

# RatingsDirect®

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## Summary:

# Connecticut Green Bank; General Obligation Equivalent Security

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### Credit Profile

US\$15.435 mil solar home renewable energy credit green libery bnds (Climate Bond Certified) ser 2020 due 11/15/2030

*Long Term Rating*

A/Stable

New

## Rating Action

S&P Global Ratings assigned its 'A' long-term rating to the Connecticut Green Bank's Solar Home Renewable Energy Credit (SHREC) series 2020-1 Green Liberty bonds. The outlook is stable.

The Green Bank is issuing approximately \$15.4 million of bonds to refinance expenditures of the bank to its Residential Solar Incentive Program (RSIP) and fund a special capital reserve fund (SCRF). The bonds are secured by revenues received under the indenture, including SHREC receivables, funds on deposit in the SCRF.

We base the rating on the security provided by the SCRF and application of our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect). We consider this a general operating pledge and in accordance with our criteria, generally rate these obligations on par with our view of the obligor's general creditworthiness, in this case, the state of Connecticut.

The reserve fund is the ultimate layer of security and will only be accessed if the revenues received under the indenture are insufficient to meet debt service requirements. This reserve fund, which is required to equal maximum annual debt service (MADS), is funded from bond proceeds. According to the terms of the indenture, the reserve fund is held by the trustee. If the reserve fund is depleted to pay debt service, funding from the state is "deemed to be appropriated" to restore the reserve to MADS. Appropriation and payment of these funds are not subject to further legislative approval, according to bond counsel. As a result, S&P Global Ratings has historically rated SCRF-enhanced issues on par with its GO rating on Connecticut. The Green Bank's obligation to fund debt service is absolute and unconditional.

The Green Bank is a quasi-public organization created in 2011 as a successor to the Connecticut Clean Energy Fund with a focus on financing clean energy initiatives, including renewable energy, energy efficiency, energy storage, alternative fuel vehicles, and infrastructure. It is not a department, institution or agency of the state, but the state treasurer serves as an ex-officio board member.

### Credit overview

Through the RSIP, the Green Bank offers incentives to homeowners and third-party owners to install solar panels. In exchange for its incentives, the Green Bank receives all rights and title to SHRECs generated and sells the SHRECs generated to the state's two investor-owned utilities (Eversource and United Illuminating) under a master purchase

agreement at a predetermined price over a 15-year tranche lifetime. Eversource must purchase 80% of SHRECs and United Illuminating 20% within each tranche. The utilities' obligation to purchase future tranches ends no later than the earlier of the Green Banks deployment of 350 megawatts of qualifying residential solar photovoltaic installations (in which case the Green Bank must notify the utilities that goal has been met) or Dec. 31, 2022 (maximum of six tranche delivery terms).

The SHRECs supporting this bond issuance (Tranche 3) will be generated from 4,818 systems with a SHREC purchase price of \$48 per SHREC with projected revenues of approximately \$25.6 million over the life of bonds.

While the Green Bank is not dissolvable through bankruptcy, SHREC payments are made by the utilities, and not customers or third-party owners. While the utilities have a greater likelihood to make SHREC payments to the Green Bank, there can be no assurance that one or both of the utilities will not become insolvent as neither utility is bankruptcy remote. Additional risk exists if customer defaults on payments to the utilities increase, affecting the financial performance of the utilities, or performance of residential systems generating the SHRECs and consequently expected revenues are worse than projected. The Green Bank also relies on public sources of funding to maintain operations and may be affected by a variety of political and economic factors.

If underlying risks of the transaction were to mount, and the Green Bank received insufficient payments to meet debt service requirements from the transaction or its public sources of funding, we expect the state's SCRF backing will be sufficient to remedy any deficiencies. Pursuant to Connecticut General Statutes (16-245mm), the aggregate amount of Green Bank bonds secured by SCRF may not exceed \$100 million and, in our opinion, limit the state's contingent liability exposure from the Green Bank. As of Feb. 1, 2020, Connecticut had \$5.1 billion of SCRF-secured debt outstanding, \$4.5 billion of which was issued by the Connecticut Housing Finance Authority. In our opinion, the state has not exhibited any political or administrative risks to suggest it would not support SCRF-backed obligations if needed.

### **Environmental, social, and governance factors**

S&P Global Ratings considers health and safety a social risk under our view of environmental, social, and governance (ESG) factors. Absent the social risks of COVID-19, we consider Connecticut to have elevated social risks compared to the sector given its older population and higher cost of living. These demographic trends could present long-term credit risks to the state's economic and budgetary performance. However, we believe Connecticut's historically strong management and policy framework will help manage this risk. Environmental risks are considered above those of other states due to its 618 miles of coastline along Long Island Sound. Its shoreline roads and communities are at risk from rising sea levels. However, we recognize the state's commitment to renewable energy installation and energy efficiency, as evidenced by the creation of the Green Bank and this transaction. We view the state's governance risks as being in line with the sector and it has historically maintained a strong management and policy framework to respond to developing risks.

## **Stable Outlook**

The outlook on the bonds reflects that of the state of Connecticut. Generally, our rating outlook timeframe is up to two years. Given the current uncertainty around the pandemic, our view of the credit risks to Connecticut and its

obligations centers on the more immediate budget effects in 2020 and is subject to change.

### **Downside scenario**

Should a significant structural gap emerge and the state no longer continues making required pension contributions, uses significant one-time budgetary maneuvers (including deficit bonds), or sees its reserves deteriorate to low levels as they were before bond covenants were imposed, we may lower the rating. We also note that the state's three-year average pension funding ratio is close to our threshold of 40%, and may result in further downward rating action if pension funding levels deteriorate. We recognize that state governments across the nation will face unprecedented challenges in the near term. The duration and severity of recent events affecting the state's fiscal profile may result in faster deterioration of its credit quality as economic conditions change.

### **Upside scenario**

If the state is able to weather the economic recession, maintaining good reserve balances and demonstrating a moderating debt burden, we may consider a higher rating. We currently estimate that the majority of our debt ratios will remain at least one-third higher than the threshold triggering our one-notch lower rating over our outlook horizon. This threshold was first triggered at the end of fiscal 2017.

## **Credit Opinion**

Connecticut released updated consensus revenue forecasts at the end of April, projecting a \$934.0 million deficit (4.8% of expenditures) in the general fund for fiscal 2020. To balance the budget this year, the state will use all of its expected volatility cap transfer to the reserve fund (\$318.3 million) and a draw from its rainy day fund (\$615.7 million). Prior to the COVID-19 pandemic, it was on track to increase reserve levels to over 15% during the biennium. The strong position of the state entering into fiscal 2020 is likely to weaken, with reserve balances at 12.9% of appropriations expected to decline to 9.4% following the drawdown for this year's deficit.

The projections also forecast a \$2.2 billion deficit (10.7% of expenditures) for fiscal 2021 that the state will need to address through some combination of expenditure and revenue changes or continued use of reserves. The level of reserves at the end of fiscal 2020 is expected to be \$1.9 billion and is insufficient to make up all of the projected deficit for fiscal 2021. The state has begun considering how to address the fiscal 2021 shortfall with revenue changes and other expenditure adjustments. However, the significance of the shortfall will likely result in some reserve use. During the last recession, the state issued nine-year deficit bonds to close its shortfall.

Despite these challenges, Connecticut enters the current recession in a significantly better position than in the past, with reserves at historically high levels. Bond covenants allow reserve drawdowns on a supermajority legislative vote, which the majority party holds at present. Previously, Connecticut had a history of carrying low reserves and ended fiscal 2017 with a reserve balance of only 1.1% of expenditures.

Further pressuring the state's finances during the recession are its extremely high fixed costs. An estimated 50% of fiscal 2020 budgeted expenditures constitute debt service, required pension and retiree health care benefit contributions, the state share of Medicaid costs, and other entitlements. The state also enacted an annual GO bond allocation cap of \$2 billion and an issuance cap of \$1.9 billion (with certain exclusions such as UConn 2000 bonds), but

the state has self-imposed a GO issuance limit of \$1.6 billion in fiscal years 2020 and 2021. Bond allocations are determined by the state's Bond Commission, whose agenda is controlled by the governor. During calendar year 2019, GO bond allocations by the Bond Commission totaled \$1.2 billion, well below the 2011 through 2018 bond allocation average of \$1.975 billion. Connecticut remains the only state with a high enough debt load to trigger a one-notch downward override rating adjustment under our state rating methodology. The bond bill authorizations are in line with prior years and we do not expect the debt profile to significantly moderate in the near term.

Based on the analytic factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a composite score of '2.2' to Connecticut, an anchor of the 'AA-' rating. However, we also calculate that a majority of Connecticut's debt ratios in our state scoring criteria may lie more than one-third above the level necessary to score a '4', which triggers a one-notch rating override under our state scoring criteria. We are further using our discretionary ability to rate one notch below the anchor rating and overriding factors to maintain our 'A' rating due to our view of the state's high fixed-cost burden and lagging economic growth compared to peers

For more information on the state's general creditworthiness, see our full analysis on Connecticut, published May 15, 2020 on RatingsDirect.

## **Related Research**

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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