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Connecticut's Special Tax Obligation Bonds Downgraded To 'A+' From 'AA' On Application Of Criteria; Outlook Stable

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NEW YORK (S&P Global Ratings) Nov. 15, 2018--S&P Global Ratings has lowered its rating on the State of Connecticut's first- and second-lien special tax obligation (STO) bonds issued for transportation infrastructure purposes to 'A+' from 'AA'. The outlook is stable.

"The downgrade follows the application of our Priority-Lien criteria, which factors in both the strength and stability of the pledged revenues, as well as the general creditworthiness of the state as issuing obligor," said S&P Global Ratings credit analyst David Hitchcock. (See Priority-Lien Tax Revenue Debt criteria published Oct. 22, 2018.)

The priority-lien rating on the STO bonds is limited to one-notch above our view of Connecticut's creditworthiness (general obligation rating [GO]: A/Stable) and is constrained from going higher unless there is an improvement in the state GO rating. Should we raise the state GO rating, we could potentially raise the rating on the STO bonds. In our view, the STO bonds do not benefit from limited scope of operations or extraordinary expenditure flexibility of the obligated entity, despite strong revenue coverage of debt service, while we believe pledged revenues could have exposure to operating risk of the state in the event of a distress situation.

The senior STO bonds are secured by a first-lien pledge of revenues deposited into the pledged Special Transportation Fund (STF) before payment of operating expenditures, while the subordinate bonds are payable from the same pledge of revenue after payment of first-lien bond debt service. According to bond counsel, the funds are deemed to be appropriated at time of issuance and no further legislative approval is required. Revenues deposited to the STF include a portion of the state sales tax; motor fuel taxes; oil companies tax; licenses, permits, and fees; and motor vehicle receipts. On Nov. 6, 2018, Connecticut voters approved a state constitutional amendment that requires any funding sources directed to the STF by statute continue to be directed 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 adds a legal restriction against potential diversion of a portion of the pledged revenue stream, we believe it does not mitigate enough the exposure of the STO rating from the operating risk of the state, as collector of the pledged taxes, to go beyond our one-notch limitation from the state rating.

We view the strength and stability of the pledged revenues deposited to the STF as strong. Key considerations in our assessment of the credit quality of the pledged STF revenues include:

- A very strong statewide diverse economic base of 3.6 million people generating the pledged revenues;
- Very low volatility of pledged STF revenues, including a history of the state increasing motor fuel tax rates, fees, and allocations of pledged revenues, as well as establishment of a 2x rate covenant;
- Anticipated continued strong debt service coverage (DSC), despite sizable state debt issuance plans, and a strong 2.0x additional bonds test (ABT) for both first- and second-lien bonds, coupled with a fully funded debt service reserve and a 2x rate covenant; and
- Strong current MADS coverage of 2.69x and 2.53x on first-lien debt, and combined first- and second-lien debt, respectively by pledged fiscal 2018 revenue.

The stable outlook on the STO bonds reflects our outlook on the state GO rating. Should we raise or lower the state GO rating or revise the outlook, the rating or outlook on the STO bonds could likewise change. Although not expected over our two-year outlook horizon, we could also lower the STO bond rating if DSC on the STO bonds weakened significantly. However, we believe the state will need to continue to levy, and over time raise, pledged tax rates to maintain adequate transportation infrastructure.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.