



Fitch Rates Connecticut's SRF General Revenue Bonds 'AAA'; Outlook Stable

Fitch Ratings-Austin-03 June 2019: Fitch Ratings has assigned a 'AAA' rating to the following bonds issued by the State of Connecticut (the state):

- Approximately \$250 million state revolving fund (SRF) general revenue bonds (green bonds) series 2019A;
- Approximately \$30.775 million SRF refunding general revenue bonds series 2019B.

The bonds are expected to sell via negotiation the week of June 17. Bond proceeds will be used to finance new money loans to borrowers and reimburse the state for amounts previously advanced to fund loans, refund certain outstanding bonds issued under the state's SRF program, and to pay for the costs of issuance.

In addition, Fitch has affirmed the rating on the following outstanding bonds:

- \$864.855 million SRF general revenue bonds.

The Rating Outlook is Stable.

SECURITY

Bonds are secured by program loan repayments, the debt service fund and the support funds. In addition, under the 2002 general bond resolution (GBR), the state is required to make sufficient transfers to pay bond debt service from all available moneys in the revolving fund, which includes program equity, if necessary.

KEY RATING DRIVERS

SOUND FINANCIAL STRUCTURE: Cash flow modeling demonstrates that the program can continue to pay bond debt service even with loan defaults in excess of Fitch's 'AAA' liability rating stress hurdle, as produced using Fitch's portfolio stress calculator (PSC).

HIGHLY RATED BORROWER POOL: Approximately 92% of the state's combined SRF loan pool consists of entities carrying investment-grade ratings. Overall, pool credit quality is higher than average for SRFs rated by Fitch.

PLEDGED GBR EQUITY: Under the GBR, the state (IDR A+/Stable) is obligated to transfer to the

debt service fund any available moneys in the SRF (including equity moneys) in an amount sufficient to make debt service payments. Connecticut's incorporation of this obligation in the GBR provides additional bondholder protection and is unique among traditional SRF programs, which typically exclude such a covenant.

ABOVE-AVERAGE BORROWER CONCENTRATION: The state's loan pool is somewhat small, with only 99 borrowers. The top 10 borrowers constitute approximately 66% of the pool total, and the largest borrower represents 40% of the total pool. These metrics are slightly weaker than Fitch's comparable 'AAA' rating category medians. Concentrated pools are assessed at higher stresses in Fitch's modeling.

SOLID PROGRAM MANAGEMENT: Connecticut maintains sound formal program underwriting and loan monitoring guidelines exhibited by the lack of pledged borrower defaults to date.

RATING SENSITIVITIES

REDUCTION IN MODELED STRESS CUSHION: Significant deterioration in aggregate borrower credit quality, increased pool concentration, or increased leveraging resulting in the program's inability to pass Fitch's 'AAA' liability rating stress hurdle would put downward pressure on the rating. The Stable Rating Outlook reflects Fitch's view that these events are unlikely to occur.

CREDIT PROFILE

Connecticut's SRFs provide subsidized loans to local entities throughout the state for eligible clean water and drinking water projects. Fitch evaluates the separate clean water and drinking water SRFs as a single program given the cross-collateralization feature, whereby debt service deficiencies in one fund may be cured by surpluses in the other.

SOUND FINANCIAL STRUCTURE, DEFAULT TOLERANCE

Fitch measures financial strength of the combined SRFs by calculating the program asset strength ratio (PASR). The PASR includes total scheduled pledged loan repayments, support fund balance, and account earnings divided by total scheduled bond debt service. The state's PASR is 1.3x, which is below Fitch's 2018 'AAA' rating category median level of 2.0x but is considered sound by Fitch.

Excluding amounts in the equity fund, cash flow modeling demonstrates that the program can continue to pay bond debt service even with hypothetical loan defaults of 64% in the first four year period and 100% in the middle and last four-year periods over the outstanding bonds' expected life (per Fitch criteria, a 90% recovery is applied in its cash flow model when determining default tolerance). These results are in excess of Fitch's 'AAA' liability rating stress hurdle of 22%, as produced by the PSC. The liability rating stress hurdle is calculated based on overall pool credit quality as measured by the rating of underlying borrowers, loan size and term, and concentration.

The program's low PSC stress hurdle is reflective of the higher than average borrower credit quality. Although Fitch's calculation of the first four-year default rate is lower than categorical medians, inclusion of available and pledged equity funds in its model analysis would have resulted in a default tolerance of 100% in each stress period.

ENHANCEMENT PROVIDED PRIMARILY BY SUPPORT AND EQUITY FUNDS

The state's SRF loan pools are primarily protected from losses by surplus pledged loan amounts and investment earnings in excess of debt service, and amounts in the support and equity funds. The support fund was initially funded with the issuance of certain previous series of bonds in amounts required under such bonds' supplemental resolutions and is not expected to be funded as part of the 2019 issues. As these bonds amortize, amounts are released in accordance with a set schedule and are then available to pay for bond debt service. As of May 2019, the combined clean water and drinking water support fund balance was \$23 million, or 2% of outstanding principal.

As mentioned previously, the program's equity fund is also available and pledged to bondholders in the event of a debt service shortfall. However, equity moneys were not included in Fitch's analysis primarily because equity balances could diminish over time if they are recycled into new loans. As of May 2019, the equity balance totals over half of current outstanding bonds.

HIGH-QUALITY LOAN POOL WITH SOME CONCENTRATION

At 99 borrowers, the current loan pool is somewhat small and concentrated. However, the large majority of borrowers are of high credit quality. The Metropolitan District Commission (unrated by Fitch but assessed to be of high credit quality) is the pool's largest borrower, accounting for 40% of the total. The remaining top 10 borrowers account for a slightly elevated 26% of the pool, and most are also assessed to be investment grade. The program's loan security is favorable, with each borrower backed by general obligation pledges (75%), net utility system revenues (21%), or a combination of the two (4%). Overall pool attributes have remained similar over the past several years.

SOLID PROGRAM MANAGEMENT AND UNDERWRITING

The state treasurer's office and Connecticut's department of energy and environmental protection (DEEP) jointly manage the clean water SRF program, while the state treasurer's office and the department of public health (DPH) jointly manage the drinking water program. Among other duties, DEEP and DPH are responsible for the preparation of the state's annual SRF priority lists, approval of construction disbursement requests, and the inspection of projects to ensure compliance.

Connecticut requires that program borrowers evidence their ability to repay loans and provide relevant documentation such as financial statements, capital budgets and economic data. Management monitors monthly loan repayments and works with its loan servicing contractor, the program's trustee bank. In the event of a late payment, a policy is in place to implement immediate collection procedures.

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Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 28 May 2019)

U.S. Public Finance State Revolving Fund and Municipal Finance Pool Program Rating Criteria (pub. 13 Mar 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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