the STF experienced a small 0.6% dip in total pledged revenue in fiscal 2016 due primarily to lower oil companies tax revenue. In fiscal 2016, there was a two-month $35.2 million delay in the allocation of sales tax to the STF in order to provide general fund budget relief, and a further $50 million budgeted reduction in sales tax allocated to the STF for fiscal 2017, also for budget relief. We believe that the state could make additional reductions in revenue flowing into the STF future years as the result of state budget stress (Connecticut GO rating: A+/Negative), but expect these transfers to remain relatively minor due to the need to fund ongoing transportation operations and the 2x STO gross revenue rate covenant. Connecticut will go to voters in November 2018 with a proposed constitutional amendment to dedicate STF money for transportation purposes once deposited in the STF, but this amendment would not prohibit the state from reducing the amount of revenue initially flowing into the STF on an annual basis. The $50 million reduction in allocated sales tax in fiscal 2017 represented only about 3% of total STF revenue. In previous years, the state has made other transfers and allocations of a one-time nature to and from the STF, but overall we believe pledged revenue has remained relatively stable and annual DSC strong. Legal covenants include a 2x annual DSC rate covenant and a fully funded debt service reserve.

We calculate estimated pledged revenues collected by the state comptroller for the fiscal year ended June 30, 2017--not including pledged BAB interest subsidy or interest earnings--covered proposed future senior-lien MADS of $538.7 million occurring in fiscal 2019 after this sale by 2.55x, and combined senior- and second-lien MADS in 2021 by 2.34x.

The state projects annual DSC will remain at levels we view as strong through 2022, despite current plans to issue $2.85 billion of new money STO through fiscal 2022, in part due to the phase-in of additional sales tax as pledged revenue, and due to a currently declining debt service schedule after fiscal 2021. The additional sales tax revenue added in 2016 was part of the state's new 30-year Let's GO CT! infrastructure plan that was originally contemplated to involve as much as $100 billion of debt, pending potential further addition of new STF revenue. However, the state expects that any substantial expansion of current bonding plans would be met with additional pledged revenue not currently in statute. Connecticut has historically maintained annual DSC well above the 2.0x ABT requirement, ranging from above 3.0x for senior-lien bonds and 2.6x for combined senior- and second-lien bonds since fiscal 2009, but under current projections, allocated revenues, and anticipated additional debt issuance, the state projects annual DSC to decline to what we view as a still-strong 2.4x on senior-lien debt by 2021 and to 2.3x for combined senior and subordinate debt, absent new revenue.

(For more information on the state and its economy, please refer to the most recent state GO analysis published Dec. 7, 2017, on RatingsDirect).

Outlook

The stable outlook reflects S&P Global Ratings' view that the financial integrity of the STF and strong DSC levels will continue over the two-year outlook horizon. Fuel tax trends are stable and increased sales tax revenue is currently being phased into the pledged STF to offset expansion of the transportation capital program. We believe planned additional bonding will eventually lead to somewhat lower annual DSC levels beyond our two-year outlook horizon, while remaining above levels that we would consider strong. If DSC weakens significantly, or Connecticut's historical focus on the integrity and support for the STF weakened so as to deplete STF resources in a significant manner, we could potentially lower the rating or revise the outlook on the bonds. We do not see the potential for a higher rating in the next two years given the sizable projected debt issuance and Connecticut's legal ability to reduce future allocations of pledged revenue up to its 2x rate covenant.

Bond Structure

Bond provisions are strong in our view. The senior-lien bonds are secured by a first-lien pledge on funds deposited in the STF and are paid before operating expenditures. The ABT requires 2x coverage (based on an historical earnings test adjusted for approved tax rate increases or decreases) of all senior- and second-lien debt. The second-lien indenture also requires that as long as second-lien debt remains outstanding, DSC for both liens must at least be equal to 2x annual debt. In addition, the debt service reserve fund must be funded at an amount equal to the MADS on the bonds outstanding. The debt service reserve fund is held with a trustee and is a combined debt service reserve available for both the first- and second-lien bonds.

Connecticut has also covenanted in both the senior- and junior-lien indentures to levy sufficient taxes and fees to provide DSC, and to provide sufficient pledged revenue so as to provide 2.0x annual DSC at the end of each fiscal year. Failure to provide such coverage, however, is not an event of default unless the state shall not enact legislation that would satisfy indenture covenants if additional debt were then to be issued.

Connecticut--Special Tax Obligation Bond Debt Service Coverage

(Mil. $)	Actual					Projected			
Fiscal year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Motor fuels tax	501	508	517	518	499	501	502	503	500
Oil companies tax	199	381	338	250	238	257	280	307	338
State sales tax	0	0	0	109	188	323	331	339	414
Motor vehicle receipts	235	236	250	252	243	245	247	248	250
Licenses, permits, fees	137	138	145	144	144	144	145	146	146
Sales tax--DMV	79	82	84	87	85	86	87	88	89
Federal grants (BAB subsidy)	12	12	12	12	12	12	12	12	12
Interest income	4	7	7	8	9	10	10	11	12
Transfers from/(to) other funds	89	(83)	35	(7)	(7)	(6)	(6)	(6)	(6)
Transfers to Transportation Strategy Board (TSB) (eliminated in 2016)	(15)	(15)	(15)	0	0	0	0	0	0
Total revenues	1,242	1,266	1,372	1,374	1,412	1,573	1,609	1,648	1,755
Refunds	(9)	(11)	(11)	(21)	(17)	(18)	(19)	(20)	(21)
Total net pledged revenues	1,233	1,256	1,361	1,353	1,394	1,554	1,590	1,629	1,734
TSB projects account transfers added back in	15	15	15	0	0	0	0	0	0
Total pledged revenues	1,248	1,271	1,376	1,353	1,394	1,554	1,590	1,629	1,734
Pledged revenue without BAB subsidy or interest income	1,231	1,252	1,357	1,332	1,373	1,533	1,568	1,605	1,711
Coverage of senior lien MADS alone ($538.7 million in fiscal 2019) without BABs (x)	2.29	2.32	2.52	2.47	2.55	2.85	2.91	2.98	3.18

Connecticut--Special Tax Obligation Bond Debt Service Coverage (cont.)									
(Mil. $)	**Actual**					**Projected**			
Fiscal year	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Coverage of combined senior- and junior-lien MADS ($587.3 million in fiscal 2021) (x)	2.10	2.13	2.31	2.27	2.34	2.61	2.67	2.73	2.91

DMV--Department of Motor Vehicles. BABs-Build America bonds. MADS--Maximum annual debt service.

Transportation Overview

The Department of Transportation (DOT) was established in 1969, and replaced the Connecticut Highway Department. DOT is headed by a commissioner appointed by, and reporting to, the governor. Total employment as of Dec. 26, 2017, was 2,933 employees. The state's transportation system includes roads (21,508 miles, of which approximately 4,143 are maintained by DOT), state and local bridges (5,296), commuter rail, a bus system, and Bradley International Airport. The transportation infrastructure program was established in 1984 and has financed a broad range of projects across Connecticut. Total funding from 1985-2022 is estimated at $39.2 billion and includes federal state and local funds, with the state's share estimated at $18.6 billion, of which $17.8 billion is to be financed by bonds. Connecticut expects to issue about $800 million-$650 million annually of additional new money STO bonds from fiscal 2019 through fiscal 2022.

Financial Update

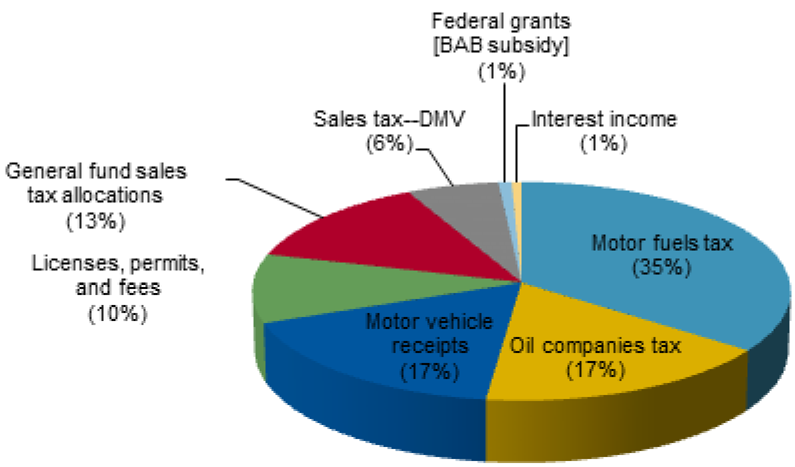
The STF recorded a $45.2 million operating deficit in fiscal 2017, following a $37.2 million operating deficit in fiscal 2016, the first operating deficits since 2009, and following operating surpluses of $11.0 million in fiscal 2015 and $4.4 million in 2014. Connecticut projects operating surpluses in fiscal years 2018-2019, before another $9.8 million operating deficit in fiscal 2020. However, the state throughout this period projects that its STF cumulative fund balance will remain above at least its $97.6 million low point reached in fiscal 2017, when it was 7% of operating expenditures, including debt service. As the size of the capital plan has increased, various legislative changes have been made over time to address projected shortfalls and support increased debt authorization including changes in fiscal years 2009 and 2016 to enhance the fund with additional transfers from the general fund. Ongoing budget pressure in the general fund subsequently reduced the amount of these transfers. In fiscal 2014, a one-time $76.5 million transfer was made from the STF to the general fund, offset by oil company taxes transferred to the STF, which are now deposited directly to the STF. In fiscal 2016, Connecticut delayed deposit of sales taxes by two months into the STF to provide $35.2 million of state budget relief, and another $50 million transfer to the state general fund in fiscal 2017. However, we believe over the long run the state has been responsive in adding new revenue to its STF to support transportation funding. The 2017 legislative session added a new allocation to the STF of sales taxes from new car sales, to be phased in over five years beginning in fiscal 2021. The state projects that the additional allocation to the STF of sales tax, net of other smaller legislative changes, will add $137.5 million to the pledged STF in fiscal 2022.

Major revenue enhancements to the fund over the years have included:

- The allocation of a portion of Connecticut sales tax, which is expected to be phased in over time until 0.5% sales tax is dedicated to the STF in 2018, plus a new allocation of sales tax on car sales expected to be phased in over five years beginning in fiscal 2021;

- The oil companies tax (of which all is now transferred directly to the STF as a statutory allocation, instead of being transferred from the general fund);
- Motor vehicle fee increases in previous years; and
- Motor fuels tax increases in previous years.

Fiscal 2017 Estimated Pledged Revenues Before Transfers And Refunds



DMV--Department of Motor Vehicles. BAB--Build America bond.

Ratings Detail (As Of January 16, 2018)		
Connecticut gas tax		
Long Term Rating	AA/Stable	Affirmed
Connecticut gas tax (BAM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut gas tax (BAM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut gas tax (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut transp infrastructure		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of January 16, 2018) (cont.)		
Connecticut 2nd lien		
Long Term Rating	AA/Stable	Affirmed
Connecticut special Tax Gas		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut Special Tax Gas		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.