11 Sep 2020 | Affirmation

Fitch Affirms Vermont's Special Obligation Transportation Infra Bonds at 'AA'; Outlook Stable

Fitch Ratings-New York-11 September 2020:

Fitch Ratings has affirmed the State of Vermont's $23.44 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

Analytical Conclusion

The 'AA' rating on Vermont's special obligation transportation infrastructure bonds reflects the limited growth prospects for pledged revenues, offset by their anticipated sound resilience through moderate economic downturns. While coverage will likely narrow through the sharp coronavirus-driven downturn, Fitch anticipates the bonds' structure will withstand revenue declines at a level consistent with Fitch's baseline macro-economic scenario, without deterioration in long-term credit quality. Looking through the current downturn, prospects for revenue growth are modest and reflect both an ongoing national trend of weakening growth in fuel consumption, given improvements in fuel economy, as well as Fitch's expectation for slow economic growth in the state, relative to the nation. Fitch's analysis assumes Vermont could leverage up to its policy limit with projected debt service coverage no lower than 3x annual pledged revenues. This limitation is more conservative than the indenture's 2x additional bonds test.

Limited Revenue Growth Prospects: Growth prospects for pledged revenues are relatively flat. Given the statutory floor on per-gallon collections and relatively weak price environment, trends are more tied to fuel consumption than price. A weak historical fuel consumption trend is a key factor in Fitch's assessment.

Robust Resilience of Security: Coverage for the bonds from pledged revenues should be highly resilient given the strong coverage cushion.

Linked to State Issuer Default Rating, Not Capped: Structural protections for bondholders, including statutory priority of debt service, indicate enhanced prospects for full and timely payment. But like nearly all state dedicated tax bonds, the structure does not have a sufficiently strong non-impairment argument to allow for a rating determined without regard to the issuer's general credit quality.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A sustained and significant improvement in the growth prospects for gasoline and diesel fuels tax revenues, at least above the inflation rate and closer to national GDP growth;

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Greater-than-anticipated, sustained and deep revenue declines (consistent with a declining revenue trajectory) and materially thinner coverage of annual debt service and a weakened level of resilience in the bonds' structure, which could all be triggered by a severe economic contraction, including one consistent with Fitch's coronavirus downside scenario.

--Negative rating action on the state's IDR, given the rating linkage could trigger negative rating action but not necessarily so.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CREDIT PROFILE

Sector-Wide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 4Q21. In its baseline scenario, Fitch assumes continued strong GDP growth in 3Q20 followed by a slower recovery trajectory from 4Q20 onward amid persisting social distancing behavior and restrictions, high unemployment and a further pullback in private-sector investment. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10135320), published Sept. 8, 2020 on www.fitchratings.com.

Dedicated Tax Bond Overview

Pledged revenues consist of a 2% assessment on the retail price (averaged over the preceding quarter, and exclusive of all federal and state taxes and subject to a statutory floor) 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. 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.

Robust Debt Service Coverage Provides Cushion

Coverage of TIBs has been strong, with a minimum of nearly 6x coverage of annual debt service from total pledged revenues since initial issuance. Fiscal 2019 pledged revenues of $16.5 million covered combined MADS by a robust 6.6x. Revenues have declined sharply during the pandemic, but Fitch views the existing coverage cushion as adequate to absorb likely declines. Through April, fiscal 2020 monthly collections averaged $1.3 million; May collections declined precipitously to $524 thousand, a 58% drop from April. The state preliminarily estimates total collections for fiscal 2020 were down approximately 11.6% from fiscal 2019 to $14.7 million. The state's August 2020 consensus revenue forecast calls for a further 12.9% decline to $12.8 million for fiscal 2021. Even at this reduced level, coverage of MADS would remain robust at more than 5x. Fitch anticipates revenue collections will remain susceptible to further wide volatility as the state and nation deal with the ongoing pandemic.

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 slow economic growth prospects.

Pledged revenues have been somewhat volatile in recent years, including a particularly sharp 26% decline in fiscal 2016 to approximately $15 million. Fitch attributes most of this volatility 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.

While pledged revenues are tied primarily to gasoline (90% of pledged revenues), the Act 40 statutory floor protects the state from sharp gasoline price weakening as occurred in fiscal 2015, mitigating the depth of future pledged revenue declines. Therefore, Fitch considers expectations for gasoline consumption as well as price when assessing growth prospects for pledged revenues.

Gasoline consumption trends in Vermont have been weak, with average annual declines of approximately 1% over the past decade. But Vermont's retail gasoline price increased notably through fiscal 2019 supporting strong growth in pledged revenues of approximately 11% as noted above. Consumption for fiscal 2019 was essentially flat. The 2019 gains reflect potential idiosyncrasies of the local retail market and Fitch does not consider them indicative of a fundamental positive shift in gasoline price growth in Vermont.

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

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 state's 3x pledged revenues policy guideline. The bonds carry a 2x additional bonds test, which Fitch does not anticipate Vermont will fully utilize given the state's generally cautious approach to debt issuance.

Fitch applies both a short-term coronavirus-driven stress and a long-term perspective to arrive at an assessment of the bonds' structural resilience. For the short-term analysis, Fitch estimates fiscal 2019 pledged revenues could withstand an up to 85% revenue decline and maintain sum sufficient coverage of maximum annual debt service. This is well in excess of Fitch's 34% coronavirus stress applied to most transportation tax credits. The 34% is informed by Fitch's initial coronavirus scenarios for passenger and truck traffic on U.S. toll roads incorporating significant traffic losses through 1H20 and moderate recovery through year end.

For the long-term assessment of structural resilience, Fitch applies FAST, using pre-pandemic moderate economic downturn expectation, considering 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. As noted above, trends in gasoline consumption (in addition to pledged revenues) are a key component of Fitch's dedicated tax bond analysis.

Fitch relies on estimated 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 FAST model generates a 9% scenario decline in pledged revenues. The largest decline was a 36% decline between fiscal 2013 and fiscal 2017.

Despite the recent steep declines, fiscal 2019 pledged revenues of approximately $16 million can still withstand a 67% decline while maintaining sum sufficient coverage of maximum annual debt service, assuming issuance up to the 3x policy guidelines. This is equivalent to more than 7x the scenario result, and 1.9x the worst actual decline in revenues.

When considering historical gasoline consumption, FAST (with pre-pandemic moderate economic downturn expectations) 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. Using gasoline consumption FAST results, fiscal 2019 pledged revenues can withstand a decline equivalent to nearly 21x the scenario result, and nearly 5x the worst actual consumption decline and still cover debt service.

Fitch's assessment of the security's resilience through a moderate economic downturn reflects the analyses using both historical pledged revenues and gasoline consumption. The 'aaa' assessment also reflects the statutory floor on gasoline prices which limits downside revenue risk related to price declines.

EXPOSURE TO ISSUER OPERATIONS

Linked to, But Not Capped by, State IDR

The rating on the transportation infrastructure bonds is linked to Vermont's 'AA+'/Stable IDR; however, the security's structural provisions could support a rating higher than the IDR if Fitch's assessment of the pledged revenue growth prospects and resilience to economic declines warranted such a rating. 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.

Pledged revenues are relatively narrow, representing only a modest portion of the state's overall revenue collections. The authorizing statute for TIBs indicates a specific but relatively broad use of proceeds for rehabilitation, reconstruction or replacement of various transportation infrastructure ranging from bridges to airports. And following debt service set-asides, residual pledged revenues flow outside of the indenture annually and can be used for other transportation capital needs.

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

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Vermont, State of (VT) [General Government]
----Vermont, State of (VT) /Fuel Tax Revenues/1 LT; Long Term Rating; Affirmed; AA; RO:Sta

Contacts:
Primary Rating Analyst
Eric Kim,
Senior Director
+1 212 908 0241
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street
New York 10019

Secondary Rating Analyst
Marcy Block,
Senior Director
+1 212 908 0239

Committee Chairperson
Karen Krop,
Senior Director
+1 212 908 0661

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

Applicable Model
Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).
FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

Additional Disclosures

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