FitchRatings

FITCH AFFIRMS VERMONT'S SPECIAL OBLIG TRANSPORTATION INFRASTRUCTURE BONDS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-New York-07 April 2017: Fitch Ratings affirms the state of Vermont's $30 million of special obligation transportation infrastructure bonds (TIBs) at 'AA'.

The Rating Outlook is Stable.

SECURITY
The bonds are special, limited obligations of the state, payable from motor fuel transportation infrastructure assessments (TIB assessments). Bondholders have a first lien on dedicated gasoline and diesel fuel assessments. Pledged funds are statutorily segregated in the Transportation Infrastructure Bond (TIB) Fund. The expenditure of such funds is further statutorily limited to debt service and, only once debt service has been accumulated for the fiscal year, pay-go capital expenditures for transportation projects.

KEY RATING DRIVERS

The 'AA' rating on Vermont's special obligation TIBs reflects the limited growth prospects for pledged revenues, offset by their anticipated sound resilience through moderate economic downturns.

Pledged Revenue Growth Prospects:
Growth prospects for pledged revenues are relatively flat. Following legislative action to establish a floor on per-gallon collections in response to the extended low oil price environment, trends will be more closely tied to fuel consumption. Fitch's expectations for the state's economy are more positive, but the weak historical fuel consumption trend tempers the assessment.

Economic Sensitivity and Resilience of Security:
Coverage for the bonds from pledged revenues should be highly resilient through a moderate downturn given the strong current coverage cushion.

Exposure to Issuer:
Fitch does not link the rating on the bonds to Vermont's Issuer Default Rating (IDR). Statutory provisions insulate the pledged revenues from general operations of the state.

RATING SENSITIVITIES
Sound Coverage Cushion: The rating on Vermont's special obligation transportation infrastructure bonds is sensitive to Fitch's expectations for the maintenance of a sound coverage cushion from the dedicated gasoline and diesel fuel assessments, consistent with the current rating level.

CREDIT PROFILE

Pledged revenues consist of a 2% assessment on the retail price (exclusive of all federal and state taxes, averaged over the preceding quarter) per gallon on motor vehicle gasoline sold in the state (90% of pledged revenues) and a 3-cent per gallon assessment on diesel fuel sales in Vermont, subject to an established floor. In both cases, the levy is collected at the wholesale level along with other vehicle-related taxes. Both sources were authorized and implemented in 2009 to fund transportation improvements across the state.

By statute, TIB assessments are segregated in the TIB fund, apart from all other Transportation Fund revenue, and TIB Fund monies must first be expended for annual debt service on transportation infrastructure bonds. Once debt service has been fully provided for in a given fiscal year, TIB monies can be used for pay-as-you-go capital expenditures for transportation projects. Vermont has covenanted to fulfill the terms of the Trust Agreement and will not impair the rights or remedies of bondholders. Pursuant to the TIB statute, the assessments shall not be reduced below the rates in effect at the time of issuance of the bonds until the bonds have been paid.

STABILIZING REVENUE STREAM
Pledged revenues have declined for three consecutive years, including a particularly sharp decline in fiscal 2016. For fiscal 2016, pledged revenues totaled an estimated $15 million, a 26% decline from the previous fiscal year. Fitch attributes most of this multi-year weakening to the national decline in gasoline prices that began in earnest in summer of 2014.

To address the effects of rapidly declining gas prices, the state implemented a floor of $0.0396 per gallon to the TIB motor fuel assessment through Act No. 40 of 2015. Fitch's analysis incorporates the demonstrated volatility of the pledged revenues as well the anticipated stability to be provided by the newly established floor.

HIGH LEVEL OF RESILIENCE
The security provided by the pledged TIB assessments is very resilient to economic volatility. Fitch's analysis focuses on maximum leverage under the 2x additional bonds test. Vermont generally maintains a cautious approach to debt issuance and will likely maintain coverage in line with or exceeding its 3x policy limit.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP scenario) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. The imposition of a price floor for gasoline will limit the depth and extent of future pledged revenue declines as the state is no longer exposed to further gasoline price weakening. Therefore, Fitch also assesses gasoline consumption trends, which are the primary driver of pledged revenues until prices rise above the statutory floor. Gasoline receipts accounted for approximately 90% of fiscal 2016 pledged revenues.

The analysis of pledged revenues relies on estimate historical revenues provided in bond offering documents as the pledged revenues were not collected for debt service until fiscal 2010. Based on the state's estimated pledged revenue history, the Fitch Analytical Sensitivity Tool (FAST) generates an 8.2% scenario decline in pledged revenues. The largest decline was 35% decline between fiscal 2013 and fiscal 2016.

Despite the recent deep declines, fiscal 2016 pledged revenues of approximately $15 million can still withstand a 50% decline while maintaining sum sufficient coverage of MADS, assuming issuance up to the 2x ABT. This is equivalent to more than 6x the scenario result, and 1.4x the worst actual decline in revenues.

When considering historical gasoline consumption, FAST generates a much more modest 3% decline in pledged revenues. The largest consumption decline is the long 13.7% decline between fiscal 2004 and 2016. In this approach, fiscal 2016 pledged revenues can withstand a decline equivalent to more than 16x the scenario result, and more than 3x the worst actual consumption decline and still cover debt service.

Fitch assesses the true resilience provided by pledged revenues as more in line with the results of the analysis based on gasoline consumption because the statutory floor limits further downside revenue risk related to price declines.

MODEST GROWTH PROSPECTS
Growth prospects for the pledged revenues are flat, reflecting the recent establishment of a statutory price floor on the gasoline component, Fitch's view of a long-term national trend of stable to declining fuel consumption, and the state's solid economic growth prospects.

Until prices rise above the price floor of approximately $2.50 per gallon, pledged revenues will be tied primarily to expectations for gasoline consumption rather than price. Gasoline consumption trends in Vermont have been weak, with average annual declines of 1.1% over the past 10 years. Fitch forecasts oil prices globally will gradually increase over the next several years, eventually bringing Vermont's price per gallon above the floor and thereby increasing pledged revenues.

The 'bbb' revenue growth prospect assessment also incorporates the state's overall solid economic prospects.

NOT LINKED TO STATE IDR

The rating on the TIBs is not exposed to operations of the state of Vermont. The TIB statute enacted prior to the first issuance of TIB bonds established the TIB Fund to receive the newly established TIB assessments on gasoline and diesel fuel. Per the statute, monies in the TIB fund must be used first for annual debt service before any additional uses. Further, the statute says any trust agreement entered into by the state for TIBs is valid and binding, including any liens created under trust agreements. The trust agreement for the bonds establishes a pledge of and lien on revenues received by the state from the TIB assessments.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

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Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478