STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Vermont; General Obligation

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Credit Profile		
US$ 50.765 mil GO bnds ser 2015 B due 08/15/2035		
Long Term Rating	AA+/Stable	New
US$28.46 mil GO rfdg bnds ser 2015 C due 08/15/2028		
Long Term Rating	AA+/Stable	New
US$26.565 mil GO bnds (Vt Citizens Bnds) ser 2015 A due 08/15/2035		
Long Term Rating	AA+/Stable	New
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating and stable outlook to Vermont's series 2015A (Vermont citizen bonds), B, and C general obligation (GO) bonds. At the same time, Standard & Poor's affirmed its 'AA+' rating on Vermont's GO bonds. The outlook is stable.

The ratings reflect our opinion of the state's:

- An employment composition reflective of the U.S. economy that is characterized by above-average income levels and low unemployment rates, but a recent slower-than-average pace of growth by most measures;
- Strong financial and budget management policies that have contributed to consistent reserve and liquidity levels over time;
- Well-defined debt affordability and capital planning processes, in our view, that have limited leverage and contributed to a modest tax-supported debt burden with rapid amortization of tax-supported debt; and
- Significant pension and other postemployment benefits (OPEB), which remain sizable relative to those of state peers despite some recent reform efforts.

The state's GO bonds are secured by Vermont's full faith and credit pledge. We understand that the bond proceeds will be used for various capital projects and refunding of certain debt outstanding for interest cost savings.

Demographic trends for Vermont have recently been weak relative for the region and national trends. The estimated population of 627,000 in 2014 is only 0.1% above 2010 levels. Despite this weaker demographic pattern, income levels have expanded at a healthy pace and per capita personal income has been above that of the U.S. for the past four years. However, Vermont's pace of economic recovery has been uneven and more recently, growth has lagged that the U.S., a trend we expect to continue.

The state has actively managed its budget over time, which is a credit strength, and has consistently maintained financial reserves, providing flexibility to address midyear budget imbalance. Unaudited budgetary basis results for fiscal 2015 indicate a $25.2 million operating surplus in the general fund before transfers. General fund tax revenues for fiscal 2015 of $1.38 billion were 3.6% above those of fiscal 2014 and total revenues increased by a healthy 3.6%. After transfers, the state projects an increase in the total fiscal 2015 general fund reserve balance to $76.11 million (5% of general fund expenditures) from $71.16 million in fiscal 2014.

For the general fund, the budget stabilization reserve increased to $69.3 million and an additional $6.8 million was available in the reserve for general fund surplus/revenue shortfall reserve. This additional reserve was established by the legislature in 2012. This reserve can be funded with budget surpluses after the existing budget stabilization fund and other statutory requirements are funded, up to a level of 5% of prior-year appropriations. The education and transportation fund reserves were also maintained at their statutory maximum of 5% at year-end.

The revenue projection for the fiscal 2016 general fund budget is now $1.43 billion, a total increase in tax revenue of $40.2 million; of which $31.6 million is new revenue adopted during the 2015 legislative session. According to the state, there was a $113 million gap in the 2016 budget, which Vermont closed through new revenues, adjustments in funding sources, and a small amount of one-time resources. The used of one-time revenues was a minimal 2% of operations, which we do not consider material and the amount is actually down from previous years. The budgets for the general, education, and transportation funds project ending balances at statutory maximums at the end of fiscal 2016.

The state has expanded Medicaid under the Affordable Care Act (ACA) and has established a health benefits exchange, Vermont Health Connect (VHC). Vermont currently enrolls individuals who earn up to 350% of the poverty line in state health programs so the ACA eligibility expansion has resulted in some recurring federal revenue to the state as well as federal funds for other elements of implementation including grants to develop its health benefits exchange. The state has had some technical and security issues with the exchange but officials indicate they have the highest per capita enrollment of any state-based exchange to date. As of July 2015, Vermont had more than 213,000 enrolled (about one-third of the population) in VHC health plans, Qualified Health Plans, and Medicaid for Children and Adults through either the marketplace, the state's legacy ACCESS system, or directly through an insurance carrier. The majority of the cost of operating VHC is covered by federal funding, at present; however, we believe that ACA implementation and general caseload activity could pressure the state's budget in the future. Recently, the state's reform efforts have focused on moving to value-based payments from fee-for-service payments across all payers, including Medicare.

Vermont's debt burden is moderate overall, in our view, and all tax-supported debt issuance is governed by a comprehensive capital and debt affordability process. Pension liabilities have grown considerably in the past several years and funded ratios steadily deteriorated through fiscal 2014. The state has increased pension funding toward annual required contribution (ARC) levels, and contributions in fiscal years 2012-2014 were significantly above the actuarially determined annual pension costs of the two pension systems. We expect that these higher contributions should improve funding levels in future years. The updated pension valuations for fiscal 2014 indicate that funding levels improved under the new Governmental Accounting Standards Board (GASB) 67 reporting requirements with assets reported on a market value basis. Despite this improvement, funded ratios have been below those of state peers. OPEB liabilities also remain high, with limited asset accumulation despite the creation of a trust fund.

Based on the analytical factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned Vermont a composite score of '1.7'.

Outlook

The stable outlook reflects Vermont's slower-than-average economic recovery, which continues to pressure the budget, in our view. In addition, pension and OPEB liabilities remain high relative to those of state peers. We believe that Vermont has a very strong budget management framework and should this lead to improved reserve levels in the future, a higher rating could be warranted. In addition, we believe that there has been progress in increasing pension contributions and the state has taken certain actions to begin to address OPEB liability. A demonstrated improvement in the pension and OPEB liability position could also translate to a higher rating. Although we do not envision it at this time, given Vermont's history of proactively managing its budget and recent actions to address retirement liabilities, substantial deterioration of budget reserves, or a deteriorating liability position could negatively pressure the rating.

Government Framework

Vermont does not have a constitutional or statutory requirement to enact or maintain a balanced budget, but it has consistently maintained sound finances. In our view, the state has significant flexibility to increase the rate and base of its major tax revenues, which include income taxes, sales taxes, and a statewide property tax that funds the state's support of local education. We view the state's revenue sources as diverse. Voter initiatives cannot affect the state. Vermont maintains the ability to adjust disbursements in order to maintain sufficient liquidity. Debt service can be paid without a budget, but there is no other legal priority for debt.

The state's tax structure is broad, and its revenue sources are diverse across several operating funds. The general fund relies primarily on unrestricted revenues from personal and corporate income, sales and use, and meal taxes.

The education fund relies primarily on a statewide property tax, and an appropriation from the general fund. The education stabilization reserve ended the year at the statutory maximum of 5% of expenditures. The transportation fund relies primarily on federal-match grant revenues, a motor vehicle license fee, and a motor fuel tax.

On a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a '1.6' to Vermont's government framework.

Financial Management Assessment: 'Strong'

Standard & Poor's considers Vermont's financial management practices "strong" under its financial management assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Much of Vermont's debt and financial management practices are embedded in state statute. These, along with internally developed policies, guide the state's long-term budget and capital planning, debt management, and investing practices. The state has a well-established consensus revenue-estimating process. According to statute, the joint fiscal office and administration provide their respective revenue estimates for the general, transportation, and federal funds for the current and next succeeding fiscal year to the Vermont Emergency Board.

Vermont law also requires a long-term capital plan. The governor submits a capital budget annually to the General

Assembly based on debt management provisions outlined by the state's capital debt affordability advisory committee. The committee's estimate is nonbinding, but the state legislature has never authorized new long-term GO debt in excess of the committee's estimated amount. The state has formal debt management policies, including a statutory debt affordability analysis developed by the capital debt affordability advisory committee that Vermont integrates into the operating budget development process and updates at least annually. Vermont has not entered into any interest rate swaps and thus does not have an adopted swap management policy. Statutory restrictions and adopted administrative policies govern investment management, and the office of the state treasurer monitors compliance.

Budget Management Framework

The state has multiple tools to assist financial management. Vermont monitors revenues and publishes results monthly; and the emergency board meets at least twice annually, in July and January, to evaluate the revenue forecast and make adjustments, if necessary. The state forecasts also include Medicaid revenues and spending. These consensus forecasting meetings can be convened more frequently, and were held quarterly during fiscal years 2008 through 2010, due to the recession and the potential impact on revenues and expenditures. The emergency board includes the governor and the legislative chairs of the house and senate fiscal appropriations committees. The forecasting process includes traditional economic and revenue forecasting, which Vermont performs with the assistance of outside economists, for the current and next succeeding fiscal year, as well as a less detailed forecast for the next eight years.

The governor has statutory authorization to adjust the budget within certain revenue and expenditure change limits when the Vermont Legislature is not in session. Vermont maintains stabilization reserve funds at statutory levels to reduce their effect on annual revenue variations. In 1993, the state created separate budget stabilization reserves within the general and transportation funds. The amount in each of these reserves is not to exceed 5% of previous-year appropriations. In fiscal 1999, the state created an education fund budget stabilization reserve, which is to fund in a range between 3.5%-5.0% of expenditures. Vermont statute requires annual funding of such reserves. The governor included a proposal in the fiscal 2013 executive budget to increase the general fund stabilization fund to 5.25% from 5.00%, but instead, the legislature added a second general fund reserve fund with a separate cap of 5.00% of expenditures.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.' to Vermont's financial management.

Economy

Vermont's economy is driven by tourism, higher education, computer and electronics manufacturing, consumer-goods manufacturing and agriculture. Exports continue to be an important part of the state's economy at 16% of gross state product (GSP), with a substantial portion going to Canada according to IHS Global Insight Inc. Exports were primarily made up of computer and electronic products (68.6%) followed by food manufactures (5.7%), and machinery (4.4%). In 2014, Vermont's exports totaled $3.6 billion of which 44.2% was with Canada; however, along with the strong dollar demand is likely to weaken as the fall in oil prices has damaged Canada's heavily oil-extraction reliant economy, thus in our view likely contributing to a weaker demand in the near term for Vermont's exports. Recent data from the International Trade Administration show that the state's export performance deteriorated in 2014, with total exports shrinking by 10% from 2013.

Vermont's employment diversity by sector is generally in line with the nation's, in our view, and has not demonstrated more cyclicality than when the U.S. Global Foundries completed its acquisition of IBM, which is the second-largest private-sector employer in the state and accounts for a large portion of the state's manufacturing employment and exports. Global Foundries employs about 3,000 at its Essex Junction plant, which manufactures semiconductors for consumer electronic products, including chips for cell phones and other devices. According to IHS Global Insight, a large portion of the state's manufacturing exports includes computers and electronics products from the facility. The Vermont Yankee nuclear power plant ceased power production at the end of 2014 and the facility is in the process of placing spent fuel into dry cast storage. Employment levels in 2015 reflects that development. The transition to site restoration will take multiple years, and state officials indicate that this close is not expected to immediately affect power prices, given that Vermont power companies do not purchase power from this plant. However, according to IHS Global Insight the facility's closure is expected to lead to layoffs of about 600 highly compensated employees in the medium term.

The state reports it was the second state in New England to complete its labor market recovery from the last recession--following the State of Massachusetts. Health care employment, in particular, will be a growth driver; however, IHS Global Insight forecasts very slow total employment growth of 1% in 2014 and an average annual growth rate of 0.98% between 2015 and 2018, which is well below forecast national employment growth rates. Despite the slow forecast employment growth, IHS projects unemployment rates to remain low in the next few years at about 3.4%, as labor force growth will be stagnant. It projects real GSP and personal income growth to average 2.0% and 4.3%, respectively, from 2015 to 2018 period. Although Vermont housing starts declined in 2014, and growth is projected to be uneven and not expected to return to its prerecession levels in the near future, home prices continue to appreciate in the near term similar to trends in the New England region.

Vermont's quality of life and well-educated workforce provide economic development opportunities; however, the state ranks low among the states in its business tax and regulatory environment and its slow labor force growth could stifle future economic growth prospects. The state's demographic trends continue to weaken with the Census Bureau estimating a population decrease from July 1, 2013, to July 1, 2014, of about 0.1% (293 people). This is below both the New England and national trends of an increase of 0.3% and 0.7%, respectively, over the same period. Vermont's population has grown more slowly than the nation as a whole; for 2000-2010, its population increased by only 0.26% compared with the nation's 0.9%. Furthermore, the state's aging population--31.7% over 55 and 16.4% over 65, compared with 26.6% and 14.2%, respectively, for the nation--will continue to be a drag on the state's growth potential in our view.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '2' to Vermont's economy.

Budgetary Performance

The fiscal 2016 general fund consensus revenue forecast was $1.39 billion for the fiscal 2016 budget. The budget that passed included $32.14 million in additional tax revenues a result of law change and $44.28 million in revenue enhancements, primarily from direct applications from special funds. Appropriations total $1.7 billion and the budget projected a budget stabilization reserve of $71.25 million and an ending general fund balance reserve of $10 million. The general fund consensus revenue forecast in July 2015, increased the general fund revenue estimate for fiscal 2016 by $40.2 million to $1.43 billion. This increase, according to the state, is due to updated economic information, technical re-specifications of the forecasting models, and tax changes enacted in the 2015 General Assembly.

The state ended fiscal 2015 with general fund revenues of $1.376 billion creating an operating gain of $25.2 million, which was offset by net transfers out to other funds of $10.27 million and transfers to reserves of $9.95 million. The fiscal 2015 general fund revenues were -1.52% below the January 2014 revenue forecast. Vermont ended fiscal 2014--the last audited year--with the budget stabilization reserves in the general fund, transportation fund, and education fund fully funded at their maximum statutory levels of 5% of the previous year's budgetary appropriations, along with some additional reserves in the general fund. These three funds' stabilization reserves remained funded at their statutory maximums through the recent recession. The total general fund balance decreased by $34 million after transfers to $125 million, a still-solid 14.6% of operating expenditures.

The state maintains separate budget stabilization funds in its general, transportation, and education funds that are available to offset undesignated fund deficits. The statutory maximum for the three stabilization reserves is 5% of the prior-year budgetary appropriations, and the education stabilization fund also has a statutory minimum of 3.5% of the prior-year appropriation. The three stabilization funds have been at their statutory maximums since fiscal 2007. Vermont pools the cash reserves for these major funds, which results in sufficient liquidity for operations during the fiscal year. Officials indicated that the state has not externally borrowed for liquidity since fiscal 2004.

On a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a '1.4' to Vermont's budgetary performance.

Debt And Liability Profile

Debt

Vermont's total tax-supported debt is moderate about $950 per capita, or 2% of personal income and 2% of GSP. The fiscal 2014 tax-supported debt service was low, in our view, at about 2% of general governmental expenditures. Vermont's debt portfolio consists of only fixed-rate debt, without any exposure to interest rate swaps. The state also does not have any direct placement debt. We consider the debt amortization to be rapid, with officials retiring more than 67% of tax-supported debt over the next 10 years. The state has a debt affordability committee that annually recommends a maximum amount of debt issuance for the next fiscal year, and while the committee's recommendations are not binding, Vermont has consistently adhered to them. The authorization for fiscal years 2015 and 2016 totals $144 million, of which $83 million is expected to be issued in fiscal 2016 from the new Capital Bill and $17 million is previous authorized but unissued debt. State projections show debt levels remaining well within the state affordability guidelines through 2026. Debt service can be paid without a budget, but there is no other priority for the payment of debt before other general state expenditures.

Pensions

Vermont maintains three statutory pension plans: the Vermont State Teachers' Retirement System (VSTRS), with about 9,950 active members; the Vermont State Retirement System (VSRS), which includes general state employees and state police and has about 8,300 active members; and the municipal employees' retirement system (6,664 members). The state appropriates funding for the first two systems; the municipal system is supported entirely by municipal employers and employees.

The pension systems' funded ratio for the combined VSTRS and VSRS systems is below average, in our view, at 67.6% as of June 30, 2014, and has declined from 72.7% as of June 30, 2010. The valuation uses a "select and ultimate" method for developing interest rate assumptions, which results in an effective expected rate of return of 8.1% for VSRS and 7.9% for VSTRS, which is somewhat high relative to state peers. The combined unfunded actuarial accrued liability (UAAL) at June 30, 2014, was $1.5 billion, or $2,426 per capita, which we also view as below average; however, on the GASB 67 basis, the net pension liability is lower at $1.31 billion due to the higher actuarial value of assets based on market value and an assumed 8.2% rate of return.

The state budgets for pension contributions based on percentage rates of each member's annual earnable compensation and the actuarial valuations from the previous fiscal year. It budgets for the VSTRS ARC appropriation at the beginning of the year. The VSRS ARC accrues as a percent of salary expenses throughout the year and the state adjusts subsequent appropriations to reconcile variations in actual payroll from year to year to meet the projected ARC. Since fiscal 2012, actual annual contributions to the systems have exceeded the respective ARCs, which state officials attribute to conservative budgeting. In fiscal 2014, actual contributions of $56.5 million to VSRS represented 132% of the pension ARC. The actual contribution to the VSTRS system in fiscal 2014 represented 106% of the ARC, which included amounts to be used toward the payment of retiree health care expenses.

Other Postemployment Benefits

The state's unfunded OPEB liability is relatively high, in our view, at $2,556 per capita, although the state has recently made plan adjustments to manage the liability. Vermont offers postemployment medical insurance, dental insurance, and life insurance benefits to retirees of the single-employer VSRS and the multiemployer VSTRS. The VSTRS plan's OPEB UAAL improved to $713 million as of June 30, 2013, from $827 million in June 2012, primarily reflecting a change to a Medicare Part D Employer Group Waiver Plan (EGWP) for prescription drug benefits from a retiree drug subsidy (RDS) program. As of June 30, 2014, however, the VSTRS OPEB UAAL increased to almost $767 million, reflecting recent demographic experience and other refinements of estimated savings related to the EGWP implementation. The fiscal 2015 OPEB cost is almost $45 million compared with $42.8 million in fiscal 2014. The VSTRS contributes to the liability on a pay-as-you-go basis, but Vermont did not historically break out the actual employer contribution, including it, instead, through the pension contribution without an explicit appropriation. In 2014, Vermont passed legislation to establish a separate retired teachers benefit fund to fund current-year health care expenses, which will receive funding from general fund appropriations, EGWP subsidies, and a future health care fee for new hires.

The state has established an OPEB trust fund for the VSRS, but as of June 30, 2014, it contained only $18.9 million of assets, for a 1% actuarial asset funded ratio. The actuarial annual OPEB cost in fiscal 2014 was $67 million for the VSRS, of which Vermont paid almost 36% under pay-as-you-go funding. VSRS also began offering Medicare prescription drug benefits through an EGWP as of Jan. 1, 2015; according to the state this should reduce the liability by $116.2 million. Before this change, the VSRS actuarial valuation had assumed the system contributed Medicare Part D refunds from the RDS program into the irrevocable trust fund. Assuming no future contributions to the trust after implementation of EGWP, the June 30, 2014, OPEB valuation assumed a lower 4.00% discount rate (from 4.25%) which, along with rising assumed per capita costs and demographic experience--and despite the savings from the EGWP implementation--increased the estimated OPEB UAAL to about $1 billion from $932 million as of June 30, 2013. The separate multiemployer Vermont Municipal Employees Health Benefit Fund for local government is administered by the state, but has no liability to the state, and is not included in our OPEB calculations.

On a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a '2.5' to Vermont's debt and liability profile.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Financial Management Assessment, June 27, 2006

Ratings Detail (As Of September 22, 2015)		
Vermont GO bnds		
Long Term Rating	AA+/Stable	Affirmed
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed
Vermont GO bnds		
Long Term Rating	AA+/Stable	Affirmed