2008 Annual Report

Office of the State Treasurer

State of Vermont

Issued January 2009

Jeb Spaulding
State Treasurer

109 State Street
Montpelier, Vermont
www.VermontTreasurer.gov

The Vermont State Treasurer's Office Strives to:

- Give Vermont taxpayers an excellent value.
- Offer the best customer service possible.
- Deliver the highest quality operational services.
- Create a productive employee work environment.

Office of the State Treasurer
Mission Statement

To manage the financial resources within our purview effectively and efficiently and to promote prudent financial practices in the State of Vermont.

Vision Statement

The overall vision of the State Treasurer's Office is to be the best office of the treasury in the U.S.A. This vision is further defined to state that the Treasurer's Office staff will:

- **Give Vermont taxpayers an excellent value.**

  Excellent value to Vermont taxpayers implies highly competent investment and funds management; and initiative and creativity to "leave no stone unturned" with regard to either maximizing returns on investments or achieving maximum savings without compromising other office objectives.

- **Offer the best customer service possible.**

  Excellent customer service implies an effort to understand customer needs, a timely and appropriate response, and a proactive approach to solving problems.

- **Deliver the highest quality operational services.**

  Providing high-quality services requires the pursuit of operating practices within the office that utilize valuable resources efficiently.

- **Create a productive employee work environment.**

  A productive employee work environment implies teamwork, satisfied and motivated staff, and an appropriate set of core objectives and values.

CORE VALUES & SUPPORTIVE BEHAVIORS

Integrity above all
Supported by honesty, fairness, trust, and self-reflection.

A strong team spirit
Supported by open communication, mutual respect and support, and consistent treatment of all.

Desire for excellence
Supported by professionalism, accountability, and pride in work.

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Our Commitment to Vermonters

The State Treasurer's Office manages money that belongs to all citizens of Vermont. The Treasurer and staff are committed to doing this honestly, efficiently, responsibly, and professionally. The Treasurer's office operates as a business, serving the needs of Vermonters while working to save the taxpayers money and earn the highest possible investment returns in its funds within acceptable risk parameters.

Letter of Transmittal

TO: Members of the General Assembly
Honorable James H. Douglas, Governor
Citizens of Vermont

As Vermont's State Treasurer, I have felt especially privileged to serve the people of Vermont during a period of substantial challenge for the state and nation. This past year has been a difficult one for many Vermonters. We have seen numerous job losses, lower housing values, increasing foreclosures, credit disruptions, and cuts in State services due to declining tax revenues. We are now officially in a recession, and the need for fiscal prudence and innovative approaches to managing State finances has never been greater. As part of my commitment to protecting Vermont's financial future, I stand ready to work diligently with the Governor, legislature, and other interested parties in developing avenues to deliver core government services in a cost-effective manner, to safeguard the State's financial assets, and to develop strategies to stimulate our economy.

The 2008 Annual Report of the Office of the State Treasurer reflects the impact of the economic downturn; in addition, it shows the value of established prudent financial practices that have served the state well to date, highlights the accomplishments of this office in the past year, and makes recommendations for future action.

As we address the challenges before us, we must be mindful of the prudent financial practices that have proved successful. For example, Vermont's disciplined approach to bonding and debt management in recent years resulted in Vermont rejoining the ranks of triple-A-rated states in February of 2007. This most favorable bond rating is extremely valuable in the current severe credit environment and should allow us to cost-effectively issue our general obligation bonds to meet our infrastructure needs, whereas less creditworthy issuers may well be constrained from meeting their needs at a reasonable cost.

In last year's report, I stated that the time was right for a thorough review of whether Vermont's approach and policies of the past 20 years relating to debt management and infrastructure financing still made sense in light of current circumstances. I am pleased to report that, in response, the legislature expanded the membership of the Capital Debt Affordability Committee to bring additional expertise to the table, and also expanded the committee's charge to include consideration of the impact of capital spending upon the economic conditions of the State and cost-benefit analysis of various levels of debt, types of debt, and maturity schedules. This will be very helpful in the coming months as we consider avenues to address our deteriorating infrastructure, while at the same time providing jobs in the current economy and preserving our favorable bond rating.

The 2008 General Assembly directed the Treasurer to prepare a report containing a long-term needs assessment for repair, maintenance, and rehabilitation of bridges and culverts in the state, and providing funding options and recommendations for such long-term needs. The report, reflecting outside expert financial consultation, clearly states that current revenue sources are not sufficient to address the deteriorating condition of Vermont bridges and that bonding alone, without concomitant additional revenues, would not be appropriate. The report outlined a number of funding and financing options, including a recommendation for a five-cent-per-gallon Motor Fuels Distributor Infrastructure Assessment (MFDIA). The MFDIA would fund a $150-$180 million bridge rehabilitation and replacement bonding program in issuances phased in over the next decade, beginning with a $30-$50 million issuance in year one, depending on the readiness of projects. An expanded effort to rehabilitate and replace, where necessary, Vermont's failing bridges would provide needed jobs and economic stimulus for Vermonters in this time of severe economic stress. The current depressed economic conditions are highly likely to provide a limited window of lower interest and construction inflation costs in the near to medium term. The time to take advantage of this opportunity is now and I urge the legislature to take up this issue early in the 2009 session.

An expanded effort to rehabilitate and replace, where necessary, Vermont's failing bridges would provide needed jobs and economic stimulus for Vermonters in this time of severe economic stress.

In addition to deteriorating bridges, Vermont has other pressing capital needs, including the rest of our highway program, school buildings, State parks, telecommunications, office buildings, laboratories, and more. Clearly, there is a need for a comprehensive capital financing strategy for the State of Vermont. I recommend the legislature establish a process to develop such a strategy.

A conservative approach to cash management by the Treasurer's office allowed us to avoid some of the attention-grabbing losses experienced by other states in their operating cash. To date, we have, through effective cash management and improved projection techniques, avoided the need for any short-term borrowing in anticipation of revenues. However, given the declining revenue base, we do expect that some form of short-term borrowing may be necessary in the fall/winter of 2009.

Vermont pension funds have experienced significant declines in 2008 due to global economic developments and a small number of investment managers whose performance has lagged, primarily related to dislocation in the credit markets, in the past year. As a result of outside review and legislative action, important changes to the Vermont Pension Investment Committee (VPIC) were made effective July 1, 2008, centering on streamlining the size and increasing the expertise of the VPIC. It is important to remember that the VPIC invests over a time horizon that lasts decades and that, despite short-term volatility, diversification combined with prudence and the utilization of established risk management practices will allow the pension funds to recover losses and realize future gains as the market recovers.

Warm & Weatherized Loan Program

This fall, the Treasurer's office partnered with TD Banknorth and Efficiency Vermont to make $2 million in unsecured loans available to homeowners who wanted to reduce their fuel costs by making their homes more energy efficient. Loans also were available to replace old, inefficient heating equipment. The interest rate for the loans was linked to the prime lending rate. In November, the 5-year fixed interest rate on program loans was 2.75 percent. The loan program runs through June 30, 2009. The Treasurer's office will be evaluating the program to determine whether to offer it again in fall 2009.

In April 2008, the Treasurer's office co-sponsored a statewide financial literacy poster contest and a State House ceremony as part of "Youth Financial Literacy Month." Above, Kelsey Craige of Allen Brook Elementary School in Williston is recognized for winning the elementary division of the contest.

The great majority of State employees, teachers, and municipal employees participate in defined benefit plans and have a legal right to their earned benefits. I want to reassure them that their pension benefits are safe. Their monthly pension benefit is based on various factors such as years of service and salary, not investment results, although a sustained, long-term decline in investment returns will have an impact on future required contribution levels by Vermont taxpayers.

The economic downturn has had a very significant adverse impact on expected revenue collections and has created considerable budgetary pressures. Despite declining State revenues, we need to continue our policies to reach full actuarial funding and resist the easy, but imprudent, urge to forego actuarially required pension contributions. The financial markets will rebound and every dollar we put into the pension funds will pay for benefits far in excess of that dollar through investment revenue over time.

At the same time, we also must take a hard look at retirement benefits. There should be no doubt that demographic and workforce trends have changed significantly since retirement benefits were first set up; we must consider whether current benefits, plan provisions, and contribution levels, including health care, are appropriate for the long term. Over the past two years, a collaborative successful effort led by the Treasurer's office resulted in a restructuring of benefits for State Group F members, the largest State employee group. This was a "win-win" solution, saving approximately $265 million over thirty years, while providing a cost of living adjustment for all Group F members and recalibrating benefits for new employees hired after July 1, 2008. We must continue to explore options that provide meaningful, fair, and affordable benefits, not only for State employees, but teachers as well.

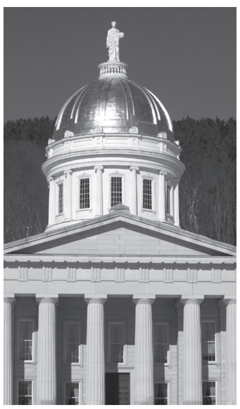
A collaborative effort led by the Treasurer's office resulted in a restructuring of benefits for State Group F members, the largest State employee group. This was a "win-win" solution, saving approximately $265 million over thirty years.

In 2008 the Treasurer's office marked the completion of several notable initiatives. My office spearheaded an initiative to provide a high-quality, low-cost supplemental retirement investment program for Vermont's teachers. The Vermont Municipal Employees' Retirement System was able to continue to make deposits into Retiree Health Savings Accounts, whereby retirees may take advantage of tax-free funds in the account for reimbursements for health-care costs. Leveraging State resources at no cost to the taxpayer, my office worked with TD Banknorth and Efficiency Vermont to make available to homeowners five-year low interest loans ranging from $2,500 to $5,000 for weatherization, helping to reduce fuel costs for Vermonters. Unclaimed property claims continued to rise significantly. My office introduced new financial education initiatives that included new workshops and seminars on planning for retirement and programs that encourage financial literacy among our youth.

These accomplishments and others are detailed throughout this report. None would have been possible without the dedicated and professional staff working within the Office of the State Treasurer and the help of our partners. This same effort will be required as we take on the economic and budgetary challenges in the coming months and years.

I urge all parties not to dismiss, out-of-hand, options that would allow us to address the fiscal obstacles that lie ahead, including carefully considered reductions in government spending and revenue increases.

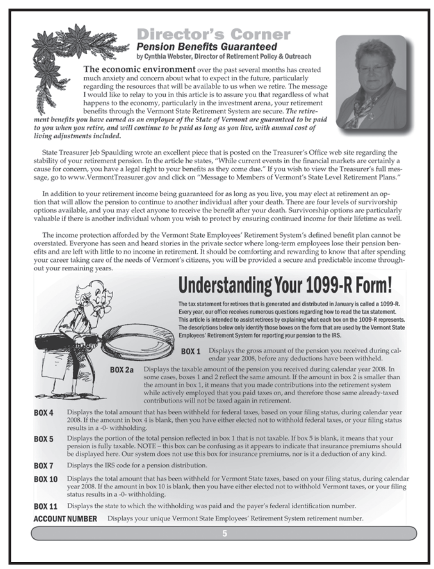
Like states across the country, Vermont faces daunting revenue declines and resulting budgetary challenges. As we consider alternatives on how best to manage our finances in an economic downturn and address longer term budgetary issues, I urge all parties not to dismiss, out-of-hand, options that would allow us to address the fiscal obstacles that lie ahead, including carefully considered reductions in government spending and revenue increases. Vermont has a history of tackling and surmounting challenges through collaborative efforts between the Governor's Office, the legislature, and interested citizens. I stand ready to assist in any way possible.



My staff and I are available to discuss the information in this report and welcome your inquiries and comments. You will find a great deal of additional information by visiting our web site at www.VermontTreasurer.gov.

Sincerely,

Jeb Spaulding
State Treasurer



Director's Corner

Pension Benefits Guaranteed

by Cynthia Webster, Director of Retirement Policy & Outreach

The economic environment over the past several months has created much anxiety and concern about what to expect in the future, particularly regarding the resources that will be available to us when we retire. The message I would like to relay to you in this article is to assure you that regardless of what happens to the economy, particularly in the investment arena, your retirement benefits through the Vermont State Retirement System are secure. ***The retirement benefits you have earned as an employee of the State of Vermont are guaranteed to be paid to you when you retire, and will continue to be paid as long as you live, with annual cost of living adjustments included.***

State Treasurer Jeb Spaulding wrote an excellent piece that is posted on the Treasurer's Office web site regarding the stability of your retirement pension. In the article he states, "While current events in the financial markets are certainly a cause for concern, you have a legal right to your benefits as they come due." If you wish to view the Treasurer's full message, go to www.VermontTreasurer.gov and click on "Message to Members of Vermont's State Level Retirement Plans."

In addition to your retirement income being guaranteed for as long as you live, you may elect at retirement an option that will allow the pension to continue to another individual after your death. There are four levels of survivorship options available, and you may elect anyone to receive the benefit after your death. Survivorship options are particularly valuable if there is another individual whom you wish to protect by ensuring continued income for their lifetime as well.

The income protection afforded by the Vermont State Employees' Retirement System's defined benefit plan cannot be overstated. Everyone has seen and heard stories in the private sector where long-term employees lose their pension benefits and are left with little to no income in retirement. It should be comforting and rewarding to know that after spending your career taking care of the needs of Vermont's citizens, you will be provided a secure and predictable income throughout your remaining years.

Understanding Your 1099-R Form!

The tax statement for retirees that is generated and distributed in January is called a 1099-R. Every year, our office receives numerous questions regarding how to read the tax statement. This article is intended to assist retirees by explaining what each box on the 1009-R represents. The descriptions below only identify those boxes on the form that are used by the Vermont State Employees' Retirement System for reporting your pension to the IRS.

BOX 1 Displays the gross amount of the pension you received during calendar year 2008, before any deductions have been withheld.

BOX 2a Displays the taxable amount of the pension you received during calendar year 2008. In some cases, boxes 1 and 2 reflect the same amount. If the amount in box 2 is smaller than the amount in box 1, it means that you made contributions into the retirement system while actively employed that you paid taxes on, and therefore those same already-taxed contributions will not be taxed again in retirement.

BOX 4 Displays the total amount that has been withheld for federal taxes, based on your filing status, during calendar year 2008. If the amount in box 4 is blank, then you have either elected not to withhold federal taxes, or your filing status results in a -0- withholding.

BOX 5 Displays the portion of the total pension reflected in box 1 that is not taxable. If box 5 is blank, it means that your pension is fully taxable. NOTE – this box can be confusing as it appears to indicate that insurance premiums should be displayed here. Our system does not use this box for insurance premiums, nor is it a deduction of any kind.

BOX 7 Displays the IRS code for a pension distribution.

BOX 10 Displays the total amount that has been withheld for Vermont State taxes, based on your filing status, during calendar year 2008. If the amount in box 10 is blank, then you have either elected not to withhold Vermont taxes, or your filing status results in a -0- withholding.

BOX 11 Displays the state to which the withholding was paid and the payer's federal identification number.

ACCOUNT NUMBER Displays your unique Vermont State Employees' Retirement System retirement number.

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In September, the Treasurer's office reassured members of Vermont's three defined benefit plans about the security of their retirement benefits and the investments that support those benefits. Through the office web site and in the newsletter *Retiring Times*, members were reminded of their legal right to their pension benefit.

About the Treasurer's Office

Administrative & Service Duties

The State Treasurer's Office serves as the State's banker and chief investment officer. We handle money that belongs to all of the citizens of Vermont. We are committed to managing these funds honestly, efficiently and responsibly, and to maintaining Vermont's hard-earned reputation as a fiscally sound and disciplined state.

Specific administrative and service duties as prescribed by State statutes include:

- **Investment of State funds.**
- **Issuing all State bonds authorized by the General Assembly.**
- **Serving as the central bank for State agencies.**
- **Management of the State's cash balances, processing of checks, and the reconciliation of payroll and vendor checks.**
- **Safeguarding and return of unclaimed or abandoned financial property, which is held in trust by the State until the rightful owner can be located.**
- **Administration of three major pension plans, the deferred compensation plan, and the defined contribution plan for State employees, teachers, and participating municipalities.**

Executive Office
(802) 828-1452

Jeb Spaulding
State Treasurer

Beth Pearce
Deputy Treasurer

Barbara Agnew
Executive Staff Assistant

Office Organization

The State Treasurer's Office is organized into an executive office and five divisions. The executive office is responsible for overall strategic planning, legislative initiatives, constituent relations, debt management, financial literacy, and supervision of the divisions.

The Treasury Operations Division is responsible for the State's banking, cash management, and financial transaction services. The Retirement Division administers three public retirement systems authorized by the legislature (see report section on Vermont Retirement Systems). Debt Management and Investment Services provides cash, investment and debt management for the State of Vermont and the three pension systems administered by the office. The Unclaimed Property Division serves as the caretaker of abandoned or unclaimed financial property, while seeking to return it to its proper owner. Technology Services is responsible for developing and maintaining automated systems, providing appropriate access to information, maintaining the office web site, and maintaining the overall security of the office network and automated interactions with other State department and entities outside of State government.

Team of the Year

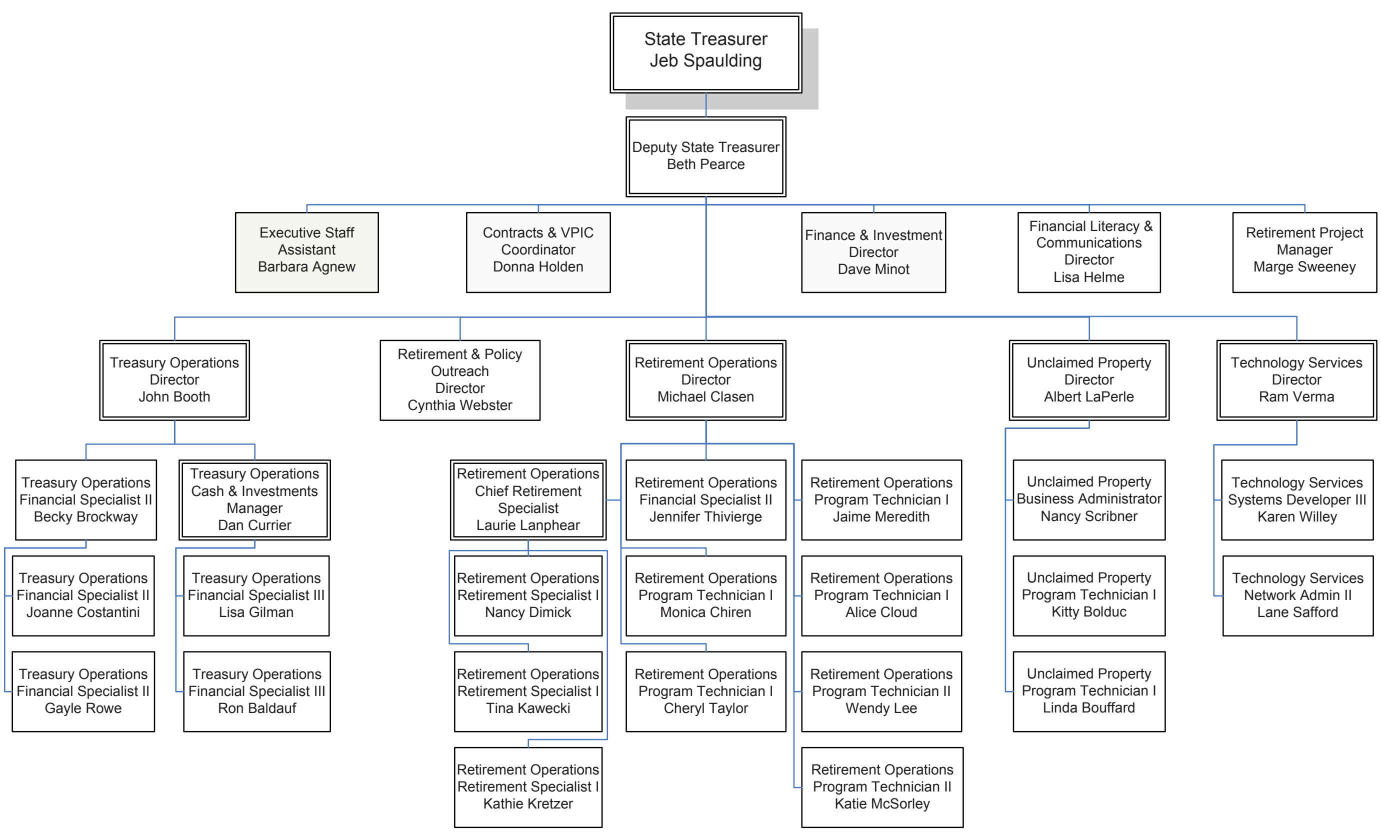
The State Treasurer's Office "Team of the Year" selection is two employees who are accustomed to being on the "front line" when it comes to public service. The selection was part of the State's annual Public Service Recognition Week 2008 observances. Retirement Operations Program Technicians Monica Chiren and Cheryl Taylor were recognized for their sense of professionalism, thoughtfulness and job knowledge. In their nominating material, the two were praised for, "routinely going the extra step to help a member or co-worker, even when their own workload is stressful and overwhelming. In addition to staying on top of their own responsibilities, they manage to deal with an everchanging flow of information—reorganizing schedules and deadlines with grace and a sense of humor."

Retirement Operations Program Technicians Monica Chiren and Cheryl Taylor (l to r) were named Team of the Year for the Office of the State Treasurer.

Organizational Chart

There are 34 staff members working within the State Treasurer's Office. Below is the office organizational chart. The organizational chart and staff listings in this report are effective as of February 1, 2009.

Vermont State Treasurer's Office



Addressing Challenges

Retirement plans administered by the State Treasurer's Office serve approximately 44,000 active and retired members. These plans serve members of the Vermont State Employees' Retirement System (VSERS), Vermont State Teachers' Retirement System (VSTRS), and the Vermont Municipal Employees' Retirement System (VMERS). Each system is statutorily overseen by a Board of Trustees. The boards addressed a variety of issues in 2008.

Boards Administration
(802) 828-2302

Cynthia Webster
Executive Secretary of the Boards and Director of Retirement Policy & Outreach

Monica Chiren
Assistant to the Boards

UPDATES

The boards have a great responsibility that entails balancing the needs of their members with the escalating cost of addressing those needs, while providing secure and adequate benefits after retirement. With more than 11,550 retirees currently receiving pensions totaling over $157.2 million annually, the task is staggering. In addition to the existing retirees, the demographics of the three systems reflect that another 9,200 members will be eligible to retire within the next five years.

The boards have a great responsibility that entails balancing the needs of their members with the escalating cost of addressing those needs, while providing secure and adequate benefits after retirement.

A central focus of all three boards is to advocate full funding of the systems. This means that they continue to request and expect that the required contributions will be made by both the members and the "employer." The employer contribution for the Teachers' and State systems are paid by the State of Vermont. The employer contribution for the Municipal system comes from individual municipal entities that participate in the system. The boards have taken steps to improve benefits for their retired members in a variety of ways. For example, the Teachers' board was successful in winning legislation that allowed them to create and offer a state-wide 403(b) tax-sheltered savings plan to school districts in Vermont. The plan offers a high-quality, low-cost option for school district employees to set aside personal savings that may be accessed in retirement. A retiree dental plan was also successfully implemented in March of 2008 for all existing and future retired teachers. The Municipal board implemented a Retiree Health Savings account in July of 2007, providing funds to active and retired members that may be accessed after retirement to pay for medical-related expenses. The State board sought to enhance the 457 tax-sheltered savings plan available to State employees by lowering fees and providing more options to assist participants in their investment choices. More about these programs may be found in the Retirement Division Operations section.

Finally, members of the State board and Treasurer's staff played a key role in an initiative that resulted in the passage of a comprehensive legislative bill that provided for a full cost-of-living adjustment to future State retirees, coupled with adjustments to benefits for future new hires. The bill actually resulted in the savings of taxpayer dollars immediately, and has the expectation of saving $265 million in taxpayer dollars over the next 30 years. More about the comprehensive legislative package can be found in the Legal Services section of this report.

The Boards of Trustees

The Boards of Trustees are statutorily charged with establishing rules and regulations for the administration of their systems and for the transaction of their business. The boards delegate the day-to-day administration of the plans to the Retirement Division staff, utilizing the governing statutes and board-established rules and policies as guidelines. If questions arise, or if a member or retiree does not agree with a decision made by staff, they may appeal to the Board of Trustees for re-consideration.

The Attorney General's Office provides legal counsel to the boards when necessary. The boards also are charged with approving regular retirement applications, disability retirement applications, and withdrawals from membership. Each Board of Trustees acts as a fiduciary of the funds held on behalf of its members and retirees. The boards are required to keep a record of their proceedings which are open to the public. Each board designates an actuary to make an annual valuation of the assets and liabilities of the funds of the system. Based on the actuarial recommendation, the State and Teachers' Retirement System Boards of Trustees advise the Governor on the annual amount of State contribution that should be appropriated for the next fiscal year to achieve and preserve the financial integrity of the funds.

Below is the current membership of the three Boards of Trustees. State Treasurer Jeb Spaulding is an *ex officio* member of all boards.

Vermont State Employees' Retirement System

Warren Whitney, Chair, VSEA
Jeb Spaulding, Vice Chair, Treasurer's Office
James Reardon, Commissioner, Dept. of Finance & Management
David Herlihy, Commissioner, Dept. of Human Resources
Richard Johannesen, Governor's Appointee
Kevin Gaffney, VSEA
Robert Hooper,VSEA
Roger Dumas, VRSEA
Donald Robisky, Alternate-VSEA
Joe Healy, Alternate-VRSEA

Vermont State Teachers' Retirement System

Jon Harris, Chair, Active Teachers
Joe Mackey, Vice Chair, Retired Teachers' Association
Jeb Spaulding, Treasurer's Office
Vacant, awaiting appointment, Active Teachers
Thomas Candon, Banking, Insurance, Securities & Health Care Admin.
Vaughn Altemus, Department of Education

Vermont Municipal Employees' Retirement System

Steve Jeffrey, Chair, Employee Representative
David Lewis, Vice Chair, Employer Representative
Jeb Spaulding, Treasurer's Office
Stephen Rauh, Governor's Delegate
Peter Amons, Employee Representative

Board Changes in 2008

In July, long-time VMERS board member Jack Mitchell retired. He served almost three decades on the board, helping to create three new defined benefit plans, an alternative defined contribution plan and a retiree health savings account option.

Jack Mitchell

In August, VSTRS board member Jay Kaplan succumbed to lung cancer. He had served as a trustee since 1989. During his tenure he fought for full funding of the retirement system, led in putting together an array of health care plan options, and served for ten years as Chair of the Board of Trustees. The valuable work of both board members is greatly appreciated.

Jay Kaplan

Retirement Division Operations

Above, State employee Harold Schwartz speaks with Cynthia Webster of the Treasurer's office and Chip Sanville of Great-West about retirement planning at one of three information booths held in observance of "Save For Retirement Week" in October.

Overview

In accordance with State statutes, each retirement system is administered by a board of trustees. The boards administer the State's three defined benefit pension plans and two defined contribution plans, with day-to-day administration provided by the Treasurer's office. The Vermont State Employees' Retirement System (VSERS) is a single-employer public employee defined benefit retirement

ACCOMPLISHMENTS IN 2008

- **The Retirement Division staff conducted 1,136 individual counseling sessions during fiscal year 2008, a 3 percent decrease over the prior year. It is noteworthy to point out that the staff still conducted nearly the same number of counseling appointments as they did in 2007, while at the same time devoting significant time to testing the new VPAS pension administration system. The staff also calculated more than 6,377 retirement estimates at the request of prospective retirees and conducted 61 member informational sessions across the state with 1,285 individuals in attendance.**

- **Effective July 1, 2008, Act 162 provided the authority for the VSTRS Board to create a state-wide 403(b) Investment Program to be selected by public school districts to assist their employees in saving for retirement. A 403(b) Investment Program allows employees to deduct money from their wages on a tax-deferred basis. The money may be accessed at any time after age 59-½ in a variety of ways to supplement income during retirement. Through a Request for Proposals process, the board selected Great-West Retirement Services to administer the new program. The program began accepting contributions on January 1, 2009.**

- **In July of 2007, the Vermont Municipal Employees' Retirement Systems' (VMERS) Board of Trustees created a Retiree Health Savings (RHS) Plan administered by ICMA-RC. The RHS Plan was designed to provide members and retirees with funds which could be used on a tax-free basis to reimburse medical expenses and insurance premiums incurred and paid for after retirement. Since its creation, $11 million has been deposited into the account. As of January, 2009, approximately $421,100 had been paid out of the account to assist retirees with their medical expenses.**

- **Legislation passed in 2007 allowed the office to offer a dental insurance plan to retired teachers, provided the retirees paid the full cost associated with the premiums and administration of the plan. Following the development of a Request for Proposals, a competitive bid process was conducted, and Northeast Delta Dental was selected as the insurance provider. Enrollment began in December 2007, and as of March 2008, more than 1,000 retired teachers signed up for coverage.**

- **Three new entities joined the Vermont Municipal Employees' Retirement System.**

Retirement Operations

(802) 828-2305
(800) 642-3191 (toll-free in Vermont)

Michael Clasen, Retirement Operations Director

Cynthia Webster, Retirement Policy & Outreach Director

Laurie Lanphear, Chief Retirement Specialist

Monica Chiren, Program Technician I

Alice Cloud, Program Technician I

Nancy Dimick, Retirement Specialist I

Tina Kawecki, Retirement Specialist I

Kathleen Kretzer, Retirement Specialist I

Wendy Lee, Program Technician II

Katherine McSorley, Program Technician II

Jaime Meredith, Program Technician I

Marge Sweeney, Retirement Project Manager

Cheryl Taylor, Program Technician I

Jennifer Thivierge, Financial Administrator II system that covers substantially all general State employees and State Police. The Vermont State Teachers' Retirement System (VSTRS) covers nearly all public day school and nonsectarian private high school teachers and administrators, as well as teachers in schools and teacher training institutions within and supported by the State that are controlled by the State Board of Education. The Vermont Municipal Employees' Retirement System (VMERS) is a multiple-employer public employees' retirement system. Employer contributions are made by the participating municipalities. It is designed for school districts and other municipal employees that work on a regular basis and also includes employees of museums and libraries, if at least half of that institution's operating expenses are met by municipal funds.

The State established an optional defined contribution plan for exempt State employees effective January 1, 1999. Although the Retirement Division has contracted with a third-party administrator (Fidelity Investments) to handle the investment options and day-to-day bookkeeping responsibilities, the office is responsible for providing new hires with information and comparisons of projected benefits under both plans. It also conducts one-on-one counseling to assist in the election process. Staff members process all transfers between the plans, and receive and transmit all contributions on behalf of the defined contribution members. Detail on these plans is included on page 13.

Outeach to members is an important goal of the Retirement Division. This poster helped to attract visitors to a Retirement Division booth for VMERS members at the annual Vermont League of Cities and Town Fair in October. Approximately 200 people visited the booth.

The Retirement Division also administers a deferred compensation (457) program for State and municipal employees and has recently expanded to teachers. Details are provided on page 14. In addition, there is also a single depository investment account (SDIA)--a tax-sheltered account funded through employee transfers to a non-contributory system for State employees and teachers. This is a closed fund with no new additional contributions. The SDIA funds are not available to the members until they retire or terminate employment. As of June 30, 2008, there were 2,213 SDIA members, with net assets of $84,574,089. Great-West Retirement System provides third-party administration for these services. Finally, the office administers a Retiree Health Savings plan for VMERS members. While health insurance is not available to retired municipal members, this plan provides a vehicle to set aside limited funds to reimburse retirees for medical expenses.

The primary function of the Retirement Division staff is to serve the needs of the active contributing members and retired members receiving benefit payments.

The State Employees' Post-employment Benefit Pension Trust Fund (an OPEB Trust Fund) was established in fiscal year 2007 as an irrevocable trust fund for the purpose of accumulating and providing reserves to support VSERS retiree post-employment benefits. While additional State appropriations may be made to this fund, contributions to date only include medical subsidy reimbursements from the federal government for the Medicare D program. During fiscal year 2008, the State contributed $1,444,757 to this fund. The fund had total assets of $3,663,517 as of June 30, 2008.

A complete detailing of the defined benefit, defined contribution, and OPEB balance sheets and results of operations is included later in this section of the annual report.

Current Environment

As economic conditions steadily worsened in 2008, the division was challenged to respond to numerous inquiries from retirees and employees about the security of their retirement benefits. The vast majority of State employees, teachers, and municipal employees participate in a defined benefit pension plan. Under such a plan, the employee is entitled to a specific amount of benefit, based on years of employment and salary history, regardless of the investment expenses or changes in the stock market. The division will continue efforts to communicate with members about the security of their pensions.

Under a defined benefit plan, the employee is entitled to a specific benefit, based on years of employment and salary history, regardless of changes in the stock market.

The largest expenditure for all three defined benefit plans is the retirement benefit. During fiscal year 2008, the three retirement systems paid out more than $157 million in monthly benefit payments. As noted in the Appendices, page 55, the benefit payout number continues to rise as more employees retire and as retirees live longer. This will put a continued burden on the systems and increases the need to meet annual funding requirements. In addition, both VSERS and VSTRS have traditionally offered health insurance to their members by picking up a large portion of the premium – 80 percent for retired teachers and 80 percent for retired State employees and their dependents. In fiscal year 2007, these health care expenses for the two retirement systems totaled more than $31.66 million. VMERS does not offer a health insurance plan. In an effort to provide some health care assistance to members without undue burden to local municipalities, the VMERS board established a new health retirement savings plan in 2008 (see update page 14).

UPDATES

Serving Members' Needs

The primary function of the Retirement Division staff is to serve the needs of the active contributing members and retired members receiving benefit payments. On the active member side, the Retirement Division oversees enrollments, transfers, refunds, processing of employee and employer contributions, and adjustments to members' accounts. On the retiree side, the division oversees the issuance of the payroll, changes to dependents, adjustments to payments, and replacement checks. Other responsibilities include employee re-instatements, calculation of buybacks and refunds, disability retirements, and determination of survivor benefits. The division manages an extremely high volume of inquiries by phone, e-mail, and face-to-face appointments. The division's accountant maintains all retiree data and ensures the timely processing of approximately 12,000 pension payments each month. Below is an update of division activities.

Retirement Division Performance Indicators

Activity	2008	2007	2006	2005	2004	Percent Change 2004 - 2008	Percent Change 2007 - 2008
Estimates	6,377	8,213	8,672	7,031	4,700	36%	-22%
Individual Counseling	1,136	1,173	1,050	1,216	1,070	6%	-3%
Retirements	867	788	785	716	655	32%	10%
Withdrawals	945	1,507	1,485	2,816	3,072	-69%	-37%
Deaths	368	333	278	279	265	39%	11%
Seminars	61	88	51	53	57	7%	-31%
Seminar Attendance	1,285	1,881	1,381	1,386	1,749	-27%	-32%

Comparative Membership Information--Vermont Retirement System

Vermont State Employees' Retirement System

	June 30, 2008	June 30, 2007	Percent Change
Active Members			
Vested	5,753	5,709	0.77%
Not Vested	2,689	2,702	-0.48%
Total Active Members	8,442	8,411	0.37%
Average Age	46.55	46.21	0.74%
Average Service	12.27	12.06	1.74%
Average Compensation	$ 47,967	$ 46,001	4.27%
Retired Members and Beneficiaries			
Number	4,555	4,399	3.55%
Annual Retirement Allowances	$ 65,701,435	$ 61,403,641	7.00%
Inactive Members	900	935	-3.74%
Terminated Vested Members	789	790	-0.13%

State Teachers' Retirement System of Vermont

	June 30, 2008	June 30, 2007	Percent Change
Active Members			
Vested	7,902	7,977	-0.94%
Not Vested	2,783	2,698	3.15%
Total Active Members	10,685	10,675	0.09%
Average Age	46.89	46.88	0.02%
Average Service	13.62	13.66	-0.29%
Average Compensation	$ 50,146	$ 48,297	3.83%
Retired Members and Beneficiaries			
Number	5,555	5,192	6.99%
Annual Retirement Allowances	$ 82,480,807	$ 74,726,093	10.38%
Inactive Members	2,929	2,901	0.97%
Terminated Vested Members	705	741	-4.86%

Vermont Municipal Employees' Retirement System

	June 30, 2008	June 30, 2007	Percent Change
Active Members			
Vested	3,424	3,249	5.39%
Not Vested	2,995	2,917	2.67%
Total Active Members	6,419	6,166	4.10%
Average Age	47.27	47.01	0.55%
Average Service	7.02	6.79	3.39%
Average Compensation	$ 27,402	$ 26,325	4.09%
Retired Members and Beneficiaries			
Number	1,447	1,309	10.54%
Annual Retirement Allowances	$ 9,015,096	$ 7,804,774	15.51%
Inactive Members	2,035	2,064	-1.41%
Terminated Vested Members	486	432	12.50%

New 403(b) Program Created

Act 162, effective July 1, 2008, provides the authority for the VSTRS Board to create a state-wide 403(b) Investment Program to be selected by public school districts to assist their employees in saving for retirement. A 403(b) Investment Program allows employees to deduct money from their wages on a tax-deferred basis that may be invested in a variety of mutual funds during the employees' working years. The money may be accessed at any time after age 59-½ in a variety of ways to supplement income during retirement. The 403(b) contributions reduce taxable wages during employment, and the money accumulates tax-free until the money is withdrawn after retirement. At that time, all of the money is taxable as regular income to the participant. The Internal Revenue Code has a cap on the amount of earnings that may be contributed into a 403(b) Program each year.

Employees electing to participate in the plan will know up-front what fees they will be paying for management of the mutual funds as well as what they will be paying for administrative fees.

The cap is currently $15,500, with additional amounts that may be contributed if you are over 50 or within a specified period from retirement. Through a Request for Proposals process, the board selected Great-West Retirement Services to administer the new VSTRS 403(b) Investment Program which was marketed to school districts beginning in early September. The new program began accepting contributions on January 1, 2009. The VSTRS Board is committed to offering a high-quality, low-cost investment program that is easy to understand and utilize. A unique feature of the program is the total transparency of all fees associated with the program. Employees electing to participate in the plan will know up-front what fees they will be paying for management of the mutual funds as well as what they will be paying for administrative fees. Many 403(b) investment products offered in the past have hidden fees that are buried in the investment returns. The board feels it is important to ensure participants understand all fees associated with an investment program so they can make an informed decision regarding the most appropriate program for them. Another unique feature of the VSTRS' 403(b) Investment Program is the on-going monitoring of the mutual funds available through the plan. Investment Policy Guidelines will be established to ensure that all of the funds offered are of the highest quality in their respective asset classes, and continue to meet the performance criteria contained in the guidelines. As the VSTRS Board is not looking to make a profit, they will not hesitate to replace an under-performing fund with another in its class that better meets the Investment Policy Guidelines.

UPDATE: 457 Deferred Compensation Program

The deferred compensation program has been available since 1979 as a savings option for State employees, municipal employees, employees of agencies such as VEDA and VHFA, and members of the General Assembly. The program is administered by Great-West Retirement Services. Since the deferred compensation plan qualifies as a Section 457 plan under the Internal Revenue Code, the portion of salary that is deferred is not taxed at the time of deferral. On June 30, 2008, the plan had 6,506 participants. Total assets in the plan were valued at $243.44 million. Participating employees made contributions in the amount of $18.06 million to the plan during fiscal year 2008.

Retiree Health Savings Plan Update

In July of 2007, the Vermont Municipal Employees' Retirement Systems (VMERS) Board of Trustees created a Retiree Health Savings (RHS) Plan administered by ICMA-RC. The RHS Plan was designed to provide members and retirees with funds which could be used on a tax-free basis to reimburse medical expenses and insurance premiums incurred and paid for after retirement. The VMERS Board determined that all active and retired members that had paid contributions into the VMERS for a minimum of five years as of June 30, 2006, would be eligible to participate in the RHS plan. On July 2, 2007, the Board distributed over $5 million into 3,545 active member accounts and 1,159 retired member accounts. The RHS Plan money is invested into individual, age appropriate Milestone accounts at

ICMA-RC. Active members cannot use the RHS Plan funds until they begin to draw their VMERS pension benefits. Retired members may use the money at any time for medical and insurance expenses incurred and paid after July 1, 2007. A second contribution of $3.5 million was made into the RHS accounts on August 1, 2008, and a third contribution of approximately $2.5 million is expected to be made by the end of January 2009, for a total combined deposit of $11 million. The August 1 contribution was shared by 5,079 existing and new RHS accounts established for active or retired members who did not have the required five years of contributory service at June 30, 2006, but reached the minimum requirement by June 30, 2007. From July 1, 2007, through June 30, 2008, approximately $409,100 was disbursed to retired members seeking reimbursement for their medical and premium expenses. Comments from retirees who have used their RHS money have been overwhelmingly positive. Many feel it makes a very real difference in being able to pay for their medical care, and even in deciding whether to go to their physician or not.

Retirement Re-engineering Project

The Retirement Division is now testing the State's new Vermont Pension Administration System (VPAS). The new software system will replace the current pension data management system that has been in place for more than 25 years. VPAS features a fully integrated browser-based pension system. The new system will, when fully operational, allow members to access their information via the web.

Work now underway includes a "cleaning" of the data to ensure the accuracy and the performance of the new system. The first phase of a two-phased approach to install the pension software is expected to "go live" in 2009. Phase one, the active members phase, involves the activities dealing with a member prior to retirement and includes employer reporting, annual statements, estimates and retirement planning, and purchases of service credit. The second phase, the retired member phase, deals with the activities of members once retired and includes pension payments, tax withholdings, and insurance deductions. The benefit phase is also expected to "go live" in 2009. It's estimated that web-based access also will become available in 2010.

Retirement Division staff are now operationally testing VPAS using a wide range of user scenarios. With the implementation of VPAS, every aspect of the daily business of the division will be affected. This solution will provide the State of Vermont with a stable, state-of-the-industry, fully-integrated pension administration solution that will allow the division to operate its business more efficiently and effectively. The new system will also provide an infrastructure that lends itself to changing technology and provide a broader framework for administering the system. Additionally, customers' needs for increased access to services and more timely information will also be met.

Defined Contribution Plan

Established in 1999, the State's defined contribution plan had 585 participants and net assets of $39,161,121 as of June 30, 2008. Under the defined contribution plan, which is modeled after private sector 401(k) plans, employees contribute 2.85 percent of their annual salary to their individual accounts. The State makes a fixed contribution of 7 percent to each employee's account. Employees are responsible for making all investment decisions. Fund line-ups are negotiated by the Treasurer's office and included in the contract with plan administrator, Fidelity Investment. At retirement or termination, employees receive the amount of contributions in their accounts, plus investment earnings. The defined contribution plan provides portability for an increasingly mobile workforce.

The State's defined contribution plan offers 11 mutual funds in equity, balanced, and fixed income asset classes, and age-based "life-cycle" funds that rebalance a multi-asset class portfolio of mutual funds appropriate to the age of the plan participant. Options include a stable value fund that has insured principal value; an intermediate term bond fund; a balanced fund of stocks and bonds, large-, mid- and small-capitalization domestic equity funds; and an international equity fund. The plan is self-directed with respect to investment selection, meaning that participants elect investment options consistent with their risk and reward preferences along with the timing of their need to access funds. In calendar 2007, the State modified and renewed its contract with the plan's administrator following a lengthy RFP (Request for Proposals) process. The new contract provides for increased flexibility to change investment options when warranted, and the plan continues to be provided to participants without costs above the fund investments' intrinsic expense ratios.

The Vermont Municipal Employees' Retirement System was given statutory authority in 1999 to approve a defined contribution plan for its members. The board implemented a defined contribution plan on July 1, 2000. The plan provides the employer municipality with the first option of deciding whether or not to offer a defined contribution plan to its employees. Once a municipality elects to offer the plan to all eligible employees or to specific employment groups, an individual employee has the choice to remain with the defined benefit plan or transfer to the new defined contribution plan. New employees of municipalities offering both a defined contribution plan and a defined benefit plan have a choice of either plan. As of June, 30, 2008, there were 71 contributing municipalities with 594 participants and net assets of $13,275,745.

Pension Funding

The VSERS, VSTRS, and VMERS defined benefit systems are funded by employee contributions, employer or State contributions, and interest earnings on the assets of the funds. These funds are used to pay current benefit payments, health care (VSERS and VSTRS), investment manager expenses, and the retirement office expenditures. The results of operations for the three systems are reported in detail in the Appendices, page 55 of this report. The charts on pages 56-57 provides a synopsis of operations at a higher level. Through the fiscal year ending June 30, 2008, pension fund assets on a net basis decreased by $276.56 million. As defined benefit plans, there is a promise to provide its members with a monthly benefit beginning at each member's retirement for the rest of his/her life (or beneficiary, depending on retirement options selected). In order to meet these obligations, each plan has developed a funding plan to accumulate monies, which, properly invested over time, will fund member retirements.

Employee Contributions: There are various group plans within the retirement system with varying contribution rates and benefits. During the fiscal year ending June 30, 2008, plan members made approximately $18.6 million in contributions in VSERS, $22.9 million in VSTRS, and $9.9 million in VMERS.

Employer Contributions: In fiscal year 2008, the VSERS received $39.2 million in employer contributions. These included an amount set by the State's independent actuary for pension benefits, and for various expenses of the fund.

The VSTRS system received $39.6 million in State contributions. In addition, the VSTRS system received approximately $1.4 million from the federal Medicare D program. Local school system employees remit the employee contributions, but the "employer contribution" is made through State appropriation rather than as an expense of the local school or district. The State's contributions to each system are based on percentage rates of each member's annual earnable compensation. These rates include a "normal contribution" rate and an "accrued liability contribution" rate and are fixed on the basis of the liabilities of the systems as shown by actuarial valuations. In the case of VMERS, local employers pay monthly into the pension fund based on fixed percentage of salary on a schedule approved by the Board of Trustees after a review of actuarial data. No state appropriations are used to fund VMERS.

Investments: Accumulated funds are invested by the Vermont Pension Investment Committee (VPIC) on behalf of each retirement system. Over time, interest on investments is the largest source of funds to pay benefits. In fiscal year 2008, the funds lost $213.6 million (net of investment expenses). The investments will vary from year to year, based on market conditions, but over time they consistently produce income to fund future retirement benefits. The investments section of this report provides extensive information on pension investment performance.

Actuarial Funding

Each year, employer contribution rates are determined based on an actuarial valuation. The employers' annual normal cost represents the present value of benefits that have accrued on behalf of the members during the valuation year. In addition to an annual normal cost, an employer may also be required to make payments toward the pension system's unfunded actuarial liability. An employer accrued liability contribution consists of the employer's share of the pension system's total unfunded actuarial liability amortized over a period set by statute of no more than 30 years. The unfunded actuarial liability of a retirement system at any time is the excess of the system's actuarial liability over the value of its assets.

The actuarial method for both the VSTRS and the VSERS plans are set by State statute. Through fiscal year 2005 the method used was the entry age normal (EAN) with frozen initial liability (FIL). The legislature has enacted a statutory change revising the method to entry age normal without FIL for the actuarial valuation for the year ending June 30, 2006, which effectively restated the starting balance. Under the previous method, the unfunded liability was frozen at 1988 levels. Any impact of underfunding subsequent to the "freezing" of the liability in 1988 falls to normal cost instead of being added to the unfunded liability, as in more conventional funding methods. In the case of VSTRS, where there had been substantial underfunding of the actuarially-determined annual required contribution (ARC), the EAN-FIL method had the effect of creating an improving funding ratio—although the total required contribution rapidly escalated (sum of the amortized unfunded actuarial accrued liability and normal). The unfunded actuarial accrued liability is amortized in a deterministic manner under the FIL method, making it easy for the ratio to rise from one year to the next, even in the presence of substantial underfunding. The shift to the EAN method, therefore, has had the effect of increasing the actuarially unfunded liability and reducing the normal contribution. The State believes that the EAN method is a more accurate indicator of actuarial funding progress and it is, in fact, the predominant method used by public retirement systems.

In the case of VSTRS, there was a historical pattern of underfunding of the State contributions paid into the fund. The 2005 General Assembly created the Commission on Funding the State Teachers' Retirement System, chaired by the State Treasurer, to address underfunding and to make recommendations to ensure an adequate, sustainable, and actuarially sound retirement benefit plan. The commission published its recommendations in December 2005 for consideration by the legislature in the session beginning in 2006. The legislature largely adopted the recommendation, including the above referenced change in actuarial method. In addition, the Governor recommended, and the legislature appropriated, full funding of the actuarial recommendation in the fiscal year 2007, 2008, and 2009 budget, through a combination of base appropriations and one-time funding.

UPDATE: Single Deposit Investment Account

The Single Deposit Investment Account (SDIA), a non-contributory defined contribution plan reported in the Pension Trust Funds, was established according to the provisions of Public Act 41 of the 1981 Session. The SDIA was intended to provide an investment vehicle in which to deposit contributions made by members of the State and Teachers' contributory retirement systems who voluntarily elected to transfer to the newly established non-contributory retirement systems. In addition to the initial deposits made into the SDIA in 1981, there were three subsequent opportunities (in 1984, 1987, and 1990) for contributory members to transfer to the non-contributory plans and invest their accumulated contributions and interest in the SDIA. No new monies have been invested in the SDIA since 1990. As of June 30, 2008, the SDIA plan had 2,213 members and beneficiaries and has approximately $84.5 million in net assets. Administrative services for the SDIA are provided by Great-West Retirement Services. Great-West administers the day-to-day activities of the SDIA, including maintaining all demographic and beneficiary information, processing all requests for withdrawals and minimum distributions, and maintaining member account value information.

Using the Commission's findings, the legislature adopted a plan to increase the "base" funding each year, over a five-year period, so that funding is included and less reliant on the existence of one time funds. For the fiscal year 2009 budget, the breakdown is as follows:

FY09 Actuarial Required Contribution	$37,077,050
Base Appropriation	$33,549,097
Surplus Funds	$2,300,000
Medicare D	$1,227,953
TOTAL:	$37,077,050

Given the declining revenue base for fiscal years 2009 and 2010, reliance on the availability of surplus funds to pay a portion of the actuarial required contribution may pose serious risk to the planned goal of full funding. In addition, weak investment performance through fiscal year 2008 and incremental increases to the normal and unfunded liability components have resulted in an increase in the actuarial recommendation for fiscal year 2010 to $41,503,002. Continued commitment to funding this actuarially calculated contribution is critical. While budget constraints may create pressures to reduce or limit full funding, investment return is the primary source of payment of future benefits. We need to fund pensions now to take advantage of any rebound in investment returns. As of June 30, 2007, the VSTRS was 84.9 percent funded. In the case of VSERS, the system dropped from being fully funded in fiscal year 2007 to 94.1 percent funded in 2008. Investment experience, in addition to changes in actuarial assumptions, accounted for this change. Additional negative investment experience in fiscal year 2009 will put additional pressures on this system. Also, for the first time in several years, the VSERS system was not fully funded in the fiscal year 2009 budget:

Actuarial Recommendation	$25,333,307
Treasurer's Administrative Costs	+ $26,966,006
	$52,299,313
2007 Reconciliation Adjustment	+$1,113,249
	$53,412,562
Town/School Contribution	- 332,575
Investment Fees	-$4,175,008
Gross Calculated Contribution	$48,904,979
Budgeted Contribution	-$46,792,369
Shortfall	$2,112,610

As in the case of VSTRS, full funding of actuarially recommended contributions is needed to assure that the pension systems are achieving the dual goals of benefit security and fiscal responsibility. The VMERS system is the only system fully funded at 101.5 percent

Other Post-Employment Benefits (OPEB)

Recently adopted rules (GASB Statement Nos. 43 and 45) by the Governmental Accounting Standards Board covering non-pension post-employment benefits, primarily health insurance, present financial and disclosure considerations for the State of Vermont beginning in fiscal year 2008. For the first time, public sector entities are now expected to report the future costs of these benefits on their balance sheets. The standards do not require pre-funding such benefits, but the basis applied by the standards for measurement of costs and liabilities for these benefits is more conservative, and therefore will result in larger yearly cost

FUNDING PROGRESS OF THE RETIREMENT SYSTEMS

VSERS

Year Ending June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	$1,377,101	$1,464,202	$87,100	94.1%	$404,938	21.5%
2007	1,318,687	1,307,643	(11,044)	100.8%	386,917	-2.9%
2006[1]	1,223,323	1,232,367	$9,044	99.3%	369,310	2.4%
2005	1,148,908	1,174,796	25,889	97.8%	349,258	7.4%
2004	1,081,359	1,107,634	26,275	97.6%	336,615	7.8%
2003	1,025,469	1,052,004	26,535	97.5%	319,855	8.3%
2002	990,450	1,017,129	26,679	97.4%	300,994	8.9%
2001	954,821	1,026,993	72,172	93.0%	278,507	25.9%
2000	895,151	967,064	71,913	92.6%	266,519	27.0%
1999	804,970	876,412	71,442	91.9%	238,281	30.0%
1998	733,716	804,501	70,785	91.2%	235,956	30.0%
1997	639,128	753,883	114,755	84.8%	227,000	50.6%

[1]The system's funding method was changed from Entry Age Normal with Frozen Initial Liability to Entry Age Normal effective with the 2006 actuarial valuation.

VSTRS

Year Ending June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	$1,605,462	$1,984,967	$379,505	80.9%	$535,807	70.8%
2007	1,541,860	1,816,650	274,790	84.9%	515,573	53.3%
2006[1]	1,427,393	1,686,502	259,108	84.6%	499,044	51.9%
2005	1,354,006	1,492,150	138,144	90.7%	468,858	29.5%
2004	1,284,833	1,424,662	139,829	90.2%	453,517	30.8%
2003	1,218,001	1,358,822	140,821	89.6%	437,239	32.2%
2002	1,169,294	1,307,202	137,908	89.5%	418,904	32.9%
2001	1,116,846	1,254,341	137,496	89.0%	403,258	34.1%
2000	1,037,466	1,174,087	136,621	88.4%	387,999	35.2%
1999	931,056	1,066,400	135,343	87.3%	372,299	36.4%
1998	821,977	955,694	133,717	86.0%	357,899	37.4%
1997	717,396	849,179	131,783	84.5%	364,695	36.1%
1996	570,776	700,377	129,601	81.5%	355,895	36.4%
1995	520,850	648,052	127,202	80.4%	346,975	36.7%
1994	473,229	597,851	124,622	79.2%	335,155	37.2%

[1]The system's funding method was changed from Entry Age Normal with Frozen Initial Liability to Entry Age Normal effective with the 2006 actuarial valuation.

VMERS

Year Ended June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	348,740	343,685	(5,055)	101.5%	175,894	-2.9%
2007	325,774	309,853	(15,921)	105.1%	162,321	-9.8%
2006	288,347	276,552	(11,795)	104.3%	148,815	-7.9%
2005	259,076	248,140	(10,936)	104.4%	146,190	-7.5%
2004	232,890	225,092	(7,798)	103.5%	135,351	-5.8%
2003	222,854	218,533	(4,321)	102.0%	126,216	-3.4%
2002	193,278	176,109	(17,169)	109.7%	106,986	-16.0%
2001	177,928	158,786	(19,142)	112.1%	101,873	-18.8%
2000	161,900	138,697	(23,203)	116.7%	87,147	-26.6%
1999	137,454	114,481	(22,973)	124.6%	70,808	- 32.4%
1998	113,678	102,005	(11,673)	111.4%	87,328	- 17.3%
1997	96,196	85,686	(10,510)	112.3%	70,800	-14.8%
1996	81,396	73,401	(7,995)	110.9%	68,700	-11.6%

and liability accruals, if they are funded on a pay-as-you-go basis—as they presently are in Vermont and in many other jurisdictions—and not pre-funded in the same manner as traditional pension benefits.

The State's independent actuary has prepared valuations of the OPEB liabilities for VSERS and VSTRS as of June 30, 2008. This is the fourth annual OPEB valuation for each system. Both the VSERS and VSTRS reports present two separate calculations of the State's OPEB liability, depending on whether the liability would be prefunded or remain on a pay-as-you-go basis. The Vermont Municipal Employees' Retirement System (VMERS), a cost-sharing, multiple-employer public employees' retirement system, is administered by the State, but has no associated state health care benefit or liability. While the Vermont Municipal Employees' Health Benefit Fund is classified as a post-employment benefit fund, there is no accrued liability in excess of the assets of the fund. There is no annual required contribution and unfunded actuarial accrued liability. Component units and authorities of the State will perform their own valuation as the State does not assume the risk or financial burden for their health care costs. An OPEB trust has been established for the VSERS although no significant funding has occurred and is limited to the deposit of Medicare-D subsidies received for state employees' health programs. The funding on a pay-as-you-go basis is as follows:

VSERS—OPEB:

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
2008	$3,664	$754,690	$751,027	0.5%	$404,937	185.5%
2007	$2,211	$606,499	$604,288	0.4%	$386,917	156.2%
2006	----	$552,152	$552,152	0.0%	$369,310	149.5%
2005	----	$529,027	$529,027	0.0%	$349,258	151.5%

Assuming no additional prefunding, the actuarial accrued liability for OPEB obligations earned through June 30, 2008, is $754.7 million with an unfunded actuarial liability of $751 million (see charts appendix page 67). To fully amortize this liability over a 30-year period, utilizing an amortization with installments increasing at a rate of 5 percent per year, would require an ARC commencing at $58.7 million

Recently adopted rules by the Governmental Accounting Standards Board require public sector entitites, for the first time, to report the future costs of non-pension post-employment benefits.

for fiscal year 2009 and projected to increase to $167 million in fiscal year 2039. If, however, prefunding is assumed, the actuarial accrued liability is reduced to $427.2 million with an unfunded actuarial liability of $423.5 million and the ARC is calculated to commence at $36.7 million for fiscal year 2009, projected to increase to $127 million for fiscal year 2038. Upon retirement of the unfunded accrued liability, the projected normal cost in fiscal year 2039 on a prefunding basis is $41.5 million. The fiscal year 2009 State budget funds the current year expected benefit payments of approximately $20.2 million, which is less than the ARC applicable under either funding basis. An OPEB valuation also was completed for VSTRS. An OPEB trust has not been created for VSTRS and no prefunding has been made. As noted above, an experience study was completed for the VSTRS retirement system. Demographic assumptions in the June 30, 2008, OPEB valuation were changed to be consistent with those used to value the system's pension benefits. In addition, the discount rate was increased to 4 percent as was the case in the VSTRS OPEB valuation. The funding, on a pay-as-you-go basis, is as follows:

VSTRS—OPEB:

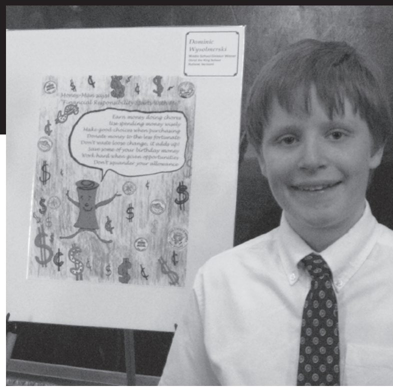
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
2008	$0	$863,555	$863,555	0.0%	$535,807	161.2%
2007	$0	$820,212	$820,212	0.0%	$515,573	159.1%
2006	$0	$952,526	$952,526	0.0%	$499,044	190.9%
2005	$0	$890,412	$890,412	0.0%	$486,587	182.9%

For VSTRS, assuming no prefunding, the actuarial accrued liability and the unfunded actuarial liability for OPEB obligations earned through June 30, 2008, is $863.6 million. To fully amortize this liability over a 30-year period utilizing an amortization with installments increasing at a rate of 5 percent per year would require an ARC commencing at $59.1 million for fiscal year 2009 and projected to increase to $322 million in fiscal year 2039. If, however, prefunding is assumed, the actuarial accrued liability and the unfunded actuarial liability is reduced to $424.2 million and the ARC is calculated to commence at $32.3 million for fiscal year 2009, projected to increase to $149.3 million for fiscal year 2038. Upon retirement of the unfunded accrued liability, the projected normal cost in fiscal year 2039 on a prefunding basis is $64.9 million. The fiscal year 2008 State budget funds the current year expected benefit payments of approximately $17.5 million, which is less than the ARC applicable under either funding basis.

Vermont Retirement Systems -- Year Ended June 30, 2008

Category	Vermont State Retirement System	State Teachers Retirement Fund	Municipal Employees Retirement Fund
SOURCES OF FUNDS			
Employee Contributions	$ 18,614,102	$ 22,918,798	$ 9,906,709
Employer Contributions - Pension Benefit	22,811,627	24,299,097	-
Employer Contributions - Healthcare benefit	16,368,196	15,250,000	-
Other Income	169,984	1,628,242	124,132
Investment Income (Reduction)	(84,156,254)	(110,019,634)	(19,472,654)
APPLICATION OF FUNDS			
Retirement Benefits	64,060,488	82,157,642	9,064,725
Refunds	1,414,144	1,280,715	1,143,397
Health/Life Insurance Expenses	16,371,373	15,081,847	-
Administrative Expenses	1,254,577	866,473	623,619
Other Expenses	631,321	542,665	506,817
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ (109,924,248)	$ (145,852,839)	$ (20,780,371)

Financial Literacy



Dominic Wysolmerski, a 7th-grader from Christ the King School in Rutland, was the middle school division winner of a financial literacy poster contest co-sponsored by the Treasurer's office, CCCS of New Hampshire and Vermont, and the Vermont Bankers Association. The theme of the contest was, "Financial Responsibility Begins With Me."

Financial Literacy
(802) 828-3706

Lisa Helme
Financial Literacy & Communications Director

Background

This was the second year of the Treasurer's office emphasis on financial literacy. The focus of the work is to promote, assess, develop, and support efforts and programs to further financial literacy among Vermont citizens. Skills such as budgeting, managing credit, and personal savings are especially needed by our citizenry in this time of economic turmoil. The Treasurer's office efforts reflect a nationwide trend among State Treasurers to implement financial literacy programs. There are 36 Treasurer's offices in the country offering financial literacy programs.

UPDATES

Financial Education & Resources

Since the Treasurer's office first introduced a new financial literacy section on its web site, there have been more than 37,000 "hits" to this section. The information is directly accessible through www.MoneyEd.Vermont.gov. The section is composed of six key pages: Teacher & Community Resources; Saving for Retirement; Retirement Plan Resources for Businesses; For Parents & Kids; Manage Your Money; and Investment Resources. The web site offers Vermonters an accessible and discreet way to obtain information that can assist them in managing

ACCOMPLISHMENTS IN 2008

- **Implemented new educational seminar on planning for retirement. Conducted 13 "Keeping the Gold in Your Golden Years" workshops across the state serving 263 participants. Received very positive responses from attendees.**

- **Conducted three "Save for Retirement Week" education and outreach public information booths in Montpelier, Burlington and Rutland.**

- **Conducted three retirement savings seminars for Vermont small business owners and managers. Seminars held in the St. Albans, Burlington, and Barre/Montpelier areas for approximately 80 people. Seminar provided information on options for offering employees a workplace retirement savings plan option.**

- **Co-sponsored statewide financial literacy poster contest and associated State House ceremony for April as part of "Youth Financial Literacy Month." Seventy-six students from schools throughout Vermont entered the competition. The aim of the competition was to encourage teachers, parents and youth to engage in discussions on what is financially responsible behavior.**

- **Built awareness of the need for financial education for Vermont youth through key partnering activities with the Vermont Jump$tart Coalition. Activities included an April State House press conference to announce results of Vermont's participation in a national financial literacy survey. The office also participated in the November Jump$tart Conference for teachers and parents. Approximately 100 people attended the conference.**

their personal financial resources. The pages were updated with new links and materials throughout the year.

A new financial education fact sheet on managing personal credit was written and distributed in 2008. The fact sheet touches on such topics as controlling debt, determining personal creditworthiness, credit scores, building a positive credit history, and the danger signs of over-extended credit card usage. Now under development is an educational fact sheet for parents on teaching children money management concepts.

The Treasurer's office seeks to make Vermonters aware of many of the excellent publications and other resources available to them free-of-charge on personal finance topics. The U.S. Department of Labor's "Taking the Mystery Out of Retirement Planning" is an especially useful book for individuals to use in assessing their retirement readiness. Through multiple venues, the office distributed more than 500 of the workbooks in 2008.

The Treasurer's office joined in with other groups on education and outreach efforts regarding two important personal finance topics—taxes and credit cards. In January, the Treasurer's office produced and distributed TV and radio public service announcements on the importance of Vermonters checking their eligibility for the Earned Income Tax Credit. A press release also was distributed and posted on the Treasurer's web site. In July, the office urged Vermonters to speak up on new federal rules regarding the regulation of credit cards and overdraft services. The office created a web page to make it easier for Vermonters to comment on the rule changes. The "Share Your Views!" web page feature provided a direct link to the public comment page for Unfair or Deceptive Acts or Practices as outlined in the Federal Register.

Keeping the "Gold" in Your Golden Years

Spend 90-minutes now to evaluate how to get your personal finances on track to cover future retirement expenses. Offer this free workshop on-site to your employees. To learn more, call (802) 828-3706 or go to:

www.MoneyEd.Vermont.gov

A FREE employee workshop by the State Treasurer's Office

A new retirement planning workshop was introduced in 2008.

Financial Education Seminars & Classes

In April, the Treasurer's office conducted the first new class on planning for retirement to thirty participants. The class, "Keeping the Gold in Your Golden Years," is a 90-minute course that teaches adults how to determine how much money they'll need in retirement, assess their current retirement savings resources, and implement a plan to ensure they will have adequate financial resources

"It was scary to find out how much more I need to save and how much longer I will have to work. It was very helpful, though."

-- Workshop Evaluation Comment

available to them at retirement. Since April, the office has conducted 13 of these "Gold" classes for approximately 263 students. The majority of the workshop evaluations characterized the class as very helpful. The following statement reflects the sentiment of many of the participants: "It was scary to find out how much more I need to save and how much longer I will have to work. It was very helpful, though." The office plans to continue offering the class through 2009.

Working with area chambers of commerce, the Treasurer's office offered a workplace retirement savings seminar for small business owners and managers. The 90-minute seminar offered participants information on options for affordably offering a workplace retirement plan to employees. Participants appreciated receiving the information from a neutral source, with no sales pressure present for a particular plan or approach. Seminars were offered in the St. Albans, Burlington, and Barre/Montpelier areas to approximately 80 attendees. Feedback on the seminar included an appreciation for the educational resources, face-to-face meeting approach, and coverage of basic plans. The Treasurer's office plans to evaluate whether the seminar approach is the most effective way to reach small business owners and managers and will continue outreach on this subject in 2009.

Planning work for 2009 includes consideration of a budgeting workshop and educational series for women on money management topics.

The poster above and bookmarks were mailed to all community libraries in the state to promote financial literacy among youth. The bookmark included a suggested reading list for grades K-12.

Youth Financial Education

In follow-up to last year's announcement of the newly available video game called "Financial Football," the Treasurer's office partnered with the Vermont Jump$tart Coalition to mail out free copies of the game to all high schools and middle schools in the state. The NFL-themed game sponsored by VISA, was introduced nationwide in December 2007. The game provides teachers and parents with an entertaining way to introduce personal finance to teens. An online version of the game is available through a link from the Treasurer's office web site. The mailing was sent to 204 Vermont schools.

A statewide youth financial literacy poster contest was initiated and co-sponsored by the Treasurer's office. The theme of the 2008 National Foundation for Credit counseling poster contest was "Financial Responsibility Begins With Me." With support from the Consumer Credit Counseling Service of NH and VT and the Vermont Bankers Association, the contest was promoted among art educators throughout the state. Seventy-six students entered the competition. An April State House event recognized the student winners and their schools. Each winning student received a $100 U.S. Savings Bond and their school a $100 cash prize. The office plans to co-sponsor the contest again in 2009, and work is already underway to promote the competition.

The survey of high school seniors showed Vermont seniors had an overall score on the financial literacy test of 50.3 percent, compared to a national average of 48.3. The failing grade underscores the need for more work in this area.

The Treasurer's office participated in several key efforts to promote youth financial literacy in Vermont. In partnership with the Vermont Jump$tart Coalition, a mailing was completed to all public libraries in the state promoting April as "Financial Literacy for Youth Month." The mailing included a poster and bookmark with a suggested reading list for grades K-12 on money topics. In April, the office also worked to create awareness of the need for financial literacy among Vermont youth by conducting a State House press conference to release the findings of the national 2008 Jump$tart Coalition for Personal Financial Literacy survey. For the first time in the 11-year history of the national survey on finance, Vermont had enough participating schools to release results. The survey of high school seniors showed Vermont seniors had an overall score on the financial literacy test of 50.3 percent, compared to a national average of 48.3. The failing grade underscores the need for more work in this area.

Also, this past fall the Treasurer's office supported the fourth annual Vermont Jump$tart Conference for teachers and parents held in Burlington. Approximately 100 people participated. The office organized two sessions for the conference. A media panel discussing ways to effectively communicate financial concepts was moderated by the State Treasurer and held as the closing session of the conference for all participants. "Keeping the Gold in Your Golden Years" was taught as a two-part session earlier in the day. In 2009, the Treasurer's office aims to explore options for offering a second teacher/parent conference for Vermonters in the southern region of the state.

National Survey Shows Vermont High School Students Struggle with Financial Literacy

Vermont high school seniors' participation in the 2008 Jump$tart Coalition for Personal Financial Literacy national survey provides a baseline of information from which to judge the future progress of the state's students in grasping financial concepts. The 31-question survey tested student knowledge in five subject areas: income, money management, savings, spending, and debt. Vermont students scored highest in the income category of questions with an average score of 59.4 percent. The state's students correctly answered 53.7 percent of questions pertaining to spending issues; 46.8 percent on questions related to debt; 43.6 percent on general money management knowledge; and 41.8 percent on savings-related questions. Below is a sampling of some of the survey questions.

Inflation can cause difficulty in many ways. Which group would have the greatest problem during periods of high inflation that last several years?

A. Older, working couples saving for retirement

B. Older people living on fixed retirement income

C. Young couples with no children who both work

D. Young working couples with children

Sara and Joshua just had a baby. They received money as baby gifts and want to put it away for the baby's education. Which of the following tends to have the highest growth over periods of times as long as 18 years?

A. Checking account

B. Stocks

C. U.S. Government Savings Bond

D. Savings account

Which of the following credit card users is likely to pay the GREATEST dollar amount in finance charges per year, if they all charge the same amount per year on their cards?

A. Jessica, who pays at least the minimum amount each month, and more when she has the money.

B. Vera, who generally pays off her credit card in full but, occasionally will pay the minimum when she is short of cash.

C. Megan, who always pays off her credit card bill in full shortly after she receives it.

D. Erin, who only pays the minimum amount each month.

correct answers in order are: B, B, D.

Above, members of the Vermont Jump$tart Coalition sponsor a State House booth as part of a "Financial Literacy for Youth Month" event in April. The State Treasurer partnered with the group to hold the event and other activities such as promotion of school participation in the bi-annual national financial literacy survey of high school seniors. Jump$tart is an all-volunteer, non-profit organization dedicated to improving financial literacy among youth.

Debt Management

Current Environment

During the recent acute credit crisis, municipal and other tax-exempt bond markets have experienced new issue conditions not seen by securities banking practitioners in their lifetimes. For periods of days and even weeks, municipal bond markets were closed to all but the highest quality issuers, and then only at interest

ACCOMPLISHMENTS IN 2008

- **The State Treasurer's Office issued $46 million aggregate principal amount of new money general obligation bonds in fiscal year 2008. This included a $35 million Series D competitive offering in November 2007 with a true interest cost of 4.30 percent and average life of 11.7 years, followed by an $11 million Series E negotiated "Citizens Bond" offering in December 2007 with a true interest cost of 3.49 percent and average life of 5.1 years. The State's high bond ratings contributed to the favorable interest rates achieved in both offerings.**

- **In December 2007 the State issued $29.195 million of its 2007 Series F General Obligation Refunding Bonds with a true interest cost of 3.33 percent. Over a ten-year period this refunding will save the State more than $1.6 million, or nearly $1.1 million in present value savings.**

- **Vermont maintained its highest in New England General Obligation Bond ratings of Aaa (Moody's Investors Service), AA+ (Standard and Poor's) and AA+ (Fitch Ratings). The State's critical debt ratios of net tax supported debt per capita and net tax supported debt as a percent of personal income as reported by Moody's also improved to rankings of 32nd and 33rd among the fifty states, respectively (50th is the best ranking).**

- **Vermont ranked in the first quintile in one of four categories of the Moody's U.S. States Credit Scorecard, second quintile in two categories, and third quintile in one category. Vermont's composite ranking is in the top tier (quintile), or in the top ten of all 50 states, for the third year in a row. The scorecard is an analytical report that ranks states in important categories of financial management: finance, economy, debt, and governance.**

- **The Capital Debt Affordability Advisory Committee (CDAAC) recommended increasing the State's annual bonding level to $69.955 million in fiscal year 2010, and increased the fiscal year 2009 authorization level to $64.65 million from an original authorization level of $54.65 million. The revised fiscal year 2009 amount is 31.4 percent higher than the $49.2 million authorized for fiscal year 2008; the additional $10 million of increase is dedicated to needed transportation capital expenditures throughout the State. This increase, and the recommended 8.2 percent increase from fiscal year 2009 to fiscal year 2010, allow for additional funding of capital projects without significant deterioration of key financial ratios used by rating agencies, and maintains the State's credit posture as a triple-A rated state.**

Debt Management
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David Minot
Finance & Investment Director

costs significantly higher than just six months prior. Included in this credit debacle are the following:

- Many municipal bond insurers have had severe credit downgrades minimizing the efficacy of bond insurance on both new and seasoned issues.
- The markets for variable rate demand bonds and other forms of auction rate securities have completely dried up in the wake of the demise or impairment of the broker-dealers making a market in them.
- De-leveraging of financial entity balance sheets has caused extraordinarily large amounts of fixed income securities to be placed for sale, depressing the values and raising the required yields of seasoned and new issue securities.

In this backdrop, the State of Vermont is fortunate to have practiced disciplined debt issuance and debt management policies including past issuance of moderate levels of new money debt, careful consideration of debt affordability and strict adherence to affordability guidelines, and strong fiscal budgetary policies that support the State's ability to have funds readily available for debt service payments. These efforts, which are the result of years of attention to rating agency and investor interests and concerns, have resulted in the high debt rating that the State currently enjoys. As a result, Vermont can expect, even in this severe credit environment, to be able to cost-effectively issue its general obligation debt and meet its infrastructure and other capital expenditure needs, whereas less creditworthy issuers will be constrained from meeting their needs. The next Vermont General Obligation Bond issue is expected to occur in later winter of 2009.

Overview

The Treasurer's office, in conjunction with the Administration and legislature, has historically set a course of maintaining modest levels of new authorizations of long-term debt and net tax-supported debt outstanding. As a result, bond issuance is currently at substantially lower levels than in the early and mid-1990s. Reduction in debt, plus continued improvement in the State's economic indices and financial condition over recent years, have improved the State's debt ratios to those among the highest-rated states. The State's practice of issuing debt with level annual principal installments has also resulted in a favorable amortization rate. At a rate of nearly 78 percent retirement within ten years, the State's bond payoff ratio continues to be favorably received by the rating agencies.

In September of 2008, the CDAAC set the fiscal year 2010 recommended debt authorization level at $69.955 million, which is the highest level that allows for adherence to CDAAC guidelines, notwithstanding creation of higher levels of debt outstanding.

A major contributing factor to Vermont's respected debt management is the work of the Capital Debt Affordability Advisory Committee (CDAAC). The CDAAC completes an annual review of the size and affordability of the State tax-supported general obligation debt, and submits to the Governor and to the General Assembly an estimate of the maximum amount of new long-term general obligation debt that prudently may be authorized for the next fiscal year. The estimate of the committee is advisory, but historically has been adopted by the State as a bonding limit. The CDAAC is made up of three *ex officio* members, two appointees of the Governor, one appointee of the State Treasurer, and an appointee of the Vermont Municipal Bond Bank. The State Treasurer serves as chair of the committee.

The committee recommended an authorized debt issuance limit in fiscal 2007 at $45 million (level with fiscal year 2006), and increased the recommended amount by 9.3 percent to $49.2 million for fiscal year 2008. In September of 2007 the committee initially unanimously voted to recommend that the fiscal year 2009 State General Obligation Debt bonding limit be set at $54.65 million, an 11.1 percent increase over the limit in fiscal year 2008.

Vermont has the ability under current challenging credit market conditions to issue debt at attractive interest rates to meet infrastructure and other capital spending needs.

In the course of the fiscal year 2008 legislative session, the general assembly approved $10 million of transportation project expenditures above the $54.65 million recommended and approved for the fiscal year 2009 capital bill. Depending on the findings of the CDAAC, this amount was to be funded by either transportation fund revenues or, if approved by the CDAAC, by an increment to the fiscal year 2009 general obligation bond limit. As part of the September 2008 CDAAC meetings, the committee considered whether the $10 million was affordable as additional bonding within CDAAC affordability guidelines. The analyses concluded that this amount would not have a substantial impact on the State's key debt ratios. Based on this affordability analysis, the CDAAC approved increasing the fiscal year 2009 authorization limit to $64.65 million, which is a 31.4 percent increase over the fiscal year 2008 amount.

Also in September of 2008 the CDAAC set the fiscal year 2010 recommended debt authorization level at $69.955 million, which is the highest level that allows for adherence to CDAAC guidelines, notwithstanding creation of higher levels of debt outstanding. The committee continues to believe that debt issuance moderation is appropriate in uncertain economic times. Of the $69.955 million, again $10 million is marked for transportation capital expenditures.

The State's disciplined approach to debt management is paying off in today's tax-exempt marketplace. By practicing debt issuance moderation and compliance with well defined guidance standards that have the clear goal of Vermont being a triple-A rated state, Vermont has the ability under current challenging credit market conditions to issue debt at attractive interest rates to meet infrastructure and other capital spending needs. Providing for a significant level of transportation expenditures within the capital budget is, with regard to recent history, a change for the State, and welcome in the context of needed transportation projects spending.

UPDATES

Bond Issues

The State Treasurer's Office issued $46 million aggregate principal amount of new money general obligation bonds in fiscal year 2008. This included a $35 million Series D competitive offering in November 2007 with a true interest cost of 4.30 percent and average life of 11.7 years, followed by an $11.0 million Series E negotiated "Citizens Bond" offering in December 2007 with a true interest cost of 3.49 percent and average life of 5.1 years. The State's high bond ratings discussed above contributed to the favorable interest rates achieved in both offerings. The Citizens Bonds, typically with shorter maturities more attractive to retail as opposed to institutional investors, were offered only to Vermont residents, in denominations as low as $1,000 instead of the more traditional $5,000 denominations.

Also, in December, 2007, the State issued $29.195 million of its 2007 Series F General Obligation Refunding Bonds with a true interest cost of 3.33 percent. Over a ten-year period this refunding will save the State over $1.6 million, or nearly $1.1 million in present value savings.

Bond Rating

Vermont was assigned a triple-A rating by Moody's in February, 2007. Vermont shares its Moody's triple-A rating with only eight other states. As of the fall of 2008, only 11 states have a triple-A rating from at least one rating agency. Combined with double-A plus bond ratings from both Standard & Poor's and Fitch Ratings, Vermont enjoys the highest general obligation bond ratings of any New England state (see bond rating chart below). With all three ratings carrying a "Stable" outlook, Vermont continues to work toward achieving a triple-A rating from Standard & Poor's and Fitch.

The triple-A rating by Moody's Investors Service and the excellent ratings by Fitch and Standard & Poor's are reflective of sound fiscal practices including budgetary discipline, an economy with significant breadth, strong debt management practices, and effective State governance reflecting sound statutes and legislative history.

Like most states, Vermont is experiencing budgetary pressures brought about by a credit crisis and a national and state economy in recession. Traditionally,

Because a higher rating enhances the State's reputation in the municipal marketplace, it makes Vermont's bonds very marketable to a broad range of individual and institutional investors.

Vermont has managed economic downturns very well in comparison to other states, with a resilient economy and strong fiscal and debt management practices. The current downturn, while not over, has been no exception to date. Vermont's unemployment rates, while high, are relatively favorable compared to New England and other states. Just as important, the State's response with regard to sound fiscal policy has been prompt and decisive. With periodic revenue downgrades and expense cuts to match, the State is maintaining a balanced budget with reserve funds available only as a last resort. This discipline is recognized by rating agencies and investors alike,

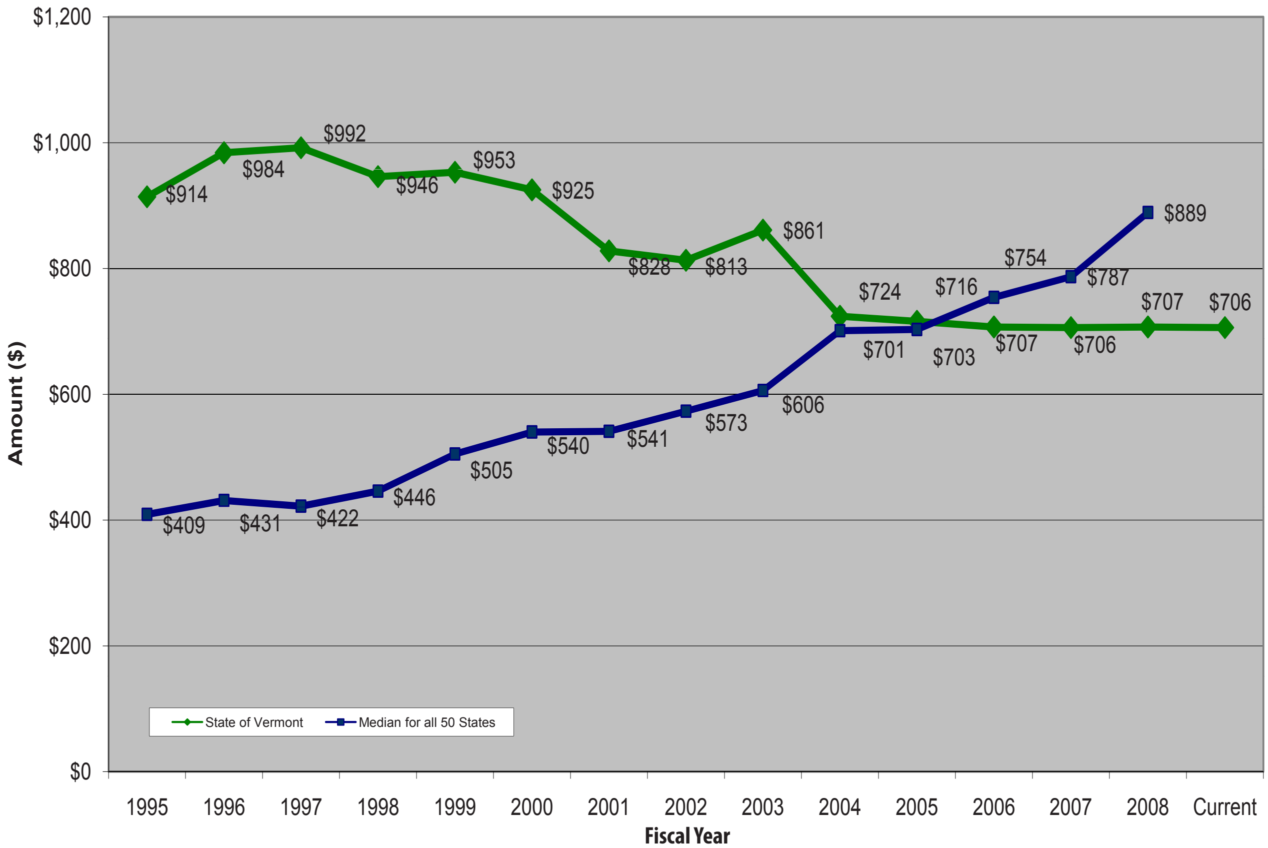
New England General Obligation Bond Ratings

STATE	FITCH	MOODY'S	S&P
Connecticut	AA	Aa3	AA
Maine	AA	Aa3	AA
Massachusetts	AA	Aa2	AA
New Hampshire	AA	Aa2	AA
Rhode Island	AA-	Aa3	AA
Vermont	**AA+**	**Aaa**	**AA+**

and contributes to both favorable bond ratings and favorable investor perceptions of the State.

Because a higher rating enhances the State's reputation in the municipal marketplace, it makes Vermont's bonds very marketable to a broad range of individual and institutional investors. As noted previously, this generally results in a lower interest rate or cost of capital for borrowing. It also is likely to reduce borrowing costs for municipalities that issue debt through the Vermont Municipal Bond Bank or other borrowers issuing State moral obligation debt through other State agencies, as the State's rating supports these bond issues. A high credit rating also is attractive to business development as it is a sign of economic and fiscal stability.

Net Tax Supported Debt Per Capita



Debt Ratios

The fiscal discipline of recent years has paid off as Vermont's debt ratios rank favorably among triple-A rated states. In fiscal year 2007, Moody's recognized this and upgraded Vermont from Aa+ to Aaa. The key to maintaining and obtaining other triple-A ratings will be to demonstrate continued diligence in the areas just discussed while making improvements on other major sustainability issues: Medicaid funding, State employees' and teachers' pension funding, the funding of other post-employment benefits (OPEBs), and preservation and development of the State's infrastructure. Summarized below are some of the key debt indicators for Vermont.

Debt Per Capita

One of the key debt factors monitored by the CDAAC and the rating agencies is the ratio of the State's net tax-supported debt per capita. The guideline adopted by the CDAAC establishes a target ratio of debt per capita at Moody's median and means for triple-A rated states. In 2008, the State's debt per capita was $707 versus the Moody's five year triple-A median and mean of $765 and $891, respectively (see charts page 31). The State's ranking versus all 50 states was 28th in 2007 and 32nd in 2008. The higher the ranking figure, the lower a state's debt per capita is relative to all other states. This 2008 ranking is better than average; only 18 states have a higher (more favorable) ranking figure. Currently, the State's debt per capita is $706. Assuming a steady level of debt authorization and issuance of $69.955 million in future years starting in fiscal year 2010, and employing the population forecast developed by Economic Policy Resources, the State's net tax-supported debt per capita is forecast to grow to $1,023 by 2019. This increase over a significant period of time is expected to remain consistent with the State's debt per capita guideline (triple-A states five year median and mean) each year through 2019.

Debt as a Percentage of Personal Income

An even more important credit factor for assessing a state's relative ability to pay its general obligation debt is the ratio of net tax-supported debt as a percent of personal income. The guideline adopted for this ratio is again to target Moody's five-year median and mean for triple-A rated states. The State has steadily improved in this area, and the State's ratio of debt to personal income for fiscal year 2008 dropped to 2.0 percent versus Moody's triple-A median and mean ratios of 2.5 percent and 2.7 percent, respectively (see chart page 32). The State's ranking in its debt as a percentage of personal income improved from the 30th highest among all states in 2007 to 33rd highest in 2008.

Moody's Investors Service -- Debt Per Capita -- State of Vermont

Triple-A Rated States	July, 2008 Ratings: Moody's	S&P	Fitch	2004	2005	2006	2007	2008
Delaware	Aaa/Stable	AAA/Stable	AAA/Stable	$1,800	$1,865	$1,845	$1,998	$2,002
Florida*	Aa1/Stable	AAA/Stable	AA+/Stable	1,023	1,008	976	1,020	1,005
Georgia	Aaa/Stable	AAA/Stable	AAA/Stable	827	803	784	916	954
Maryland	Aaa/Stable	AAA/Stable	AAA/Stable	1,077	1,064	1,169	1,171	1,297
Minnesota	Aa1/Stable	AAA/Stable	AAA/Stable	691	679	746	827	879
Missouri	Aaa/Stable	AAA/Stable	AAA/Stable	461	449	496	613	675
North Carolina	Aaa/Stable	AAA/Stable	AAA/Stable	556	682	804	728	898
South Carolina	Aaa/Negative	AA+/Stable	AAA/Stable	599	558	661	630	966
Utah	Aaa/Stable	AAA/Stable	AAA/Stable	846	792	707	621	542
Virginia	Aaa/Stable	AAA/Stable	AAA/Stable	546	589	601	692	764
MEAN**				823	831	879	922	998
MEDIAN**				691	682	765	778	926
VERMONT*	Aaa/Stable	AA+/Stable	AA+/Stable	724	716	707	706	707

*** Florida raised to triple-A in 2005 and first reflected in 2006 numbers; Vermont raised to triple-A in 2007.**

**** These calculations include Florida for the years 2006, 2007 and 2008, and exclude Vermont numbers.**

Triple-A Rated States: 5-Year Average Mean & Median including Florida & excluding Vermont:

MEAN: $891 Vermont: $712

MEDIAN: $765 Vermont: $707

Debt as a Percentage of Revenue

The guideline used for this ratio states that projected annual State debt service on bonds should not be in excess of 6 percent of projected revenues in the combined General and Transportation Funds. The debt service as a percentage of revenues ratio was 5.0 percent for fiscal year 2008. This percentage is expected to rise to 5.3 percent in fiscal years 2009 and 2010, and then decline through fiscal year 2019, assuming the issuance of $69.955 million of debt from fiscal year 2010 through fiscal year 2019.

Moody's Investors Service -- Debt as % of Personal Income -- Vermont

Triple-A Rated States	2004	2005	2006	2007	2008
Delaware	5.6%	5.5%	5.3%	5.5%	5.2%
Florida*	3.5	3.4	3.2	3.1	2.8
Georgia	2.9	2.8	2.7	3.0	3.0
Maryland	3.0	2.9	3.0	2.8	3.0
Minnesota	2.0	2.0	2.1	2.2	2.3
Missouri	1.6	1.5	1.6	1.9	2.1
North Carolina	2.0	2.5	2.8	2.4	2.8
South Carolina	2.4	2.2	2.5	2.3	3.3
Utah	3.5	3.2	2.7	2.3	1.9
Virginia	1.7	1.8	1.7	1.8	1.9
MEAN**	**2.7**	**2.7**	**2.8**	**2.7**	**2.8**
MEDIAN**	**2.4**	**2.5**	**2.7**	**2.3**	**2.8**
VERMONT*	2.5	2.3	2.2	2.1	2.0

* Florida raised to triple-A in 2005 and first reflected in 2006 numbers; Vermont raised to triple-A in 2007.

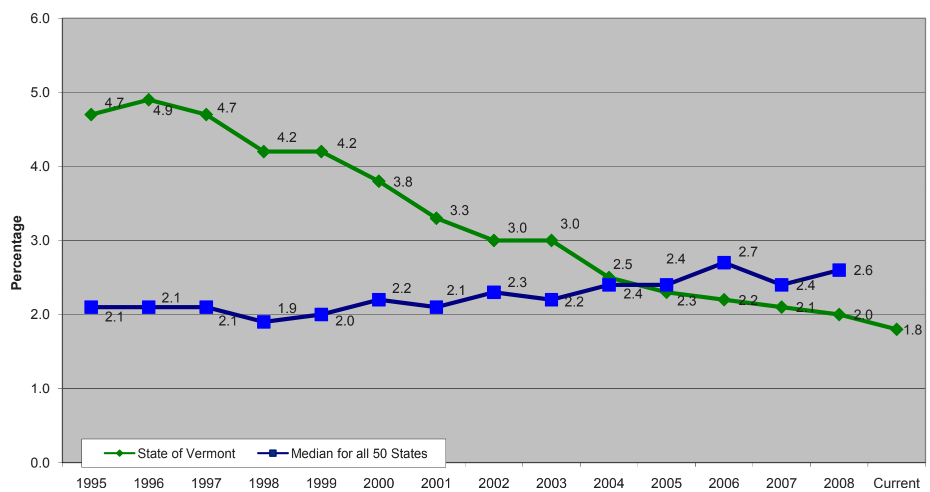
** These calculations include Florida for the years 2006, 2007 and 2008, and exclude Vermont numbers.

Triple-A Rated States: 5-Year Average Mean & Median Including Florida &Excluding Vermont:

MEAN: 2.7% Vermont: 2.2%

MEDIAN: 2.5% Vermont: 2.2%

Net Tax Supported Debt as a Percentage of Personal Income



Additional Factors Affecting Bond Ratings

There are many other factors considered in a state's bond rating besides ratio analyses. These include:

Budget Stabilization Reserves: The State has budget stabilization reserve levels required by statute for each of the State's General Fund, Transportation Fund, and Education Fund. Required reserves for the General Fund and Transportation Fund are 5 percent, and for the Education Fund are 3.5 percent to 5 percent of the previous year's appropriations. Currently, all three funds are at their statutory requirements and as stated above have not yet been tapped in response to the current economic downturn. In addition, the State has human services caseload reserves which at June 30, 2008, were over $17 million. The combined effect of full budget stabilization reserves plus the caseload reserves is positive for the State's ratings.

Pension Funds Funding Percent: Of the three State-level pension funds, two receive State contributions—the Vermont State Employees' Retirement System (VSERS) and the Vermont State Teachers' Retirement System (VSTRS). Inasmuch as State contributions derive from taxes, the rating agencies are very concerned with the percentage of future pension liabilities that are funded in these plans. As of June 30, 2008, the VSERS funding level is at 94.1 percent and the VSTRS funding level is 80.9 percent, indicating that both are under-funded. The State's plan is to amortize the VSTRS under-funded amount over a 30-year period and fully fund the annual actuarial recommended contributions in fiscal year 2009 and beyond. The State also intends to fully fund the actuarial recommended contribution for VSERS in fiscal year 2009 inclusive of an amount to amortize its underfunding over a period of the remaining nine years of a 30-year amortization period.

Required reserves for the General Fund and Transportation Fund are 5 percent, and for the Education Fund are 3.5 percent to 5 percent of the previous year's appropriations. Currently, all three funds are at their statutory requirements and have not yet been tapped in response to the current economic downturn.

In the eyes of the rating agencies, such plans by the State are an important commitment to achieving the full funding of VSTRS. Other post-employment benefits (OPEBs), beyond pension benefits, to retired system participants also are of interest to the rating agencies. While Vermont's OPEBs have minimal funding for VSERS and none at present for VSTRS, the State has undertaken studies over the past three years to analyze the size of these obligations and assess alternative funding strategies. This is recognized by the rating agencies.

Other Factors: The rating agencies also consider the breadth of the economy; the level and condition of the State's transportation, utilities and other infrastructure; personal income levels; fiscal responsibility; employment levels; workforce size and training; population demographics and trends; internal controls and auditing standards; need for short-term borrowings; and other factors.

Short-Term Borrowing

The seasonal nature of the revenue and expenditure cycles occasionally requires the use of short-term borrowing. Typically, education payments to local towns and school districts occur in the first half of the fiscal year, while tax revenues are collected later in the year, primarily April. By April the revenue flow is generally positive. While the State has had a line of credit available to it during the last four years, it has not had to access it, a continuing sign of fiscal health. While the seasonal dip continues to occur, the overall healthy cash position has further reduced the likelihood of any short-term borrowing for the current fiscal year 2009. Current economic conditions and declining State revenues require monitoring in the context of short-term borrowing needs. While the State has been diligent in managing expenditures according to revised revenue projections, an extended economic downturn may require future borrowing to accommodate low points in seasonal cash balances. The State began fiscal year 2008 with approximately $261.2 million in unrestricted cash and investments on hand and ended the year with $279.8 million in unrestricted cash and investments. While these cash balances do not bear a direct one-to-one relationship to fund balance, they indicate a very healthy position as of fiscal year 2008.

Approach Toward Establishing Debt Ratio Goals -- State of Vermont

Comparative Mean Debt Ratios*

Per Capita	2004	2005	2006	2007	2008
All States	$ 944	$ 999	$1,060	$1,101	$1,158
Triple-A**	823	831	879	922	998
VERMONT	**724**	**716**	**707**	**706**	**707**
% of Pers. Inc.	**2004**	**2005**	**2006**	**2007**	**2008**
All States	3.1%	3.2%	3.2%	3.2%	3.2%
Triple-A**	2.7	2.7	2.8	2.7	2.8
VERMONT	**2.5**	**2.3**	**2.2**	**2.1**	**2.0**

* Based on data provided by Moody's Investors Service and excluding Florida prior to 2006 and Vermont.

** See chart on "Debt Per Capita" for complete listing of triple-A states and respective ratings. Eleven states currently rated triple-A by one or more of the nationally recognized rating agencies: Delaware, Florida (in 2005), Georgia, Maryland, Minnesota, Missouri, North Carolina, South Carolina, Utah, Virginia and Vermont (in 2007).

Investments

Overview

The State Treasurer's Office is responsible for investment of the State's short-term and operating funds and certain trust funds, and is the administrative arm for the Retirement Boards and the Vermont Pension Investment Committee. Short-term operating funds are invested by the Treasury Operations Division, which is also responsible for banking and cash management and projections. These funds are invested based on the Treasurer's authority in State statute. The State Treasurer has issued further guidelines for these investments, consistent with statute. The guidelines are available on the State's web site at http://www.vermonttreasurer.gov/cash/index.html. The guiding principles for these investments are safety followed by liquidity and yield.

Certain trusts, including the Higher Education Fund, Tobacco Trust Funds, a State OPEB Trust Fund and other trusts are pooled and invested in a Trust

Investments
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Treasury Operations Director

Dan Currier
Cash & Investments Manager

Donna Holden
Contracts & VPIC Coordinator

ACCOMPLISHMENTS IN 2008

- **The State Treasurer's office short-term investments exceeded the established benchmarks of the average three-month Treasury bill auction rate, earning 3.74 percent as compared to the benchmark of 2.83 percent.**

- **The State Treasurer's Office conducted an RFP to solicit additional money market fund options for its short-term investment program to further diversify assets.**

- **As a result of an outside review of the Vermont Pension Investment Committee (VPIC) and legislative action, important changes to the VPIC were made effective July 1, 2008, centering on streamlining the size and composition of the Committee. With six members and three alternates, the VPIC has both considerable investment expertise and the ability to nimbly develop investment programs for the three Vermont Retirement Systems (see update page 35).**

- **As part of the diversification efforts, new account investment managers were added in the categories of global asset allocation, fixed income, and emerging markets equities.**

- **The VSTRS created a new 403(b) retirement investment program available to school districts throughout the State. This investment program offers cost-effective investment choices in life-cycle and traditional asset classes and is effective January 2009 (see update page 14).**

- **The VPIC hired a consultant/advisor to assist in the administration of its policy on Investments in Terrorist or Genocide Link Countries. This advisor, selected through a competitive RFP process, applies VPIC policy to the universe of equity and debt issuers to provide a list of issuers that may be in conflict with our policy. Based on this list, the VPIC will take appropriate action to either engage or divest potential offenders.**

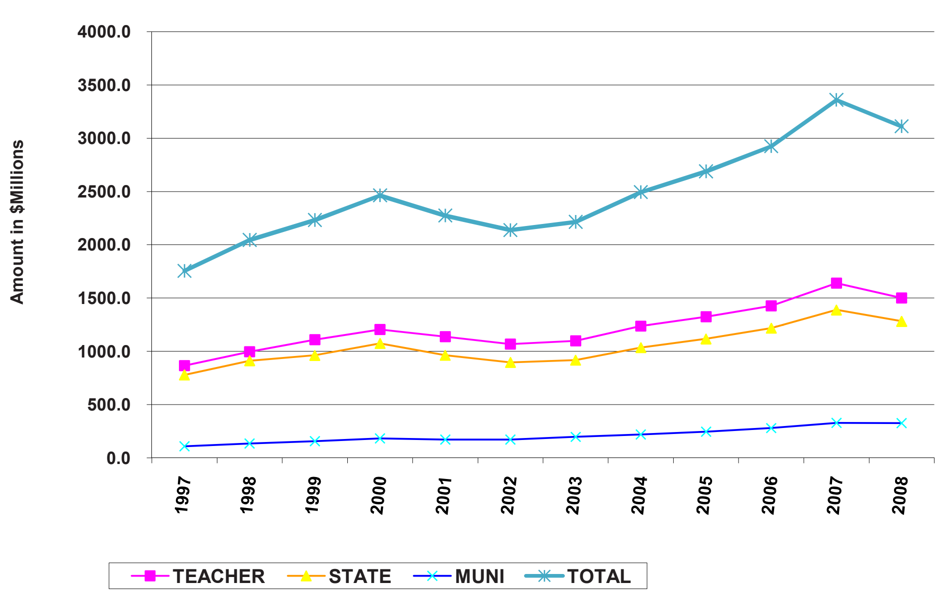
Investment Account (TIA). The Trustee for these funds is the State Treasurer. The Director of Finance and Investment provides administrative support including due diligence and portfolio review. Treasury Operations reconciles the investment management and custodian reports and maintains the financial statements. Investment of funds is delegated to four investment managers, three of whom are Vermont-based firms; the fourth invests in mortgage securities, creating capital for Vermont. Chittenden Bank provides custody services.

The Retirement Boards act as trustees for various benefit related trusts including two defined contribution plans (State and municipal), a single deposit investment account or SDIA (State and teachers), a deferred compensation fund (open to teachers and municipal and State members, the State Retirement Board acting as trustee), and a Municipal Employees' Health Benefit Fund. All employ outside managers. The Director of Finance and Investment and other staff provide due diligence and portfolio review, as well as contract compliance and reconciliation functions.

The Vermont Pension Investment Committee acts as the trustee for the defined benefit plan investments. The board of trustees for each system maintains its fiduciary role in the area of benefits administration, actuarial recommendations, and asset allocation. In 2007, the legislature passed legislation enabling municipalities not participating in the municipal defined benefit plan to pool their assets in VPIC for investment purposes. During fiscal year 2008, the City of Burlington transferred assets to the VPIC, effective the end of October, 2007. VPIC is therefore classified as an external investment pool, investing the funds for Burlington and the three defined benefit plans (state, teachers, municipal). Effective July, 1, 2008, the VPIC was reorganized and streamlined (see story at right).

With respect to pensions, the VPIC employs an outside investment consultant, New England Pension Consultants, to assist them in their fiduciary responsibility, including development of investment policies and objectives; risk management assessment and asset allocation plans; investment manager and custodian searches; monitoring of management performance; industry issues; SEC compliance; and on-going due diligence on investment managers, performance measurement, and

Growth of Pension Assets -- Fiscal Year 1997-2008



VPIC Reorganized in 2008

The Vermont Pension Investment Committee, responsible for investing as of June 30, 2008 more than $3 billion in assets for the three state-level retirement systems, was reduced in size from 17 to six. The change, approved by the State Legislature and the Governor in the 2008 legislative session, was aimed at enhancing the investment decision-making process for the committee.

The reorganized VPIC continues its original mission of making decisions that strive to maximize the total return on investments within acceptable levels of risk for public retirement systems.

Act 100 redefines the membership of VPIC to six voting members and four alternates. The active and retired employee members of the Vermont State Employees' Retirement System and Vermont State Teachers' Retirement System boards of trustees each appoint one member and one alternate. The employee and municipal official members of the board of the Vermont Municipal Employees' Retirement System appoint one member and one alternate. In addition, two members and one alternate are appointed to the VPIC by the Governor. The sixth member is the State Treasurer or designee. In considering appointments, the legislation directs that the experience and knowledge of potential appointees be considered in light of the purposes of the committee. The members serve staggered four-year terms with no term limits.

Act 100 went into effect July 1. Individuals appointed to the committee are: Warren Whitney, VSERS voting member; Robert Hooper, VSERS alternate; Stephen Rauh, VMERS voting member; Steven Jeffrey, VMERS alternate; Joseph Mackey, VSTRS voting member; Jon Harris, VSTRS alternate; Richard Johannesen, Governor's appointee; Michael K. Smith, Governor's appointee; Vaughn Altemus, Governor's alternate; and Jeb Spaulding, State Treasurer.

education on various issues (asset classes, alternative investments, risk assessment). The Director of Finance and Investment and other staff provide administrative support including rebalancing the portfolio, portfolio review and due diligence, and instructions to managers to receive/remit cash to fund benefit programs, based on projections provided by Treasury Operations.

UPDATES

Recent Market Volatility & Risk Mitigation by the Treasurer's Office

The economic recession and credit crisis has impacted the entire spectrum of investments and has presented significant challenges over the past eighteen months in particular. The Office of the State Treasurer remains committed to meeting the cash needs of State operations while protecting the value of its assets, and approaches these responsibilities in a prudent, deliberate way. As market conditions have worsened, we have taken steps to minimize risk.

The State's short-term portfolio has traditionally been comprised of money market instruments, certificates of deposit, commercial paper, and money market mutual funds, consistent with the stated priority of safety of principal. On the national level, this perceived "safe" area of investments has experienced considerable upheaval. Some money funds and short-term portfolios are paying the price for chasing high returns. Over the past several years, many portfolios, including so called "Prime Money Market Funds," added increasing levels of commercial paper (CP), especially more highly leveraged forms such as asset-backed commercial paper (ABCP) or other securities, such as structured investment vehicles (SIVs) or collateralized debt obligations (CDOs). The intent was to "enhance" return but this was done, in many cases, without a full understanding of the potential risks. SIVs issued ABCP using the financial assets as collateral for the CP. When the credit markets began to freeze, many SIVs and CDOs started to collapse and some stopped making payments on their notes, decreasing their value. Several state portfolios, not including Vermont, suffered losses in 2007 and 2008.

What began as the housing and subprime crisis has now led to radical corrections and restructuring in the global financial industry.

As a matter of policy, the Treasurer's office ranks safety of principal first, followed by liquidity and return on investment, in that order. In particular, SIVs and CDOs have been completely avoided as have all other forms of asset-backed securities, including ABCP. As a result, there has been no loss of principal on any Vermont State Treasury investments.

In addition, the Lehman Brothers bankruptcy in September, 2008, left some money market funds with losses on portions of their portfolios. A money market fund managed by Reserve Management Corporation (RMC) "broke the buck" as its net asset value (NAV) dropped below $1 per share based on RMC's decision to write $785 million held in Lehman Brothers debt down to zero. In the history of money market funds, first created in 1971, there had only been one other such instance occurring in 1994. A securities lending fund, not a money market fund, also broke the buck due to Lehman holdings. This created a "run on the bank" for money market funds. The Federal Government stepped in and on September 19 provided a guarantee fund which covers assets, similar to FDIC insurance, of participating funds and participants at levels as of that date.

The State Treasurer's Office conducted a review of its money market funds, including those used by its TIA and pension trust funds, in the fall of 2007 and had already made strategic moves in non-pension funds away from prime money markets to the more conservative government-only securities funds that did not employ any commercial paper. Continued due diligence and review in this areas is taking place within the Treasury Operations Division. In addition, the office conducted an RFP to secure additional money market fund providers to create additional diversity. Fidelity and Federated money market funds are available to the Treasurer's office and it is expected that a third manager will be added. Our money market fund managers participate in the federal program; therefore, the State has "insured" money market funds up to the September 19 levels or $120.6 million in total, across TIA, bond investment, and short-term operating funds.

VPIC fixed income portfolios are positioned on the high quality end of the market and managers have avoided lower-grade riskier investments.

Another aspect of our investment "safety net" is collateralization of deposits and investments. Although the statute provides some requirements for the collateralization of deposits, it does not establish limits. These limits are set by published formal guidelines issued by the State Treasurer. In past years our primary bank of record collateralized deposits and certificates of deposit with agency overnight repurchase agreements. With increased market volatility, the Treasurer's office and our bank of record jointly decided to move to an irrevocable letter of credit with the Federal Home Loan Bank and put this into place in fiscal year 2008, providing up to $250 million in coverage. As a matter of practice, CDs with the Bank in Vermont program have varying levels of collateralization, depending upon the bank, its assets, and capitalization levels. These are reviewed quarterly and some collateral requirements have been raised over the past year.

In the market place, there is a wide dispersion of quality among subprime related investments. Mortgage pools backing subprime investments are segregated into senior and subordinated tranches, whereby senior tranches receive prioritization of payments in defaulted mortgages and have superior collateralization versus subordinated tranches. Most of the recent headlines regarding subprime investment failures have involved either SIVs or CDOs backed by lower tranches. The Treasurer's office continues to review and evaluate portfolios for any subprime exposure or indirect impacts, including the trust SDIA and pension portfolios.

VPIC fixed income portfolios are positioned on the high quality end of the market and managers have avoided lower-grade riskier investments except as mandated in high yield segments of the portfolio. The VPIC Core Plus fixed income portfolio as of December 31, 2008 has 0.5 percent of its assets in fixed rate

Long-term Investment Performance of Vermont's Retirement Systems (As of June 30, 2008)

Gross of Fees

Retirement System:	Last 1 Year	Last 3 Years	Last 5 Years	Last 7 Years	Last 10 Years
Teachers Composite	-6.6%	6.6%	9.0%	6.4%	6.3%
State Composite	-5.9%	6.6%	8.8%	6.1%	5.6%
Municipal Composite	-6.1%	6.8%	8.7%	6.1%	6.3%
Median Public Fund	-4.4%	6.8%	8.9%	6.1%	5.9%

Source: New England Pension Consultants

Higher Education Trust Fund

The 1999 Legislature established the Vermont Higher Education Endowment Trust Fund and appropriated $6 million for the creation and management of the fund by the State Treasurer. An additional $1 million was added to the fund in fiscal year 2001--$635,881 at the end of fiscal year 2002, $2,363,355 in fiscal year 2006, $5,823,450 in fiscal year 2007 and $57,209 in fiscal year 2008. On June 30, 2008, the fund had a market value of $17,974,360. In August of 2008, the State Treasurer authorized the distribution of 5 percent of the average market value of the assets over the prior 12 quarters equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation. Each entity received $259,215.90 to be applied as non-loan financial aid to Vermont students attending Vermont post-secondary institutions.

The Higher Education Endowment Trust Fund Act further provides that contributions shall include "… in any fiscal year in which a general fund surplus exists and the general fund stabilization reserve is funded to its required statutory level, funds raised by the estate tax under chapter 190 of Title 32 which are more than 125 percent of the amount projected by the emergency board in the July annual forecast made pursuant to section 305a of Title 32." In fiscal year 2008 a substantial contribution from this provision was made: $5,223,449.94 derived from fiscal year 2006, and this contribution became part of the Higher Education Trust Fund early in fiscal year 2007. In addition, pursuant to legislation introduced by the Treasurer, all unclaimed property worth less than $100 that has been under State custody for ten years or longer is to be turned over to the Higher Education Trust Fund. In the first year of this provision deriving from fiscal year 2006, $600,000 was added to the fund

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first lien subprime mortgages. In addition, 1.3 percent of the portfolio assets are in Prime Fixed Second Lien mortgage-related securities. Most of these subprime exposures are rated triple-A, reflecting senior tranche investments with various priority accesses to payments versus lower tranches. With one small exception, the prime second lien mortgage securities are rated investment grade. Relative to the VPIC overall assets of approximately $2.3 billion, this subprime exposure is approximately 0.05 percent; adding in the Prime Second Lien mortgages, the exposure is about 0.16 percent. Importantly, this exposure as discussed above is primarily in vastly superior credit positions to subprime related investments experiencing losses that do not involve senior tranches.

Our Trust Investment Account fixed income manager has zero subprime exposure. TIA equity managers have financial holdings, such as bank stocks and investment firms, that have been negatively impacted by subprime holdings. However, the TIA equity accounts are well diversified and as a result the impact to the overall portfolio is limited. This would be expected in any well balanced equity portfolio.

The SDIA fund has some limited senior tranche exposure to subprime related investments. Treasurer's staff has met several times with the one manager that has some exposure. In total, approximately 4.8 percent of all SDIA funds are subprime, mostly rated triple-A and none rated below investment grade. Importantly, not only is the credit and investment quality of all of the SDIA subprime-related debt superior to subprime-related investments involving lower tranches, but the SDIA carries a double-A rated insurance "wrapper" guaranteeing the book value of principal in the account to participants.

VPIC fund managers, based on our guidelines and oversight, and the types of firms that VPIC has selected, have avoided low-grade, riskier investments except as mandated in high yield segments of portfolios. In the case of subprime-related investments, most VPIC investments have maintained a triple-A rating due to the tranche seniority.

What began as the housing and subprime crisis has now led to radical corrections and restructuring of the global financial industry. Financial institutions once viewed as inviolate and solid have become bankrupt, forced to merge, or in need of vast amounts of federal aid just to survive. With financial companies in such dire condition, lending ground to a halt, and is only recently showing any

Asset Allocation of Pension Funds as of June 30, 2008

Investment Category	Teacher	State	Municipal
Domestic Equity			
Large Cap	29%	25%	24%
Small Cap	12%	13%	11%
Total	41%	38%	35%
Domestic Fixed Income			
Core	16%	20%	25%
High Yield	5%	5%	5%
Total	21%	25%	30%
International Equity	14%	14%	14%
Global Fixed Income	5%	5%	3%
Global Asset Allocation	10%	10%	10%
Real Estate	9%	7%	8%
Other	0%	1%	0%
Total	100%	100%	100%

signs of recovery. The result has been declining values for securities of virtually all classes with the notable exception of government obligations. The S&P index lost 37 percent for the calendar year 2008, wiping out gains for the past several years.

Asset allocation is essential to the investment performance of the plans. In order to insulate the portfolios from short-term market fluctuations, the three pension systems continue to diversify assets across a broad group of asset classes,

It is anticipated that while most current investment strategies will continue, adjustments to both manage risk of loss and realize opportunities will be required.

which enables each portfolio to enhance stability through market cycles of the different asset classes. VPIC asset allocations also are significantly diversified in order to maximize overall returns with acceptable portfolio risk. Each system's assets are invested in stocks, fixed income, real estate, and global asset allocation strategies, with an additional small allocation to alternative investments, such as venture capital partnerships (see chart on page 38--Asset Allocation of Pension Funds as of June 30, 2008).

In this current market environment, for the calendar year to date ended June 30, 2008, only three of seventeen asset classes had a positive rate of return: commodities, global fixed income and core fixed income. All remaining asset classes had returns ranging from zero percent (municipal bonds) to negative 13.6 percent (large cap value stocks). For this six-month period, the Standard and Poor's 500 index was negative 11.9 percent.

For the calendar year to date through October 31, 2008, every asset class ranging from global fixed income (negative 0.2 percent) to emerging markets equities (negative 53.2 percent) was negative. The Standard and Poor's 500 Index was negative 32.8 percent. While fixed income sectors performed better (less negative) than equities, there was truly "no place to hide" in this capital markets carnage.

Investment times such as these cause pause for reflection upon current asset allocations and strategies, and questions as to what adjustments to make, if any. At the current time there is an enormous flight to quality (treasury and to a lesser extent government agency bonds) that has drained the liquidity out of markets for other, risk-based securities. Until liquidity in these markets returns, securities within them will continue to exhibit suppressed values.

In its new configuration, the VPIC is structuring annual meeting agendas to focus on asset allocation, manager performance, and education in traditional and newer asset types and classes. It is anticipated that while most current invest-

The VPIC has reviewed its options in the current environment. The following themes have been discussed and are guiding the investment process:

* Out-of-favor asset classes and investment styles in today's risk-averse market are likely to prosper in an economic recovery and a return of investor confidence. In particular, corporate bonds and other credit spread securities--currently exhibiting yield spreads over treasury securities of historic magnitudes--will do well in a recovering economy.

* While asset diversification has not prevented composite losses for VPIC and the three Vermont Retirement Systems, it continues to provide less volatility and better long-term returns than an investment strategy without diversification.

* While asset allocation continues to dominate investment performance, diligent investment manager reviews are necessary and prudent with regard to underperforming portfolios.

* Attempts to accommodate near-term negative factors can lead to substantial opportunity costs available from long-term strategies that take advantage of the long-term liability structure of pension fund obligations.

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in fiscal year 2007. While the contributions from these sources were small in fiscal year 2008, over time these statutory provisions are expected to make significant contributions to this fund.

In addition to the above disbursements from the fund, the Vermont Commission on Higher Education Funding authorized the Treasurer to make available the additional 2 percent distribution of $311,059 to be divided equally between the University of Vermont and the Vermont State Colleges for application to their respective permanent endowments. In fiscal year 2009, the additional endowment allocation will be $155,529 for each institution, provided that it is matched on a two-to-one basis by external donations for endowment purposes by the end of the fiscal year and subject to statutory limitations on distributions exceeding contributions. A copy of the State Treasurer's Annual Report to the Commission is attached at the back of this report in the appendix section.

Trust Investment Account

The 2000 Legislature authorized the establishment of a trust investment account administered by the State Treasurer for purposes of investing restricted funds with non-expendable principal balances. As of June 30, 2008, the fund had a principal balance of approximately $59.3 million, of which $34.5 million was allocated to the Tobacco Trust Fund, $18 million to the Higher Education Endowment Trust Fund, and the remainder to various smaller trust funds.

In fiscal year 2008, the Treasurer's office invested $2.5 million of TIA assets in a mutual fund that invests in public housing and other fixed income securities in the U.S.

The current target allocation of the Trust Investment Account is 70 percent fixed income securities and 30 percent equities. For fiscal year 2008, the fund had a dollar weighted total return of 3.10 percent versus the target return of 1.14 percent, which is based on actual asset allocation, and the performance of the S&P 500 Stock Index (negative 13.13 percent) and the Lehman Aggregate Bond Index (7.12 percent).

In fiscal year 2008, the Treasurer's office invested $2.5 million of Trust Investment Account (TIA) assets in a mutual fund that invests in public housing and other fixed income securities throughout the United States. The fund manager, Access Capital, has an equal investment in high-grade Vermont securities that address principally underserved segments of the housing market, such as affordable housing. The aim of the

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ment strategies will continue, adjustments to both manage risk of loss and realize opportunities will be required. The Treasurer's office is grateful for the skill and dedication of members of VPIC during these challenging times in the capital markets.

FUND PERFORMANCE & OPERATIONS

Pension Fund Investments

VPIC oversees all investment assets held by the Vermont State Employees' Retirement System, the State Teachers' Retirement System of Vermont, and the Vermont Municipal Employees' Retirement System. The three systems had combined assets of approximately $3.09 billion on June 30, 2008. In addition, the Burlington Employees' Retirement System, which became a participating investor with the VPIC at the end of October, 2007, had assets of approximately $117.6 million as of the same date.

In fiscal year 2008, one-year investment returns were negative 5.9 percent for VSERS, negative 6.6 percent for VSTRS and negative 6.1 percent for VMERS versus the median public fund return of negative 4.4 percent (see chart on page 37--Long-term Investment Performance of Vermont's Retirement Systems). For the ten years ending June 30, 2008, the median public retirement plan in the consultants' cooperative had an average annualized total return of 5.9 percent, compared with 6.3 percent for VSTRS, 5.6 percent for VSERS, and 6.3 percent for VMERS.

Due primarily to extraordinarily poor capital markets conditions, VPIC returns since fiscal year end have continued to be negative, with retirement system returns ranging from negative 9.7 percent to negative 10.1 percent for the quarter ended September, 2008. Poor conditions and negative returns persist following the end of the quarter. VPIC has maintained its asset allocation discipline in order to avoid selling assets at the bottom of an investment cycle and to position itself appropriately when the market rebounds.

In fiscal year 2008 the VPIC executed plans to invest in important asset categories and to continue its efforts to diversify its holdings. Following VPIC approval of a 4 percent allocation to emerging markets equities funded equally from domestic large capitalization and international equities asset allocations, the VPIC engaged a dedicated emerging markets equity manager to invest in Brazil, Russia, India and China ("BRIC" countries), as well as emerging countries in Asia, Central and South America and other parts of the world. The "BRIC" countries and others have become a significant portion of the world economy as measured by market capitalization and growth potential.

Because of the high volatility of emerging markets stock prices, the VPIC elected to "dollar cost average" the 4 percent allocation by investing 1 percent initially and the remaining 3 percent in 1 percent amounts at six-month intervals such that only 1 percent was invested as of fiscal year end. With the downturn in global equities in calendar 2008, this decision has proven to be advantageous. While the absolute performance of emerging markets has been especially poor in this period, the dollar cost averaging decision and the relative performance of the manager selected has mitigated the effects of committing to this asset class, and over longer investment horizons emerging markets equities are expected to contribute significantly to overall investment performance.

VPIC engaged a core-plus fixed income manager. As a result of the current credit crisis, this asset class has not performed well through the end of the fiscal year and beyond. However, given the extraordinary spreads of corporate and mortgage backed securities over same maturity treasury bonds, this portfolio is expected to return to positive performance in an economic recovery and return to more normal liquidity in the credit markets.

VPIC engaged two new managers for a portion of its fixed income assets which captures fixed income markets performance ("Beta") through an interest rate swap and offers advantages of non-correlated and diversifying Alpha components (portable alpha). One of these managers was engaged in fiscal year 2008 and the second after the fiscal year end.

Investments within the Global Asset Allocation (GAA) asset class include index funds, index futures, mutual funds, and other vehicles which GAA managers use to take advantage of asset class pricing anomalies to create incremental returns. These assets are invested tactically on a daily basis, unlike traditional asset class portfolios which maintain investment in a class of assets irrespective of changes in daily market conditions. Following the end of fiscal year 2008, the VPIC engaged a new GAA manager and also interviewed new real estate managers with an eye towards investing value-added and opportunistic spaces both domestically and internationally. At this juncture, two investments are being pursued in the international arena.

VPIC has maintained its asset allocation discipline in order to avoid selling assets at the bottom of an investment cycle and to position itself appropriately when the market rebounds.

In fiscal year 2008, the VPIC selected through a competitive process a consultant and advisor to assist with its previously adopted policy relating to investing in companies involved in genocidal or terrorist states. VPIC had previously requested divestiture of one issuer held on two VPIC accounts, and the request was accommodated. With assistance from this advisor, the VPIC has the tools required to identify issuers that may be in conflict with its policy and proceed with engagement or divestiture as appropriate. The VPIC continues to discuss this policy and ways of enhancing its efficacy in engaging or divesting companies found to be in conflict with it.

Proxy voting guidelines adopted in March, 2004, continued to be in effect in fiscal year 2008. In calendar 2007, VPIC engaged a proxy voting firm to vote its equity securities in accordance with these guidelines, in place of investment manager voting. As a result of the passage of time, this contract expired in calendar 2008 and a competitive process was undertaken for selection of the advisor. The corporate governance guidelines include voting policies relating to boards of directors, auditors, shareholder rights, and executive and director compensation. The policy's corporate responsibility and accountability guidelines include voting policies on environmental issues such as global warming and environmental reporting, as well as workplace issues such as equal employment opportunities, human rights, and labor codes. A copy of this policy may be obtained on the Vermont Treasurer's web site.

Trust Litigation Settlement Fund & the Tobacco Trust Fund

In November, 1998, Vermont was one of 46 states to enter into a settlement agreement with four major tobacco companies. The State's estimated share of settlement payments at the time was expected to total $806 million over the first 25 years of payment, with an additional $156 million of strategic contribution payments to be paid between 2008 and 2017. Through fiscal year 2008, the State has received payments that total $260.3 million. Fiscal year 2008 marked the first year of receipt of strategic payments, which were $14.4 million and are included in the fiscal year 2008 total.

Pursuant to the Agreement, the expected settlement amounts are adjusted for inflation and the effect of any decreases in the sale of tobacco products

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investment was to increase the pool of available capital funds for affordable housing in Vermont.

Access Capital invests in mortgages to homebuyers making less than 80 percent of an area's median income. With the median income reported for all Vermont households now at approximately $50,000, the investments expand home mortgage loan opportunities for households making, on average, less than $40,000 a year. The recent loan default problems in the subprime mortgage lending market combined with all other credit market conditions has tightened the availability of funds for home loans to low-income households. However, unlike in the subprime lending market, potential homebuyers must go through a tougher loan approval process before being granted a federally-qualified mortgage. Since the loans structured and purchased by Access Capital are federally-qualified mortgages, the investments are more secure. The fund invests primarily in AAA/credit quality community economic development investments, usually specially created mortgage-backed securities.

Vermont Veterans' Home

By legislative act in fiscal year 2001, the Vermont Veterans' Home was required to transfer its endowment fund to the State for administration by the State Treasurer. In the fall of 2001, the home transferred $455,441.85 into the trust to the State. The legislation allows the State Treasurer to invest these funds, if appropriate, with the long-term investments in the Investment Trust Account. The funds were invested with the State's short-term investments, until a spending policy for these funds was established by the Board of Trustees for the Vermont Veterans' Home. At the board's September 2002 meeting, a spending policy was adopted that allowed for transfer of the funds to a fund in the State's Trust Investment Account ("TIA"). Of the amount transferred, $400,000 was deposited in the TIA fund as of October 1, 2002. In November and December of 2002, the Vermont Veterans' Home received a bequest of $410,000 that was deposited into the TIA fund as a second, separately-named fund pursuant to the terms of the bequest. On July 1, 2004, an additional contribution of $75,000 was credited to this second fund.

During fiscal year 2008, withdrawals from the Vermont Veterans' Home TIA funds totaled $55,000. As of June 30, 2008, the balance of the fund first contributed to the TIA was $488,567.51, and the balance of the second (later) fund was $577,046.79, for a combined total of $1,065,614.30.

Vermont's Expected and Actual Receipt of Tobacco Settlement Funds

Fiscal Year	Master Settlement Amount* ($millions	Expected* ($ millions)	Actual* ($millions)
2001	$28.47	$28.47	$24.68
2002	34.18	34.18	30.92
2003	34.51	34.51	30.55
2004	28.80	28.80	25.82
2005	28.80	26.10	26.21
2006	28.80	24.50	24.06
2007	28.80	22.60	24.99
2008	29.37	39.50	39.91
2009	29.37	39.91 **	na
2010	29.37	40.65 **	na

* Source: JFO. Master Settlement amounts shown are at time of initial settlement. Expected amount determined third quarter of each fiscal year unless noted. Actual excludes Settlement Fund Account performance.

**Estimated including estimated Strategic Contribution payments of $14,422,228 in FY 2009 and $14,600,000 in FY 2010.

to the base year. To date and not considering strategic contributions, these have accounted for an 11.5 percent decrease. It remains difficult, therefore, to predict the amount of the future payments due from the tobacco settlement that will be received by the State.

In fiscal year 2000, the Vermont Legislature established a Tobacco Litigation Settlement Fund ("Settlement Fund") to be administered by the State Treasurer and subject to further appropriations. In fiscal year 2008, $29.6 million from the settlement fund was directed to healthcare services (Medicaid; includes funds redirected to the Medicaid Global Commitment Fund). A total of $3.9 million was spent on programs in various departments for tobacco enforcement, prevention, and education programs. Additionally, $3.1 million funded substance abuse and youth protection programs in the Agency of Human Services. In fiscal year 2009, the legislature has appropriated $39.5 million for Medicaid health services; $3.9 million for enforcement, prevention, and education; and $3.1 million for substance abuse and youth protection programs. Any remainder of the settlement fund receipts is earmarked for the separately established Tobacco Trust Fund, a trust established to eventually endow the education and prevention programs. In fiscal year 2008, there was a $2.5 million surplus in funds received by the Settlement Fund. This surplus, plus a withdrawal from the Tobacco Trust Fund, will be used in fiscal year 2009 to fund the appropriations cited above. The balance of the Tobacco Trust Fund at June 30, 2008, was $30.9 million, equal to the $30.9 million balance at the end of fiscal year 2007.

Bank in Vermont Initiative

The Treasurer's office continues to maintain its Bank in Vermont Program to invest State funds on a predictable basis through certificates of deposit (CDs) via a competitive bidding process in banks with branches in Vermont. The program is designed to be attractive to the wide range of banking institutions in Vermont, and is predicated on the belief that investing Vermont funds in Vermont, consistent with earning a competitive rate of return, is a good policy. Banking institutions that wish to be placed on a list of eligible institutions must complete an application/questionnaire. The responses are used to evaluate prospective candidates wishing to provide investment services for CDs, and to determine maximum levels of participation based on the bank's size, financial health, risk factors, credit ratings, and capital levels.

Banks so pre-qualified are then eligible to participate in a monthly competitive bidding process for CDs. Banks that have been prequalified are notified in writing and/or by e-mail in advance of this schedule, and bidding is done on a web site designed by the Treasurer's office. A block of funds is set aside for the scheduled bid in specified time frames. The CDs may be short duration, or have longer maturities, depending on the yield curve and cash management requirements. Between its inception in August, 2004 and December, 2008, $460.65 million in CDs have been awarded. As of December 31, 2008, $21 million is invested in Bank in Vermont CDs of varying maturities with rates well above comparable maturity Treasury rates. During 2008 a total of $123.80 million in such CDs were issued. In light of current market conditions, and in order to help ensure the safety of the State's funds, the Treasurer's office has been reviewing various performance measures and third-party ratings of the pre-qualified banks. The Treasurer's office has modified the collateral requirements for some of the pre-qualified banks. There have been no losses associated with this program.

Short-Term Investing

The State Treasurer's Office manages the investment of the State's cash in its short-term investment program. The short-term portfolio earned $7.49 million in interest income in fiscal year 2008 on average daily available balances of $200.5 million. Of this amount, $2,002,336 was credited to interest earning funds, and the balance of $5,483,664 remained in the general fund. The yield on the available cash in the portfolio was 3.74 percent for the year, which exceeded the average three-month treasury bill auction rate of 2.83 percent. The Treasurer's office utilizes money market funds, in-state certificates of deposit, and solicits offerings from the institutional trading desks of a number of national and local brokers in order to achieve maximum rate of return and diversification in the portfolio. As noted in the market overview above, the Treasurer's office has taken significant steps to mitigate any risks in the current market environment.

Banks Pre-qualified to Participate in Bank in Vermont through 12/31/08

- Citizens Bank
- Connecticut River Bank
- First National Bank of Orwell
- Key Bank
- Mascoma Savings Bank
- Merchants Bank
- National Bank of Middlebury
- Northfield Savings Bank
- Passumpsic Savings Bank
- Peoples Trust Company of St. Albans
- Randolph National Bank
- TD Banknorth Vermont
- The Bank of Bennington
- Union Bank

Bank in Vermont--CDs Awarded and Outstanding through 12/31/08

Bank Name	Awarded Through 12/31/2008	Outstanding At 12/31/2008
Chittenden Bank	$ 79,500,000.00	
Citizens Bank	127,000,000.00	$ 12,000,000.00
Connecticut River Bank	2,600,000.00	
Factory Point National Bank NA*		
First Brandon National Bank**		
First Community Bank**	2,100,000.00	
First National Bank of Orwell		
Keybank	45,425,000.00	
Lyndonville Savings Bank and Trust Company***		
Mascoma Savings Bank	27,950,000.00	
Merchants Bank		
National Bank of Middlebury	2,200,000.00	
Northfield Savings Bank		
Passumpsic Savings Bank	19,050,000.00	
Peoples Trust Co of St. Albans	5,200,000.00	
Randolph National Bank	4,250,000.00	450,000.00
TD Banknorth	137,425,000.00	8,550,000.00
The Bank of Bennington	2,200,000.00	
Union Bank	5,750,000.00	
	$ 460,650,000.00	$ 21,000,000.00

Notes:
* Now part of Berkshire Hills Bancorp, Inc., which is not prequalified for the Bank in Vermont Program.
** Now part of Lake Sunapee Bank, which is not prequalified for the Bank in Vermont Program.
*** Now part of Community National Bank, which is not prequalified for the Bank in Vermont Program.

Unclaimed Property Division

Unclaimed Property Division
(802) 828-2407
(800) 642-3191

Al LaPerle
Unclaimed Property Director

Nancy Scribner
Business Administrator

Linda Bouffard
Program Technician I

Kitty Bolduc
Program Technician I

Overview

The Unclaimed Property Division's primary goal is to reunite individuals with their unclaimed financial property. To accomplish this goal, the division uses a twofold approach. The first is to ensure that holders of unclaimed financial property file their annual unclaimed property report, and the second is to locate and return the property to the rightful owners or their heirs. To accomplish the primary goal of the division, we use a variety of programs to ensure compliance and to reach out to potential owners of property.

The future holds some exciting initiatives for the division. We will be upgrading our system to allow Vermonters to go online to file certain claims, saving time and money for both the claimant and the State. The new system will allow holders of unclaimed property to report property electronically, making it faster for the division to load reports and allowing residents to receive their lost or forgotten funds sooner. We will continue to expand our outreach efforts to both holders and owners of unclaimed funds.

UPDATES

Reporting and Compliance

Vermont's unclaimed property statute requires entities, know as holders, to report and remit certain tangible and intangible property to the State when the owner of such property cannot be located or contacted after a certain period of time. The unclaimed property statute is applicable to every type of industry and includes a variety of property types which are held in perpetuity for the rightful owner or owner's heirs. The State of Vermont is currently in possession of more than $44 million in unclaimed property belonging to approximately 262,000 individuals and organizations.

The State acquires unclaimed property through Vermont's Unclaimed Property Law, which requires "holders" such as corporations, business associations, financial institutions, and insurance companies to annually report and deliver property to the State Treasurer's Office after there has been no customer contact for generally three years. Often the owner forgets that the account exists, or moves

ACCOMPLISHMENTS IN 2008

- **Paid 10,545 claimants more than $4.4 million, 80 percent more than the previous year.**
- **Holders of unclaimed property reported $8.3 million worth of unclaimed funds to the State.**
- **Managed a database of 257,133 properties and $44 million.**
- **25 percent increase in web searches over the previous fiscal year.**
- **Added 1,818 new holders to the unclaimed property database.**

and does not leave a forwarding address or the forwarding order expires. In some cases, the owner dies and the heirs have no knowledge of the property.

The most common types of Unclaimed Property are:

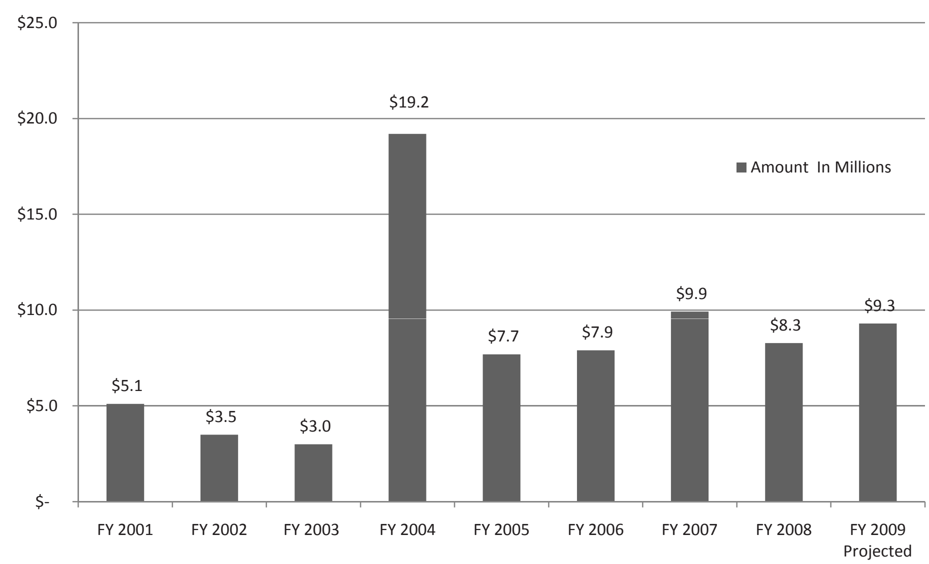
Bank accounts and safe deposit box contents
Stocks, mutual funds, bonds, and dividends
Uncashed cashier's checks or money orders
Payroll checks
Certificates of deposit
Matured or terminated insurance policies
Estates

Vermont's Unclaimed Property Law does NOT include real estate property.

The Unclaimed Property Law gives the State an opportunity to return money and provides Vermont citizens with a single source, the State Treasurer's Office, to check for unclaimed property that may be reported by holders from around the nation. During fiscal year 2008, the State of Vermont received $8.3 million from holders of unclaimed property.

Over the past 12 months the division added 1,818 new holders to the unclaimed property database. While the majority of these holders are filing reports that indicate they do not have financial property to surrender, the number is significant because it shows that our outreach efforts are having an impact—whether they be educational seminars or by using one of our contract auditors to let holders know their responsibilities under the unclaimed property statute. Since the beginning of fiscal year 2009, 320 holders have reported 14,539 properties worth a total of $920,789. This compares to 347 holders reporting 3,805 properties totaling $606,472 for the same period during fiscal year 2008.

Unclaimed Property--Property Value Turned Over to the Treasurer's Office



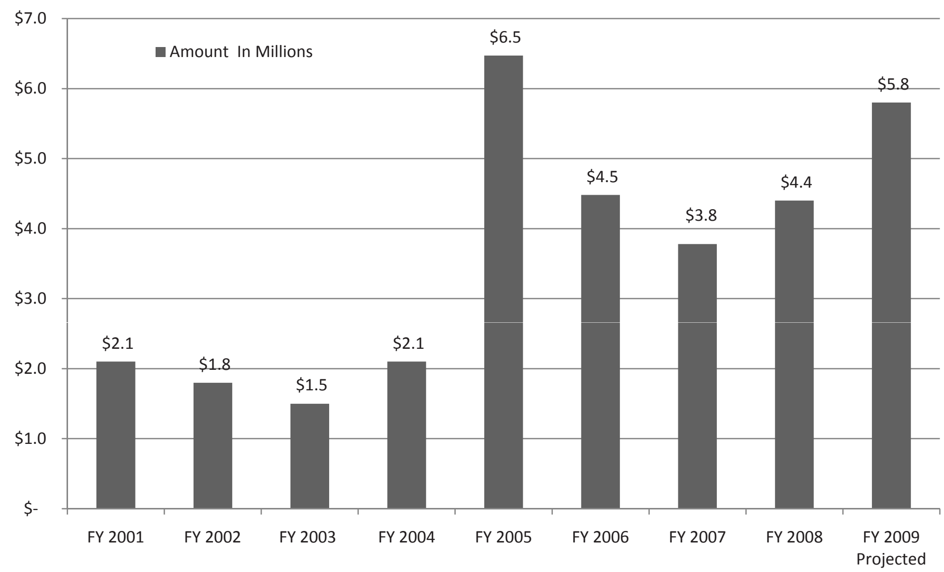
Claims Processing

The Unclaimed Property Division acts as custodian to safeguard the assets until they can be claimed by the rightful owner or heirs. In fiscal year 2008, the division paid 80 percent more claims than it did in fiscal year 2007. The division paid more than 10,500 claims totaling $4.4 million. The average claim was $417.

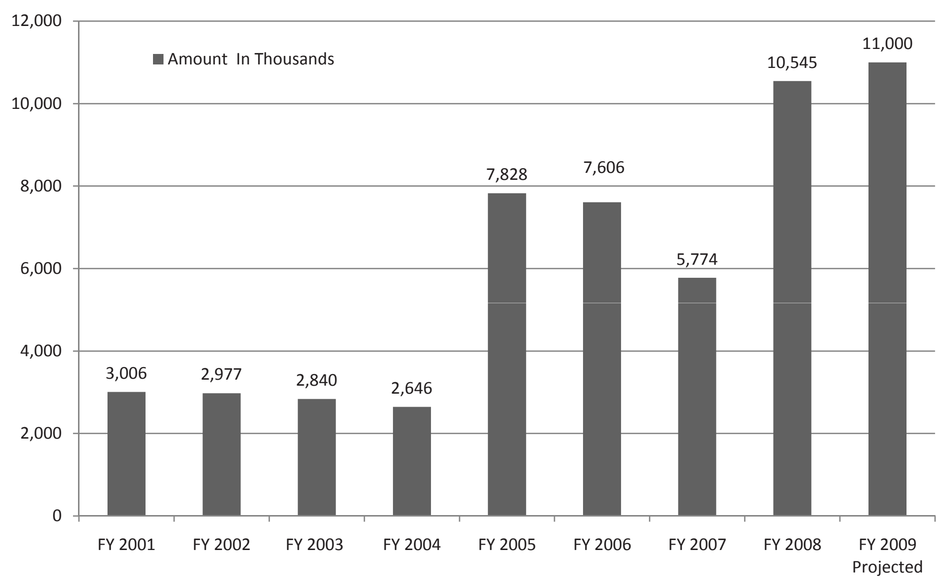
Reaching out to owners of unclaimed property remains the goal of the division. By promoting our web site we continue to see an increase of activity in the number of searches for unclaimed property. In this past fiscal year we have seen an increase of 25 percent in the number of web searches. Our database was searched 328,138 times versus 261,885 times for fiscal year 2007. We continue to use outreach methods that have worked well for us in the past, such as publication of our annual list of names in daily newspapers, spring advertising campaign; staffing a booth at the Champlain Valley Exposition; town clerk and legislator listings; and other outreach events. This year's exposition alone generated 1,070 claims worth $160,000.

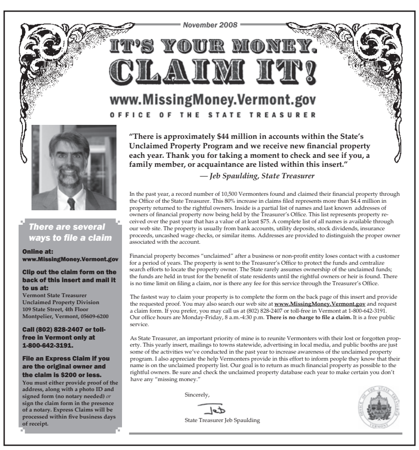
Going into its third year, the express claim initiative remains one of the most positive programs in the unclaimed property division. Within five business days of receiving a claim, the express claim program will pay the original owner of property totaling $200 or less. Total express claims paid numbered 3,778, all paid within the established guidelines. Claim information is shown in the charts below.

Unclaimed Property Amount Returned to Vermonters



Number of Claimants Paid





November 2008

IT'S YOUR MONEY. CLAIM IT!

www.MissingMoney.Vermont.gov

OFFICE OF THE STATE TREASURER

"There is approximately $44 million in accounts within the State's Unclaimed Property Program and we receive new financial property each year. Thank you for taking a moment to check and see if you, a family member, or acquaintance are listed within this insert."
— Jeb Spaulding, State Treasurer

In the past year, a record number of 10,500 Vermonters found and claimed their financial property through the Office of the State Treasurer. This 80% increase in claims filed represents more than $4.4 million in property returned to the rightful owners. Inside is a partial list of names and last known addresses of owners of financial property now being held by the Treasurer's Office. This list represents property received over the past year that has a value of at least $75. A complete list of all names is available through our web site. The property is usually from bank accounts, utility deposits, stock dividends, insurance proceeds, uncashed wage checks, or similar items. Addresses are provided to distinguish the proper owner associated with the account.

Financial property becomes "unclaimed" after a business or non-profit entity loses contact with a customer for a period of years. The property is sent to the Treasurer's Office to protect the funds and centralize search efforts to locate the property owner. The State rarely assumes ownership of the unclaimed funds; the funds are held in trust for the benefit of state residents until the rightful owners or heir is found. There is no time limit on filing a claim, nor is there any fee for this service through the Treasurer's Office.

The fastest way to claim your property is to complete the form on the back page of this insert and provide the requested proof. You may also search our web site at www.MissingMoney.Vermont.gov and request a claim form. If you prefer, you may call us at (802) 828-2407 or toll-free in Vermont at 1-800-642-3191. Our office hours are Monday-Friday, 8 a.m.-4:30 p.m. **There is no charge to file a claim.** It is a free public service.

As State Treasurer, an important priority of mine is to reunite Vermonters with their lost or forgotten property. This yearly insert, mailings to towns statewide, advertising in local media, and public booths are just some of the activities we've conducted in the past year to increase awareness of the unclaimed property program. I also appreciate the help Vermonters provide in this effort to inform people they know that their name is on the unclaimed property list. Our goal is to return as much financial property as possible to the rightful owners. Be sure and check the unclaimed property database each year to make certain you don't have any "missing money."

Sincerely,

JeD

State Treasurer Jeb Spaulding

There are several ways to file a claim

Online at:
www.MissingMoney.Vermont.gov

Clip out the claim form on the back of this insert and mail it to us at:
Vermont State Treasurer
Unclaimed Property Division
109 State Street, 4th Floor
Montpelier, Vermont, 05609-6200

Call (802) 828-2407 or toll-free in Vermont only at 1-800-642-3191.

File an Express Claim if you are the original owner and the claim is $200 or less.
You must either provide proof of the address, along with a photo ID and signed form (no notary needed) *or* sign the claim form in the presence of a notary. Express Claims will be processed within five business days of receipt.

The annual list of names, published in daily newspapers throughout Vermont each fall, draws attention to new individual listings to the unclaimed property database.

Treasury Operations Division

Overview

The Treasury Operations Division processed approximately 1.5 million payments during the 2008 fiscal year. More than half of those were conducted electronically, and the goal is to continue increasing the proportion of transactions that occur electronically. The division is responsible for the banking and cash management of more than $4 billion annually in both receipts and disbursements; the establishment and maintenance of the State's banking network; the disbursement of the State's warranted payments and debt service; the collection of certain receipts, including those related to Act 68; and the recording of accounting transactions associated with the above activities. The reconciliation of internal and external accounts comprises a major portion of the office's staff time, in addition to the proper reporting and recording on the State's books for financial reporting.

The Treasury Operations Division is the core operation for money movement within the State.

In addition, the division is responsible for preparing financial statements and schedules for the annual audit of the State's books (as it relates to cash and investment disclosures), administering the Municipal Equipment Loan Fund, and assisting the Retirement Operations Division staff in the preparation of the pension trust fund financial statements.

ACCOMPLISHMENTS IN 2008

- **Responded to more than 700 information requests received via the division's centralized e-mail account.**
- **During 2008, a review was completed of the process for clearing and reconciling items, and several process improvements were identified. Reconciliation of the State's core bank accounts was completed within 30 days of the monthly closing of the State's books, as has been the practice for nearly five consecutive years.**
- **Initiated a Payment Card Industry Data Security Standard compliance and education program for all State agencies and departments that accept credit card payments.**
- **Converted electronic bank systems for all State agencies and departments when the State's bank of record rolled out a new system in February 2008.**
- **Under the direction of the Payroll Department of the Agency of Finance and Administration, oversaw a significant reduction in the number of payroll checks printed and distributed each payroll period as part of the State's efforts to maximize the use of direct deposit for payroll.**

Treasury Operations Division: (802) 828-2301

John Booth
Treasury Operations Director

Dan Currier
Cash & Investments Manager

Ron Baldauf
Financial Specialist III

Lisa Gilman
Financial Specialist III

Becky Brockway
Financial Specialist II

Joanne Costantini
Financial Specialist II

Gayle Rowe
Financial Specialist II

TD Banknorth serves as the State's master banking contractor. Bank personnel and Treasury staff work continuously together to provide new and improved services and processes.

UPDATES

Reconciliations

The Treasurer's office staff reconciles approximately 31 State core bank accounts. In the 2008 fiscal year, 76,786 deposits were processed to State accounts through a network designed to accelerate the collection of cash so that it may be used for operating needs or efficiently placed in short-term investments. On the disbursement side, 1,536,522 payments were processed, either through paper checks or electronic payments. Working cooperatively with all of the Treasury's business partners, we have been able to assure that the number and duration of reconciling items from user department entries remains low, and that reporting/review processes are in place to continually improve the accuracy and timeliness of financial reports and the supporting data.

Electronic Payments

The issuance of paper checks is labor-intensive and costly. Electronic payments reduce bank fees, printing costs, fraud, and postage, as well as staff time to reconcile bank accounts. Tracking of lost checks is time-consuming and can be largely eliminated through electronic payment processing. Time spent searching for cleared payments is eliminated. Bank fees related to "stop payments" are eliminated, as are the costs associated with re-issuing payments, and inconvenience to the payees. This past year, 2,180 check payments were reissued because the original check was lost or was never received by the payee.

Moving further from a paper-based payment system to electronic forms provides increased safety and efficiency in the payment process.

One of the barriers to the use of electronic payments by vendors is the lack of payment remittance information received with the payment. The State currently issues and mails a remittance advice for each electronic payment. Of the more than 1.5 million payments processed during fiscal year 2008, approximately 54 percent were electronic transfers. The Treasurer's office is continuing work on the development of a web-based vendor portal that will allow vendors that receive payments by electronic transfer to view their payment advices via a secure website.

In November of 2008, 93.4 percent of retired State employees, 87.7 percent of retired municipal employees, and 95.4 percent of retired teachers received their monthly benefit payments via direct deposit. This is an increase from the November 2007 percentages of 92.5 percent-State, 86.3 percent-municipal, and 94.7 percent-teachers.

Act 68 Receipts

Notification and initial invoicing of the municipalities for the principal payment are completed by the Department of Education. Per statute, the Treasury Operations Division monitors the receipt of payments mandated by Act 68. In fiscal year 2008, all municipalities made their Act 68 principal payments.

As of December 24, 2008, all principal receivable for the payment due on December 1, 2008 had been collected. The Treasurer's office has also billed interest, calculated at 8 percent per annum, for five municipalities that made principal payments after the December 1 due date. Subsequently, all of the interest bills were paid. The Act 68 receipts approximate $77 million for the most recent semi-annual billing cycle.

Treasury Operations Division Structure

In February 2008 a Treasury Operations Director was brought on board to oversee the increasing operational demands in this division. The director is the primary liaison with internal and external auditors. The Director of Treasury Operations also is chair of an Internal Control Committee which is comprised of staff from its various divisions and is responsible for enhancing the office's control environment. Internal control is broadly defined as a process to provide reasonable assurance regarding the achievement of objectives including effectiveness and efficiency of operations, reliability of financial reporting, compliance with applicable laws and regulations and the safeguarding of assets. The committee reviews operations across all divisions within the Treasurer's office, recommends business process improvements, and identifies implements and tests appropriate internal controls. This team approach has generated increased efficiencies and has the added benefit of cross-training.

Legislative Reporting Requirements

Brandon Training School/Vermont Veterans' Home

Section 23 of Act 62 of the Public Acts of 1995 specifies that the State Treasurer shall notify the chairs of the Senate and House Institutions committees upon receipt of monies from the sale of the Brandon Training School property, as well as certain federal receipts associated with the Vermont Veterans' Home. For fiscal year ending June 30, 2008, the State has timely received amounts due from the federal government associated with the Vermont Veterans' Home. There were no sales of property belonging to the Brandon Training School in fiscal year 2008.

Burma (Myanmar)

Act 13 of the Public Acts of 1999 specifies that the Treasurer shall implement the purposes of the Act by voting in favor of shareholder resolutions concerning individual companies doing business with the government of Burma. In addition, the Treasurer shall separately notify the company that Vermont wishes to convey its grave concerns regarding the company's economic ties to the government of Burma. The Treasurer complies with this Act through measures including mandating compliance through VPIC investment guidelines that must be observed by investment managers and by the proxy voting firm engaged by VPIC to vote its proxies. Proxy voting guidelines adopted by the three Vermont Retirement Systems and the Treasurer's office for U.S. domestic equity managers also specify manager voting compliance including support of labor standards in connection with a company's involvement in Burma, and reporting on Burmese operations and activities.

Credit Card Payments

The Treasurer's office contracts with TD Banknorth Merchant Services Group, a division of TD Banknorth, to provide credit and bank card services. Acceptance of credit and debit card payments is broadly practiced in many agencies and departments as a method of payment of registration fees, licenses, penalties, fines,

Credit Card Accounts Summary

DEPARTMENT	TOTAL SALES	TOTAL FEES
VT Dept. of Liquor Control	$ 17,743,384.99	$ 359,219.41
VT Dept. of Motor Vehicles	13,526,924.03	233,512.81
VT Dept. of Taxes*	4,691,813.04	79,736.96
VT Dept. of Forest, Parks & Recreation	2,398,577.01	50,123.45
VT Dept. of Fish and Wildlife	873,360.04	17,669.17
VT Life Magazine	521,845.66	11,767.15
VT Secretary of State	1,038,250.00	24,741.76
VT Vital Records**	38,870.05	4,494.00
VT Judicial / Courts	4,597,548.83	14,387.04
VT Center for Crime Victims / Restitution Unit	158,564.67	3,074.12
VT Dept. of Health Department	172,838.00	4,241.12
VT Dept. of Environmental Conservation	4,872.53	278.03
VT Dept. of Historic Preservation / Historic Sites	130,171.58	7,537.07
VT Dept. of Child & Family Services	429,894.00	9,901.85
Total	$ 46,326,914.43	$ 820,683.94

* This represents gross fees assessed. Certain taxpayers using credit cards to make payments to the Department of Taxes pay a convenience fee, which offsets the credit card fees for those payments. The Department of Taxes' expenditures for credit card services totaled $8,372.03 during this reporting period.
** This was billed to the Department of Buildings & General Services until July 2008.

durable goods, park reservations, interest, and payment of taxes. Credit and debit card acceptance provides our customers, the citizens of Vermont, with a more convenient method of payment. In addition to public convenience, electronic processing of consumer and business purchases improves governmental cash flows, offers greater financial security, and reduces the overhead costs associated with the handling of currency.

The Court Administrator has been working with Vermont Information Consortium (VIC) since February, 2007 to allow for the payment of fines and fees by credit card. In the fiscal year ending June 30, 2008, approximately 25,000 transactions were processed with almost $3.7 million collected in fines and fees. Of those transactions, approximately 18,000 were conducted by users over the Internet, with the remaining 7,000 processed either in person at a District Court or over the phone. A convenience fee of $3.95 is currently charged to users of the service each time a person pays with their credit or debit card. In order to market the on-line credit card payment option for Judicial Bureau judgments, the Judiciary has added the website address for the service to payment envelopes, the judgment form and the collection notice. The judgment form and the collection notice also include a tear-off credit card payment stub that can be mailed.

MacBride Principles

Act 50 of the Public Acts of 1989 specifies that the State Treasurer and the Retirement Boards compile a list of corporations that conduct business in Northern Ireland in which the State Treasurer and Retirement Boards have invested funds. Notifications from external investment managers listing such businesses are due in the Treasurer's office on January 1 of each year, and these notifications are kept on file in the Treasurer's office. The Act further requires that the Treasurer and the boards of the trustees of the Vermont State Employees' Retirement System and the Vermont State Teachers' Retirement System shall support the MacBride Principles addressing worker equality and security issues through support of shareholder issues. The Treasurer's office and the trustees comply with Act 50 by mandating MacBride Principles compliance through Vermont Pension Investment Committee (VPIC) investment guidelines to be observed by investment managers and by the proxy firm engaged by VPIC to vote its proxies. Proxy voting guidelines approved by the three Vermont Retirement Systems and the Treasurer's office for U.S. domestic equity managers also specify manager voting compliance with MacBride principles.

Survivors of Emergency Personnel

Originally established by the legislature in 2002 as the Firefighters' Survivors Benefit Fund, it was expanded during the 2005 legislative session to include not only firefighters, but ambulance service, emergency medical, first responder service and volunteer personnel. A review board administers the grant of a one-time monetary benefit to the survivor or survivors of emergency personnel employed by or who volunteer for the state of Vermont, a county or municipality of the state, or a nonprofit entity which provides services in the state, who die in the line of duty or of an occupational-related illness. The board met once during the year. Thankfully, no benefit awards were required to be paid out to survivors this past year. As of November 30, 2008, the fund has assets of $235,569.

Financial Literacy Trust Fund

The legislature authorized the establishment of a trust fund to finance financial literacy in Vermont. According to the legislation, "the purpose of the fund is to promote the adoption of fiscally sound money management practices by Vermonters through education and outreach efforts that raise awareness of the need for and benefits of practicing such skills; and to create opportunities to build and encourage the development of new financial literacy activities and educational products for Vermont citizens." The Treasurer is authorized to collect money from a variety of sources to fund these activities. To date, the fund has received deposits of $5,400, earning $16.24 in interest. Funds received are planned for expenditure in support of a range of financial education programs including a statewide financial literacy poster contest and adult education materials.

Technology & Legal Updates

Technology Services

The Technology Services Division is committed to providing programming and technical support services to the Treasurer's office. Office personnel in this area provide support to the entire range of software and hardware facilitating the operations of the office, including banking reconciliation software, check and EFT issuance, unclaimed property, and the various programs supporting the retirement services for the State's approximately 44,000 active, vested, and retired members.

UPDATES

The Technology Services staff continued to implement important upgrades to the Treasurer's office's infrastructure to improve the speed and dependability of its systems during 2008. This work included:

- **Implementation of the Treasurer's office disaster recovery and business continuity plan that continues with further onsite testing at the McFarland Building remote site, and the development of detailed procedures for processing during an outage;**
- **The addition of a secure FTPS server for file transfers between departments;**
- **The installation of numerous new desktops running the Vista OS;**
- **VPAS (Vermont Pension Administration System) implementation—continuing the second phase scheduled to be rolled out in 2009; and**
- **Working closely with various Treasurer's office operations staff and other departments to enhance existing services, such as the development of a web-based Vendor Advice Portal, and planning for a comprehensive check-printing solution.**

Technology Services
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Ram Verma
Technology Services Director

Lane Safford
Network Administrator II

Karen Willey
Systems Developer III

Legal Services

During the past legislative session the General Assembly enacted a variety of measures to improve the State's retirement plans, which include decreasing the size of the Vermont Pension Investment Committee (see update pg. 35); providing a full COLA for retiring State employees; authorization for a new 403(b) program for the teacher's system; and creation of a Financial Literacy Trust Fund (see update pg. 51). Below are updates on some of these measures.

UPDATES

State Employees' COLA and Health Care

After an exhaustive summer study the legislature passed Act 116, which contains a comprehensive approach to funding a full (up to 5 percent) group F cost-of-living adjustment (COLA) for State employees retiring on or after July 1, 2008. Previously, Group F members were the only State employee group that did not have this benefit. It will be paid for by a combination of an increase in the group F member contribution rate coupled with changes in retirement benefits and medical insurance subsidies for future newly hired group F members. It is important to note that this legislation actually saves the State money. In fact, over the next 30 years, the projected savings total approximately $265 million if we continue to fund our retiree medical benefits on a pay-as-you-go basis, and an estimated $308 million if we move to pre-funding our retiree medical insurance. The present value of these projected savings is $46 million and $70 million respectively.

Teachers' 403(b) Deferred Contribution Retirement Program

This past year the Vermont Superintendents' Association approached the Treasurer's office and requested that the State consider providing a statewide voluntary tax deferred 403(b) retirement investment program to Vermont's teachers. Recent changes to federal tax law have caused school districts to reexamine their own deferred compensation programs, particularly the plans established under Sec. 403(b) of the Internal Revenue Code. In addition to the usual mandatory defined benefit retirement plans for State employees and teachers, Vermont has also offered a tax deferred Sec. 457 voluntary deferred compensation plan to State and other governmental employees since 1979. At the end of 2007, the 457 plan held $256 million in assets and had 6,410 participants. State law did not, however, allow the State to offer a 403(b) plan to its teachers. As a result of the superintendents' request, the General Assembly enacted Act 162, which authorized the Vermont Teachers' Retirement Board to offer Vermont teachers a statewide 403(b) retirement savings program. The Teachers' Board selected Great-West Life and Annuity to handle record keeping for the program and has since entered into a contract with that company. The program is now being offered to school districts across the State.

Appendices

HISTORICAL SUMMARY OF OPERATIONS: *Pension Fund Operations*

State Employees' Retirement System -- Summary of Operations

Category	2003	2004	2005	2006	2007	2008
SOURCES OF FUNDS						
Employee Contributions	$ 12,171,186	$ 13,716,264	$ 15,112,105	$ 14,561,467	$ 15,456,691	18,614,102
Employer Contributions	24,394,933	26,645,619	36,493,435	36,866,451	39,297,002	39,179,823
Other Income	813,168	695,397	777,792	1,171,516	205,321	169,984
Investment Income (Reduction)	40,435,216	138,426,552	90,452,723	115,146,415	192,625,279	(84,156,254)
APPLICATION OF FUNDS						
Retirement Benefits	41,614,187	44,637,116	48,893,673	53,435,617	58,859,659	64,060,488
Refunds	923,964	1,171,957	1,402,481	1,351,911	1,526,140	1,414,144
Health/Life Insurance Expenses	9,916,398	9,236,526	11,329,269	11,590,588	13,541,092	16,371,373
Administrative Expenses	971,394	659,447	1,255,852	1,329,081	511,435	1,254,577
Other Expenses	369,383	617,658	635,618	668,929	344,719	631,321
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 24,019,177	$ 123,161,128	$ 79,319,162	$ 99,369,723	$ 172,801,248	$ (109,924,248)

Teachers' Retirement System -- Summary of Operations

Category	2003	2004	2005	2006	2007	2008
SOURCES OF FUNDS						
	$ 18,820,703	$ 21,088,345	$ 21,158,452	$ 21,884,140	$ 22,533,479	22,918,798
Employer Contributions	20,446,282	24,446,282	24,446,282	24,446,282	37,341,609	39,549,097
Other Income	438,166	267,330	373,705	1,180,606	2,093,219	1,628,242
Investment Income (Reduction)	52,506,838	166,325,045	115,058,694	130,835,585	244,437,213	(110,019,634)
APPLICATION OF FUNDS						
Retirement Benefits	50,409,313	55,246,342	60,147,731	66,272,471	74,368,306	82,157,642
Refunds	1,109,174	711,806	1,104,278	1,290,197	1,625,140	1,280,715
Health/Life Insurance Expenses	6,634,738	8,279,332	10,167,601	11,233,854	13,040,783	15,081,847
Administrative Expenses	763,527	805,495	1,052,772	1,679,883	817,052	866,473
Other Expenses	702,568	543,746	682,438	580,403	203,444	542,665
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 32,592,669	$ 146,540,281	$ 87,882,313	$ 97,289,805	$ 216,350,795	$ (145,852,839)

Municipal Retirement System -- Summary of Operations

Category	2003	2004	2005	2006	2007	2008
SOURCES OF FUNDS						
Employee Contributions	$ 5,000,479	$ 6,507,268	$ 7,404,119	$ 8,744,718	$ 9,769,882	9,906,709
Employer Contributions	5,707,184	7,114,813	8,058,810	7,926,436	8,535,396	0
Other Income	17,855,452	2,125,294	298,475	228,746	206,101	124,132
Investment Income (Reduction)	2,630,247	27,271,821	18,165,861	27,697,371	46,637,360	(19,472,654)
APPLICATION OF FUNDS						
Retirement Benefits	4,929,747	5,694,080	6,418,097	7,120,325	7,969,703	9,064,725
Refunds	639,170	1,110,243	1,140,245	1,102,940	1,389,583	1,143,397
Health/Life Insurance Expenses	-	-	-	-	-	0
Administrative Expenses	118,038	151,228	367,810	439,983	687,382	623,619
Other Expenses	546,692	668,624	423,937	1,101,883	560,473	506,817
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 24,959,715	$ 35,395,021	$ 25,577,176	$ 34,832,140	$ 54,541,598	$ (20,780,371)

STATE OF VERMONT: *Pension Trust Funds—Combining Statements of Plan Net Assets—6/30/2008*

	Defined Benefit Plans			Defined Contribution Plans			Other Postemployment Benefits Funds			
	Vermont State Retirement Fund	State Teachers' Retirement Fund	Vermont Municipal Employees' Retirement Fund	Vermont State Defined Contribution Fund	Single Deposit Investment Account Fund	Vermont Municipal Employees' Defined Contribution Fund	Vermont State Postemployment Benefits Trust Fund	Vermont Municipal Employees' Health Benefit Fund	Eliminations	Total
Assets:										
Cash and short term investments	$ 2,480,523	$ 3,162,383	$ 1,349,355	$ 284,111	$ 4,475,160	$ 66,231	$ 294,790	$ 3,029,141	$ -	$ 15,141,694
Receivables:										
Contributions - current	3,798,026	2,522,316	1,027,017	155,998	-	17,318	-	1,166,817	-	8,687,492
Contributions non-current	-	-	11,051,031	-	-	-	-	-	-	11,051,031
Interest and dividends	11,272	13,792	572,680	-	574,821	-	-	-	-	1,172,565
Investments sold	-	-	-	-	4,112,227	-	-	-	-	4,112,227
Due from other funds	149,073	-	29,889	-	-	-	152,269	-	(178,962)	152,269
Other	-	264,169	-	-	-	-	-	-	-	264,169
Total receivables	3,958,371	2,800,277	12,680,617	155,998	4,687,048	17,318	152,269	1,166,817	(178,962)	25,439,753
Investments at Fair value:										
Pooled investments	1,272,646,888	1,488,625,458	312,272,761	-	-	-	-	-	-	3,073,545,107
Fixed income	497	28	4,196	-	85,873,527	-	2,284,004	-	-	88,162,252
Equities	-	1,462	-	-	565,650	-	760,684	-	-	1,327,796
Real estate and venture capital	2,102,641	5,739,881	767,390	-	-	-	-	-	-	8,609,912
Mutual funds	-	-	-	38,732,811	-	13,222,481	171,770	4,451,368	-	56,578,430
Total investments	1,274,750,026	1,494,366,829	313,044,347	38,732,811	86,439,177	13,222,481	3,216,458	4,451,368	-	3,228,223,497
Prepaid expenses	1,424,823	1,284,417	-	35,211	-	-	-	-	-	2,744,451
Capital Assets:										
Construction in progress	994,427	1,138,877	274,194	-	-	-	-	-	-	2,407,498
Capital assets being depreciated:										
Equipment	68,011	79,040	36,763	-	-	-	-	-	-	183,814
Less accumulated depreciation	(26,638)	(30,957)	(14,399)	-	-	-	-	-	-	(71,994)
Total capital assets, net of depreciation	1,035,800	1,186,960	296,558	-	-	-	-	-	-	2,519,318
Total assets	**1,283,649,543**	**1,502,800,866**	**327,370,877**	**39,208,131**	**95,601,385**	**13,306,030**	**3,663,517**	**8,647,326**	**(178,962)**	**3,274,068,713**
Liabilities:										
Payable for investments purchased	-	-	-	-	11,027,296	-	-	-	-	11,027,296
Accounts payable	1,075,176	1,270,637	269,094	9,630	-	396	-	-	-	2,624,933
Retainage payable	80,495	98,357	41,681	-	-	-	-	-	-	220,533
Due to other funds	-	111,693	-	37,380	-	29,889	-	-	(178,962)	-
Total liabilities	**1,155,671**	**1,480,687**	**310,775**	**47,010**	**11,027,296**	**30,285**	**-**	**-**	**(178,962)**	**13,872,762**
Net assets held in trust for employees' pension and other postemployment benefits	**$ 1,282,493,872**	**$ 1,501,320,179**	**$ 327,060,102**	**$ 39,161,121**	**$ 84,574,089**	**$ 13,275,745**	**$ 3,663,517**	**$ 8,647,326**	**$ -**	**$ 3,260,195,951**

STATE OF VERMONT: *Pension Trust Funds—Combining Statements of Changes in Plan Net Assets—Fiscal Year Ended 6/30/2008*

	Defined Benefit Plans			Defined Contribution Plans			Other Postemployment Benefits Funds			
	Vermont State Retirement Fund	State Teachers' Retirement Fund	Vermont Municipal Employees' Retirement Fund	Vermont State Defined Contribution Fund	Single Deposit Investment Account Fund	Vermont Municipal Employees' Defined Contribution Fund	Vermont State Postemployment Benefit Trust Fund	Vermont Municipal Employees' Health Benefit Fund	Eliminations	Total
Additions :										
Contributions										
Employer - pension benefit	$ 22,811,627	$ 24,299,097	$ -	$ 1,959,169	$ -	$ 625,539	$ -	$ -	$ -	$ 49,695,432
Employer - healthcare benefit	16,368,196	15,250,000	-	-	-	-	1,444,757	9,250,816	-	42,313,769
Plan member	18,614,102	22,918,798	9,906,709	692,433	-	625,341	-	-	-	52,757,383
Transfers from other pension trust funds	166,746	221,773	124,132	187,975	-	38,519	-	-	(739,145)	-
Transfers from non-state systems	3,238	-	-	104,074	-	140,808	-	-	-	248,120
Medicare part D drug subsidy	-	1,406,469	-	-	-	-	-	-	-	1,406,469
Total contributions	**57,963,909**	**64,096,137**	**10,030,841**	**2,943,651**	**-**	**1,430,207**	**1,444,757**	**9,250,816**	**(739,145)**	**146,421,173**
Investment Income:										
Net appreciation (depreciation) in fair value of investments	35,834,967	38,255,622	8,147,578	(5,305,166)	(177,201)	(1,752,734)	(114,737)	(208,779)	-	74,679,550
Income (loss) from pooled investments	(132,073,225)	(161,803,403)	(31,438,559)	-	-	-	-	-	-	(325,315,187)
Dividends	4,513,469	5,733,058	1,033,561	2,550,928	-	847,630	17,803	-	-	14,696,449
Interest income	10,237,214	11,073,277	3,426,899	10,273	4,552,492	2,596	104,820	48,045	-	29,455,616
Securities lending income	2,220,415	2,648,751	502,161	-	99,672	-	-	-	-	5,470,999
Other income	526,239	545,228	72,972	-	6,049	6,741	-	-	-	1,157,229
Total investment income (loss)	**(78,740,921)**	**(103,547,467)**	**(18,255,388)**	**(2,743,965)**	**4,481,012**	**(895,767)**	**7,886**	**(160,734)**	**-**	**(199,855,344)**
Less Investment Expenses:										
Investment managers and consultants	4,850,023	5,798,123	1,089,451	525	308,952	-	-	33,377	-	12,080,451
Securities lending expenses	565,310	674,044	127,815	-	-	-	-	-	-	1,367,169
Total investment expenses	**5,415,333**	**6,472,167**	**1,217,266**	**525**	**308,952**	**-**	**-**	**33,377**	**-**	**13,447,620**
Net investment income (loss)	**(84,156,254)**	**(110,019,634)**	**(19,472,654)**	**(2,744,490)**	**4,172,060**	**(895,767)**	**7,886**	**(194,111)**	**-**	**(213,302,964)**
Total additions	**(26,192,345)**	**(45,923,497)**	**(9,441,813)**	**199,161**	**4,172,060**	**534,440**	**1,452,643**	**9,056,705**	**(739,145)**	**(66,881,791)**
Deductions:										
Retirement benefits	64,060,488	82,157,642	9,064,725	2,149,065	8,874,501	383,697	-	-	-	166,690,118
Other post employment benefits	16,371,373	15,081,847	-	252,083	-	-	-	409,379	-	32,114,682
Refunds of contributions	1,414,144	1,280,715	1,143,397	-	-	-	-	-	-	3,838,256
Death claims	332,573	391,483	217,602	-	-	-	-	-	-	941,658
Transfers to other pension trust funds	298,748	151,182	289,215	-	-	-	-	-	(739,145)	-
Depreciation	26,638	30,957	14,399	-	-	-	-	-	-	71,994
Operating expenses	1,227,939	835,516	609,220	39,126	-	38,963	-	-	-	2,750,764
Total deductions	**83,731,903**	**99,929,342**	**11,338,558**	**2,440,274**	**8,874,501**	**422,660**	**-**	**409,379**	**(739,145)**	**206,407,472**
Change in net assets	**(109,924,248)**	**(145,852,839)**	**(20,780,371)**	**(2,241,113)**	**(4,702,441)**	**111,780**	**1,452,643**	**8,647,326**	**-**	**(273,289,263)**
Net assets held in trust for employees' pension and other postemployment benefits:										
July 1	**1,392,418,120**	**1,647,173,018**	**347,840,473**	**41,402,234**	**89,276,530**	**13,163,965**	**2,210,874**	**-**	**-**	**3,533,485,214**
June 30	**$ 1,282,493,872**	**$ 1,501,320,179**	**$ 327,060,102**	**$ 39,161,121**	**$ 84,574,089**	**$ 13,275,745**	**$ 3,663,517**	**$ 8,647,326**	**$ -**	**$ 3,260,195,951**

HIGHER EDUCATION TRUST FUND: *Annual Report—September 5, 2008*

TO: Commission on Higher Education Funding

FROM: Jeb Spaulding, State Treasurer

RE: Annual Report on the Higher Education Trust Fund

DATE: September 5, 2008

I am pleased to present the State Treasurer's ninth annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by the 1999 General Assembly to provide non-loan financial aid to Vermont students attending the University of Vermont, the Vermont State Colleges, and other Vermont post-secondary institutions (16 V.S.A. § 2885). Total principal contributions through June 30, 2008 have been $15,879, 896 - $6,000,000 appropriated in FY 2001, $1,000,000 in FY 2002, $635,881 in FY 2003, $2,363,357 in FY 2006, $5,823,449 in FY 2007, and $57,209 in FY 2008.

The statute provides that in August of each year, the State Treasurer is to withdraw 5% of up to a 12-quarter moving average of the fund's assets and divide the amount equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation.

During fiscal year 2008, the Higher Education Trust Fund dollar weighted investment return was 3.10% gross of fees. This return compares to the Lehman Aggregate Bond Index return of 7.12% and to the S&P 500 Stock Index return of -13.13% for the same period, and exceeds the Fund's target rate (based on actual asset allocation and index returns) of 1.14%. The 5% distribution available this year is $777,647.69 in total, or $259,215.90 each for UVM, VSC, and VSAC; the distribution made following Fiscal Year 2007 was $206,860.67 for each institution. (See Appendix A for quarterly market values and distributions for fiscal year 2008.)

16 V.S.A. § 2885 further provides that in August of each year, the Commission on Higher Education Funding may authorize the State Treasurer to make an additional amount equal to up to 2% of the fund's average assets available to UVM and the Vermont State Colleges for the purpose of creating or increasing a permanent endowment fund. The amount appropriated, however, cannot exceed an amount that would bring the fund balance below total contributions to principal. At its meeting last year, the Commission authorized this 2% appropriation in the amount of $248,232.81, or $124,116.40 each for distribution to the University of Vermont and the Vermont State Colleges dependent upon a finding by the Commission that the terms of this appropriation have been met. Each institution is required to match the appropriation by raising twice that amount, or $248,232.80, and to certify to the Commissioner of Finance and Management that it received private donations in the requisite amount and that the funds will be

used to create or increase a permanent endowment at the respective institution. Each of these institutions is in the process of establishing the required certification.

After payments of $777,647.69 and $248,232.80, the balance in the fund at the beginning of fiscal year 2008 totals $16,948,480.36.

All principal contributions through June 30, 2008 total $15,879,895.69 (see Chart #1). This represents the current minimum balance that must be maintained in the fund. The 2% distribution proposed for this year of $311,059.08 would leave a balance of $16,637,421.28 excluding contributions to be received, 5% distribution following FY 2009, and any gains from investment activity in Fiscal Year 2009. If the committee authorizes this distribution, each institution's share will be $155,529.54 with a required match to be raised by each entity in Fiscal Year 2009 of $311,059.08. Chart #2 is a graphical depiction of distributions, including this 2% distribution subject to committee approval.

An accounting of the fund balances is provided below:

Ending balance FY 2007		$18,269,599.72
Contributions received FY 2008		57,208.65
Opening balance FY 2008		18,326,808.37
Distribution September 2007		(815,776.66)
Income earned FY 2008		1,537,099.12
Appreciation (Depreciation) FY 2008		(1,001,292.84)
Fees and Other Charges FY 2007		(72,477.14)
Balance June 30, 2008		17,974,360.85
5% of 12-Quarter Moving Average June 30, 2008		(777,647.69)
Distributions: University of Vermont	(259,215.90)	
Vermont State Colleges	(259,215.90)	
Vermont Student Assistance Corp.	(259,215.90)	
2% Income Available for Endowments from FY 2007		(248,232.80)
Balance after distributions		16,948,480.36
Total contributions as of 6/30/2008		15,879,895.69
2% Income Available for Endowments from FY 2008 (requires institutional match in FY 2009)		$311,059.08

I have attached a spreadsheet as Appendix B that shows the total return of the entire Trust Investment Account, of which the Higher Education Trust Fund at $17,974,360.85 (prior to cash distributions to be made in fiscal year 2009) comprises approximately 30.29%. The Tobacco Trust Fund comprises 58.14% of the account, or $34,503,352.62, and the remaining 11.57% is made up of eight small trusts that total $477,711.92, the ANR Stewardship Fund at $698,152.73, two Veterans' Home trusts totaling $1,065,614.30, the Fish and Wildlife Trust Fund at $1,274,360.88 and a State Employees' retirement benefits trust of $3,352,123.37. Chart #3 displays the relative share of the Higher Education Trust Fund compared to the entire fund. Chart #4 identifies the major asset classes in the portfolio and their performance over the past eight years.

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As noted in Chart #5, assets increased significantly in FY 2007 due to receipt of funds raised by the Estate Tax in the amount of $5,223,449.94 and a $600,000 contribution form the State's unclaimed property fund as a result of legislation proposed by the Treasurer in FY 2006. Both of these amounts were derived from FY 2006 and were received into the fund in FY 2007. Assets decreased slightly in FY 2008 as a result of investments returns in FY 2008 being less than distributions made in FY 2008 as well as the small amount of contributions received in FY 2008.

Fixed income investments have been the principal source of total return over the life of the Fund due to a combination of Fund asset allocation and market forces. However, in both fiscal years 2006 and 2007 equity investments provided the majority of the contribution to the Fund's investment performance based on favorable equity market conditions in those years and a combined above benchmark performance by the equity managers. In FY 2008, the Fund achieved a modest investment return in spite of very poor equity market conditions and turmoil in debt capital markets. This was due to the conservative asset allocation in favor of fixed income securities, strong fixed income benchmark performance and a significant outperformance of the fixed income benchmark by the fixed income investment manager. The asset allocation of the Fund at June 30, 2008, comprised 26.8 % equities and 73.2% fixed income securities versus 33.8% equities and 66.2% fixed income securities, respectively, at June 30, 2007.

In Fiscal Year 2008, the Access Capital Strategies Community Investment Fund was added to the Trust Investment Account as a fixed income manager. This fund invests in very high grade housing and other bonds with an amount approximately equal to the initial investment of $2,500,000 funding principally housing in Vermont. Thus, these assets are meeting goals of preservation of capital and investment return along with providing benefits to Vermonters.

Currently, allocations of contributions and sources of distributions in the Trust Investment Account are used to target a 30% - 70% ratio in favor of fixed income securities. This mechanism and annual rebalancing will be used again this year to bring this ratio back in balance. This balance addresses joint investment objectives of investment return and capital preservation.

In summary, while the investment performance of the Trust Investment Account once again exceeded its target return, unfavorable equity market conditions created a return below a level fully supporting this year's distributions. Going forward, distributions will depend on the ongoing performance of the Fund, and will require continued monitoring of the Fund's investment performance, as well as ongoing consideration of optimal asset allocation in evolving investment marketplaces.

Please feel free to contact me if you have any questions or concerns regarding this report.

cc: James Reardon, Commissioner of Finance & Management
Donna Russo-Savage, Legislative Council

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HIGHER EDUCATION TRUST FUND: *Quarterly Market Values and Computation of Distributions*

	Balance 9/30	Balance 12/31	Balance 3/31	Balance 6/30		
Education Trust						
FY2006	$10,849,205.23	$10,921,067.11	$11,272,112.39	$11,188,699.76		
FY2007	$16,853,847.32	$17,407,882.23	$17,896,475.61	$18,269,599.72		
FY 2008	$17,827,605.83	$18,164,200.03	$18,010,390.14	$17,974,360.85		
Twelve Quarter Average	**$15,552,953.85**					
5% Distribution 2008	**$777,647.69**					
VSAC		$259,215.90		Contributions		
UVM		$259,215.90				
VSC		$259,215.90		2001	$6,000,000.00	
				2002	$1,000,000.00	
2% FY2007	**$248,232.81**			2003	$635,881.49	
UVM		$124,116.40		2004	$0.00	
VSC		$124,116.40		2005	$0.00	
				2006	$2,363,355.61	
				2007	$5,823,449.94	
Balance after Distributions	**$16,948,480.35**			2008	$57,208.65	
				Total	**$15,879,895.69**	
2% FY2008	$311,059.08					
UVM		$155,529.54				
VSC		$155,529.54				*

VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance for Fiscal Year 2008*

MANAGER	Quarter Ended 9/30/2007	Quarter Ended 12/31/2007	**Calendar Year 2007**	Quarter Ended 3/31/2008	Quarter Ended 6/30/2008	**Fiscal Year 2008**	Portfolio Market 6/30/2008	Portfolio Percent 6/30/2008
DOMESTIC EQUITY								
Hanson Investment Management	-1.02%	-1.53%	14.32%	-10.92%	-1.69%	-14.64%	$8,619,623	14.5%
Prentiss Smith & Co.	1.95%	-0.67%	10.85%	-5.20%	-1.00%	-4.96%	$7,259,541	12.2%
S&P 500	*2.03%*	*-3.33%*	*5.50%*	*-9.45%*	*-2.73%*	*-13.13%*		*26.8%*
DOMESTIC FIXED INCOME								
NL Capital Management	3.22%	3.11%	7.61%	2.61%	-0.10%	9.10%	$40,832,784	68.9%
Access Capital*	0.00%	2.83%	2.83%	1.41%	-0.73%	3.52%	$2,576,519	4.3%
Lehman Aggregate	*2.84%*	*3.00%*	*6.96%*	*2.17%*	*-1.02%*	*7.12%*		*73.2%*
TOTAL FUND DOLLAR WEIGHTED RETURN	2.20%	1.83%	9.47%	-0.47%	-0.47%	3.10%		
Total Fund Target	2.58%	1.12%	6.80%	-1.04%	-1.48%	1.14%		
TOTAL FUND MARKET VALUE ($mil.)	**$56.9**	**$58.8**	**$58.8**	**$59.3**	**$59.3**	**$59.3**	$59,288,468	**100.0%**
* Common Trust Fund Investment Inception date in							**	
Access Capital: 10/12/07								
** 6/30/08 Total excludes $57,209 in the Higher Educ.								
Trust Fund contributed late June 2008								

VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance for Fiscal Year 2007*

MANAGER	Quarter Ended 9/30/2006	Quarter Ended 12/31/2006	**Calendar Year 2006**	Quarter Ended 3/31/2007	Quarter Ended 6/30/2007	**Fiscal Year 2007**	Portfolio Market 6/30/2007	Portfolio Percent 6/30/2007
DOMESTIC EQUITY								
Hanson Investment Management	2.70%	7.20%	**20.28%**	6.58%	10.05%	**29.13%**	$10,585,985	19.1%
Prentiss Smith & Co.	1.32%	8.28%	**16.61%**	1.60%	7.74%	**20.09%**	$8,139,800	14.7%
S&P 500	*5.67%*	*6.70%*	***15.80%***	*0.64%*	*6.28%*	***20.60%***	$18,725,785	33.8%
DOMESTIC FIXED INCOME								
NL Capital Management	3.43%	1.48%	**5.31%**	2.20%	-1.07%	**6.12%**	$36,723,827	66.2%
Lehman Aggregate	*3.81%*	*1.24%*	***4.33%***	*1.50%*	*-0.52%*	***6.12%***		
TOTAL FUND DOLLAR WEIGHTED RETURN	3.00%	3.39%	**9.48%**	2.88%	2.24%	**12.02%**		
Total Fund Target	4.39%	2.92%	**7.96%**	1.23%	1.71%	**10.62%**		
TOTAL FUND MARKET VALUE	**$53.8**	**$52.8**	**$52.8**	**$54.3**	**$55.5**	**$55.5**	$55,449,612	**100.0%**

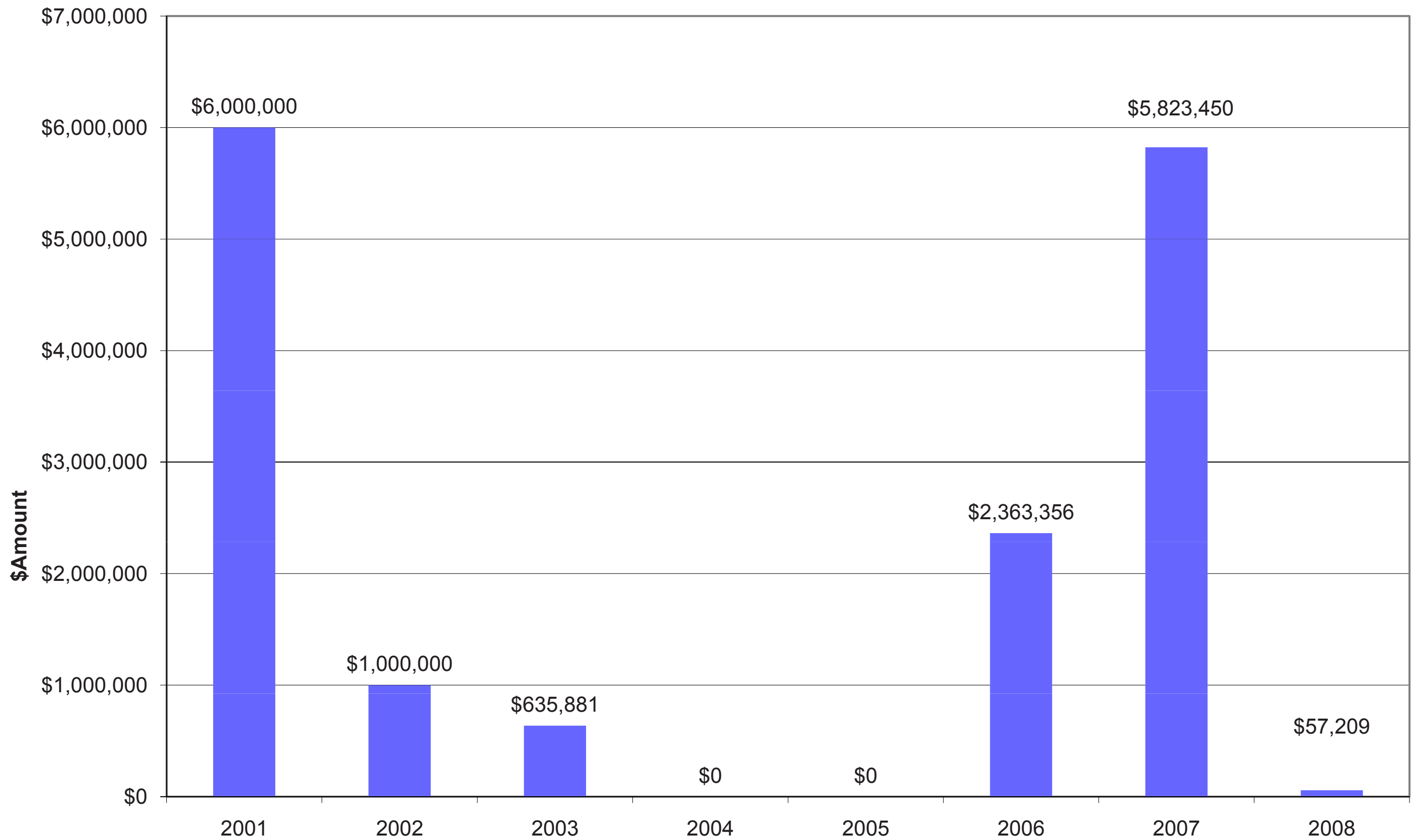
VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance for Fiscal Years 2005 and 2006*

MANAGER	Fiscal Year 2005	Quarter Ended 9/30/2005	Quarter Ended 12/31/2005	Calendar Year 2005	Quarter Ended 3/31/2006	Quarter Ended 6/30/2006	Fiscal Year 2006	Portfolio Market 6/30/2006	Portfolio Percent 6/30/2006
DOMESTIC EQUITY									
Hanson Investment Management	**22.25%**	8.40%	2.26%	**19.18%**	13.33%	-3.60%	**21.10%**	$8,781,896	17.7%
Prentiss Smith & Co.	**11.00%**	7.92%	0.86%	**10.68%**	6.40%	-0.10%	**15.77%**	$7,369,828	14.8%
S&P 500	***6.32%***	*3.60%*	*2.09%*	***4.91%***	*4.21%*	*-1.44%*	***8.63%***		*32.5%*
DOMESTIC FIXED INCOME									
NL Capital Management	**7.42%**	-0.50%	0.44%	**3.07%**	0.16%	0.17%	**0.26%**	$33,529,229	67.5%
Lehman Aggregate	***6.80%***	*-0.67%*	*0.59%*	***2.43%***	*-0.65%*	*0.08%*	***-0.81%***		
TOTAL FUND DOLLAR WEIGHTED RETURN	**10.17%**	2.15%	0.80%	**6.64%**	3.37%	-0.55%	**5.86%**		
Total Fund Target	**6.76%**	0.64%	1.05%	**3.27%**	0.91%	-0.42%	**2.19%**		
TOTAL FUND MARKET VALUE ($mil)	**$43.5**	**$48.3**	**$48.6**	**$48.6**	**$50.1**	**$49.7**	**$49.7**	$49,680,953	**100.0%**

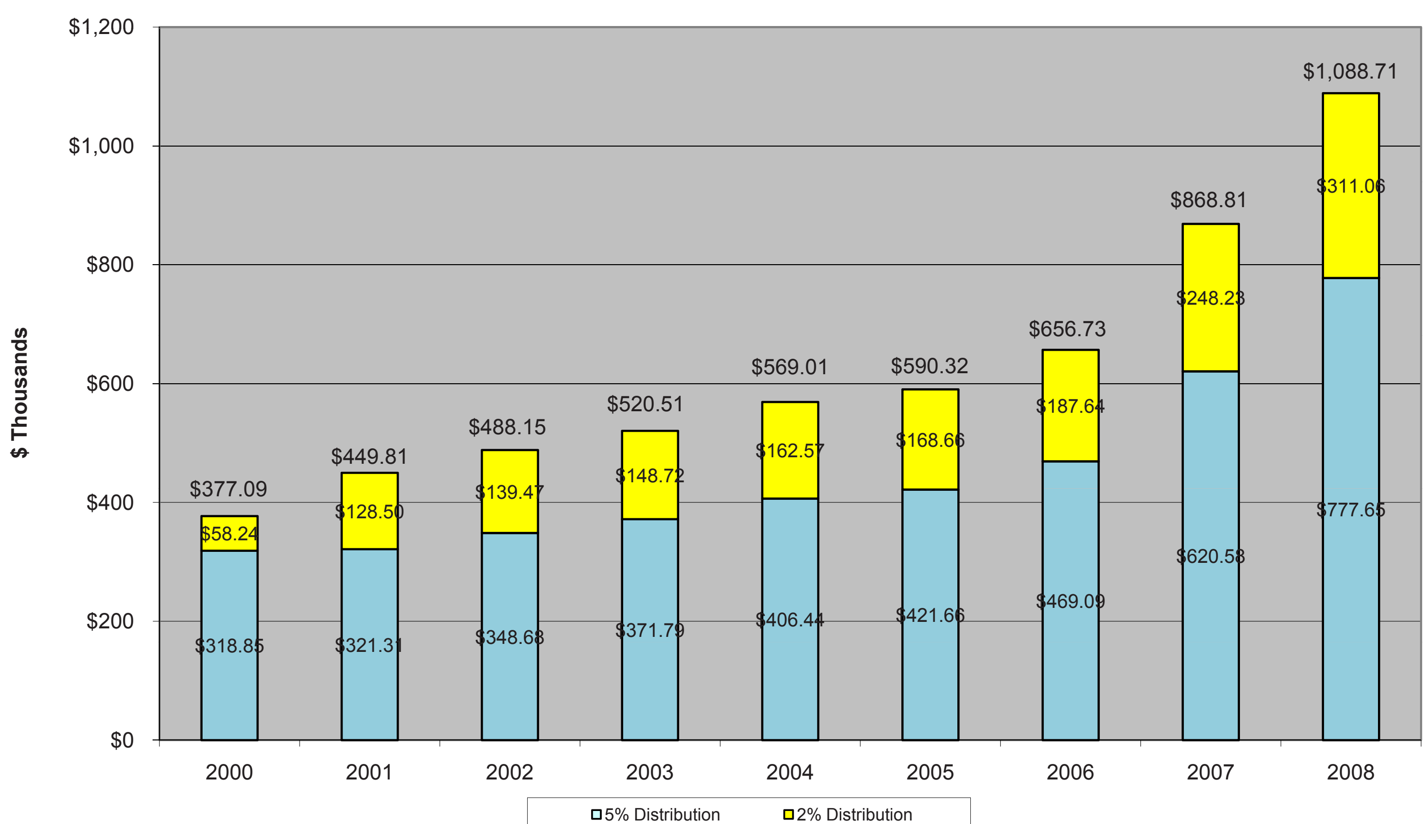
VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance from Fiscal Year 2001 to Fiscal and Calendar Year 2004*

MANAGER	Fiscal Year 2001	Calendar Year 2001	Fiscal Year 2002	Calendar Year 2002	Fiscal Year 2003	Calendar Year 2003	Fiscal Year 2004	Calendar Year 2004
DOMESTIC EQUITY								
Hanson Investment Management	**29.41%**	**17.41**	**(7.78)**	**(18.01)**	**-1.89%**	**42.55%**	**29.10%**	**15.92%**
Prentiss Smith & Co.	**7.59%**	**13.69**	**3.60**	**(7.35)**	**7.70%**	**18.17%**	**11.47%**	**13.25%**
S&P 500	***-13.56%***	***-11.89%***	***-17.99%***	***-22.11%***	***0.25%***	***28.69%***	***19.14%***	***10.90%***
DOMESTIC FIXED INCOME								
NL Capital Management	**10.34%**	**10.07%**	**9.41%**	**9.48%**	**8.92%**	**5.43%**	**3.48%**	**5.56%**
Lehman Aggregate	***10.23%***	***8.44%***	***8.63%***	***10.25%***	***10.40%***	***4.10%***	***0.32%***	***4.34%***
TOTAL FUND DOLLAR WEIGHTED RETURN	**11.27%**	**11.62**	**7.94**	**5.15**	**8.59%**	**11.24%**	**7.59%**	**8.14%**
Total Fund Target	**7.52%**	**6.57**	**3.94**	**3.29**	**9.23%**	**9.94%**	**4.96%**	**6.23%**
TOTAL FUND MARKET VALUE ($mil)	**$26.5**	**$32.6**	**$33.3**	**$34.9**	**$37.3**	**$38.8**	**$39.3**	**$41.1**

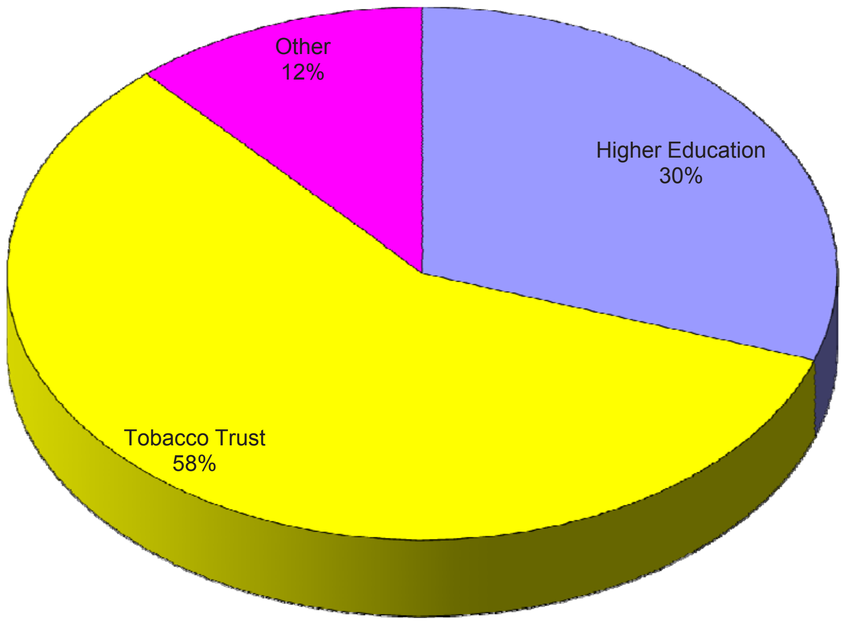
HIGHER EDUCATION TRUST FUND: *Fund Contributions—Fiscal Years*



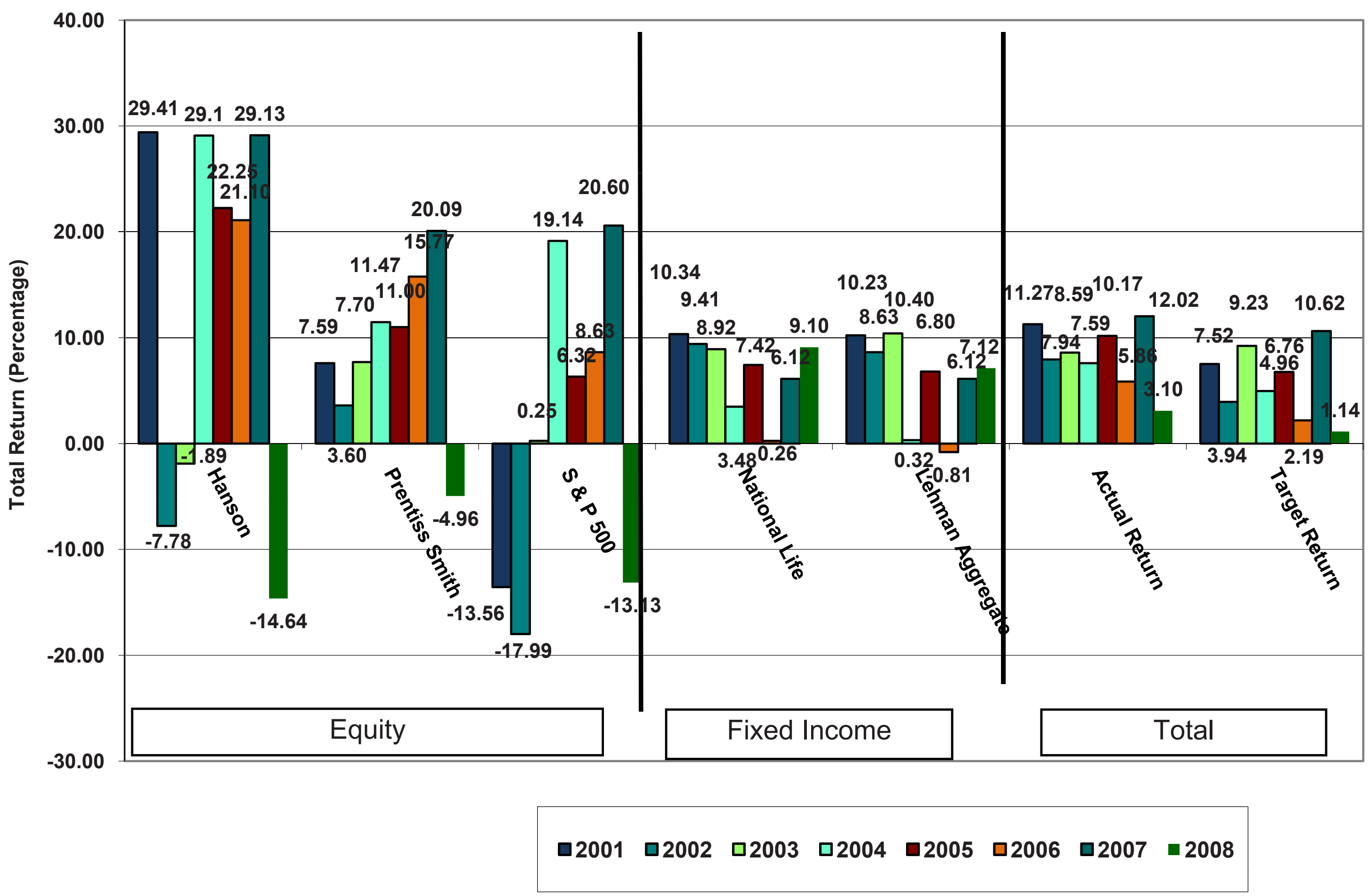
HIGHER EDUCATION TRUST FUND: *Authorized Distributions by Year and Type*



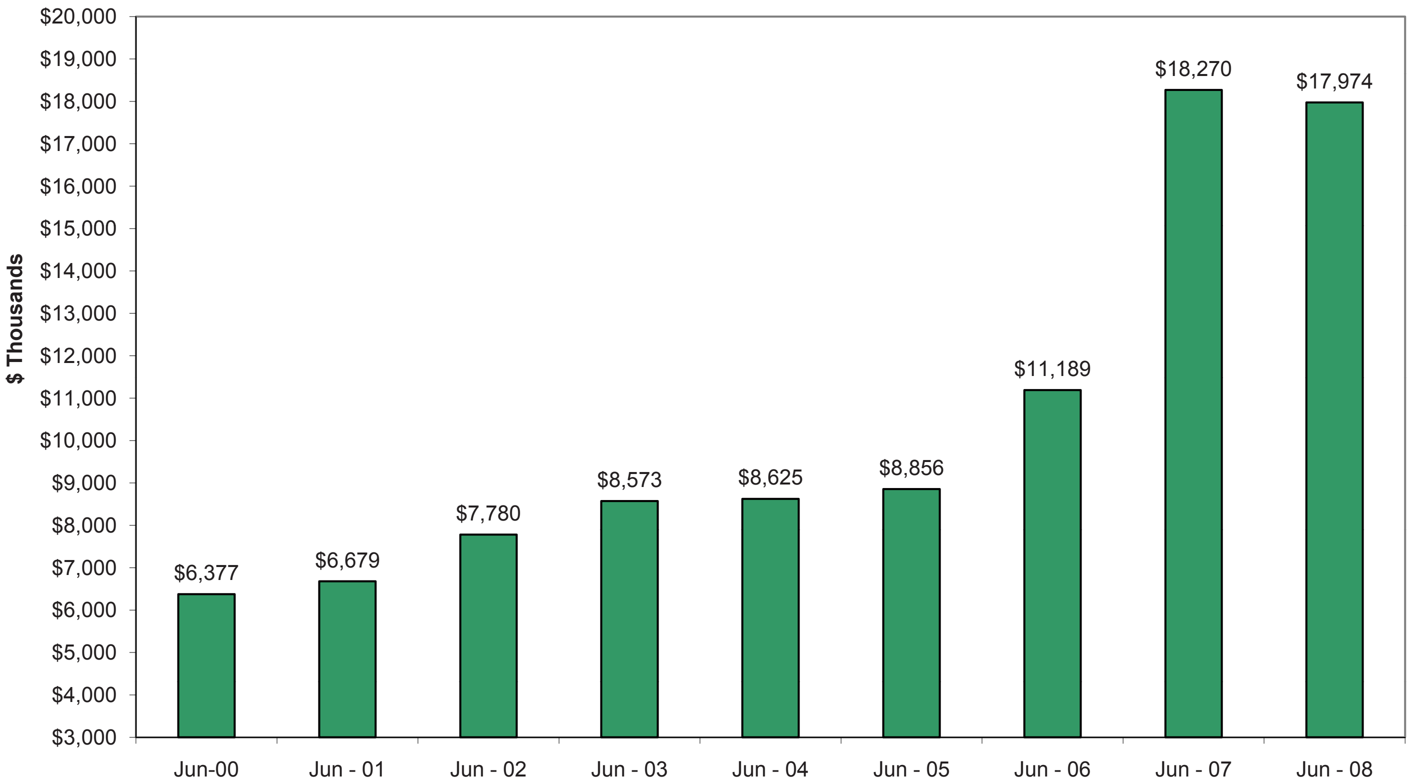
HIGHER EDUCATION TRUST FUND: *Common Trust Fund Breakdown as of June 30, 2008*



HIGHER EDUCATION TRUST FUND: *Total Return by Asset Class Fiscal Years 2001-2008*



HIGHER EDUCATION TRUST FUND: *Asset Growth—6/30/00 to 6/30/08, includes distributions*



VSERS -- Other Post-Employment Benefits Funding Analysis

	PRE-FUNDING BASIS	PAY-AS-YOU-GO BASIS
Assumed Discount Rate	8.25%	4.00%
Actuarial Value of Assets	$3,663,518	$3,663,518
Actuarial Accrued Liability		
- Active Participants	$229,147,049	$467,967,442
- Retired Participants	198,013,153	286,722,632
- TOTAL	$427,160,202	$754,690,074
Unfunded Actuarial Liability	$423,496,684	$751,026,556
Funded Ratio	0.9%	0.5%
Annual Covered Payroll	$404,937,574	$404,937,574
Unfunded Actuarial Liability (as % of covered payroll)	104.6%	185.5%
Normal Cost for FY 2009	$15,526,527	$36,950,755
Amortization of Unfunded Actuarial Liability (for FY 2009-30 yr)	$21,216,621	$21,716,204
Annual Required Contribution (ARC) FY 2009 *	$36,743,148	$58,666,959
Expected Benefit Payments	$23,053,284	$23,053,284
Increase in Annual Cost to Fund Plan	$13,689,864	N/A

** Payment is assumed to be made at the beginning of the fiscal year.*

VSTRS -- Other Post-Employment Benefits Funding Analysis

	PRE-FUNDING BASIS	PAY-AS-YOU-GO BASIS
Assumed Investment Return	8.25%	4.00%
Actuarial Value of Assets	$0	$0
Actuarial Accrued Liability		
- Active Participants	$196,940,917	$490,552,525
- Retired Participants	227,220,558	373,003,287
- TOTAL	$424,161,475	$863,555,812
Unfunded Actuarial Liability	$424,161,475	$863,555,812
Funded Ratio	0%	0%
Annual Covered Payroll	$535,807,012	$535,807,012
Unfunded Actuarial Liability (as % of covered payroll)	79.2%	161.2%
Normal Cost for FY 2009	$11,029,253	$34,154,136
Amortization of Unfunded Actuarial Liability (for FY 2009-30 yr)	$21,249,926	$24,970,028
Annual Required Contribution (ARC) FY 2009 *	$32,279,179	$59,124,164
Expected Benefit Payments	$16,978,585	$16,978,585
Increase in Annual Cost to Fund Plan	$15,300,594	N/A

** Payment is assumed to be made at the beginning of the fiscal year.*

I. Executive Summary

The General Assembly directed the State Treasurer, working jointly with the Agency of Transportation (AOT) and the Legislative Joint Fiscal Office (JFO), to prepare a report containing a long-term needs assessment for repair, maintenance, and rehabilitation of bridges and culverts in the state, and providing funding options and recommendations for such long-term needs. Further, the General Assembly directed that funding options and recommendations be developed by the State Treasurer, working with an investment bank to act as an adviser to the State to develop multiple financing proposals, including but not limited to general obligation, revenue, and GARVEE bond options, for a long-term program dedicated to funding life-cycle rehabilitation work on bridges and culverts that will extend the useful lives of these structures on a long-term, cost-effective basis.

The most significant findings are:

1) AOT estimates, in 2008 dollars, that the cost for replacement of structures over 70 years of age (including structurally deficient structures) is $2,308,359,115. In addition, to replace all structurally deficient structures at or under 70 years of age would require an additional $856,253,360. Further, an additional $7,000,000 is needed for preventative maintenance (a detailed analysis is included in Section IV of this report):

2) Based on the AOT study pursuant to Act 164, the Joint Fiscal Office has stated that if during the next 20 years the State wants to reach the structural-deficiency targets, and also replace all bridges over 70 years old, additional funding of approximately $110 million a year would be required. The analysis is as follows:

JFO Estimate

Scenario - spread replacement costs over 20 years	
$158,260,000	Replacement costs per year
$7,000,000	Annual cost of preventive maintenance
$165,260,000	Total annual program need
-$55,800,000	FY-09 total bridge spending
$109,460,000	Annual gap

3) AOT's plans do not contemplate a 100% targeting of all over-70 and structurally deficient bridges. AOT states that federal ratings, such as "structurally deficient," tell us a bridge component is within a range that requires assessment. A "structurally deficient" rating does not necessarily mean the structure is unsafe, but it does indicate that the bridge is aging and could require repairs in the near future. AOT has historically established performance measures to address these needs. AOT calculated the cost of meeting the currently established "structurally deficient" targets or goals. Even taking this more moderate approach, the State is not meeting its goals. Without additional funding, the agency projects that these goals, developed in partnership with the General Assembly several years ago, will remain out of reach.

AOT has completed a year-by-year analysis through 2018 to meet the "structural performance goals," factoring in agency capacity. Using an "unconstrained" scenario (not factoring in annual implementation constraints), it estimates that it would need $1,161,356,132 in resources over that time-frame. Using a "constrained" scenario (factoring in annual implementation constraints), it estimates it would need $896,899,969 in resources through

2018. Assuming all of the current approximately $55,800,000 annual bridge spending were to be devoted to this effort, an additional infusion of $283,000,000 to $517,000,000 through 2018 would be needed.

4) Traditional sources of transportation revenues at both the federal and state levels are in decline, further increasing the funding gap. While a federal economic stimulus bill of some kind is likely to include a transportation component, it is unclear how this will impact the dollars available to fund these initiatives at this time. There are concerns that the current formula associated with the Highway Trust Fund distributions could be adjusted in a way that would be disadvantageous to Vermont. Vermont's congressional delegation will need to play a key role in preventing a negative outcome. Discussion of this issue is included in Section III of the report.

5) The Office of the State Treasurer has reviewed the State's needs with two investment banks (Citi and Morgan Stanley) per the request of the General Assembly. These professionals stated unequivocally that bonding alone will not solve Vermont's bridge problems. They firmly believe that a significant infusion of up-front revenues from bonding, supported by increased ongoing of revenues to AOT for debt service, is necessary. While certain types of bonding, such as general obligation debt, revenue bonds pledging existing revenue sources, and GARVEES can provide some assistance by accelerating the project schedule, thereby reducing costs associated with inflation and early maintenance, these measures are insufficient to meet the need and pay debt service. New revenue sources, or increases to existing sources, are needed to fund any bonds. As noted by recent study in another state:

"…while borrowing to pay for transportation projects can be a good idea, … it can also simply be a way to put off for a few years the politically difficult task of restructuring transportation finance. And, unfortunately, many recent decisions to debt -inance transportation projects have been motivated by a desire to get needed projects off of the ground as traditional revenue sources have run dry rather than by dispassionate calculations of expected benefits and costs." [1]

In other words, borrowing makes sense when:

- The costs saved through accelerated construction (inflation and preventative maintenance) ex ceed the interest paid on the funds; and/or

- Quantifiable economic benefits exceed the cost of borrowing; and

- A future identifiable and available revenue sources exists to pay for the bonds.

6) Any significant bonding will require an examination of the revenue sources currently used to pay for transportation costs, including bridges, and a frank discussion of potential sources of funds. Several possibilities

[1] Wachs, "A Quiet Crisis in Transportation Finance," 2006, page 10.

are discussed in the body of this report, based on a previous study completed by AOT (RSG Report, see below), the JFO Fiscal Facts, and ideas developed by the participating investment bankers. Identification of new sources of revenues as opposed to increases to existing sources has an added advantage in that the rating agencies are more inclined not to treat such bonds as increasing net tax-supported debt, permitting the state to maintain its debt ratios and to protect its debt ratings. One form of bond issue, referred to as a "double-barreled" bond, seeks to optimize the credit rating attributes of general obligation debt while reducing the coverage ratios (i.e., the amount of revenue designated to pay debt service), thereby reducing the cost of capital.

7) The State has taken the position, as evidenced by the discipline associated with the Capital Debt Affordability Advisory Committee process, that it will issue debt only where prudent and cost-effective and within limitations consistent with maintaining manageable debt service levels and favorable credit ratings. Any debt issuance for transportation infrastructure should be analyzed within this framework.

8) A Comprehensive Infrastructure Needs Assessment is needed. The approach directed by Act 164 clearly moves the dialogue to an assessment of needs and relative cost and benefits. While this project has been very useful in identifying the problems and possible remedies related to the bridge program, it is just one component of a larger infrastructure picture. Bridges are a critical issue but need to be incorporated into an overall transportation plan including roads, paving, maintenance, rail, and public transit. As noted in a recent report prepared by the Snelling Center, citing additional studies by AOT consultants and JFO, there are additional needs and funding gaps within the entire scope of the transportation arena.[2]

- Vermont's pavement is also deteriorating and cannot be maintained with current funding levels; at current spending levels, the percentage of payment in "very poor" condition will rise from 21% to 49% by 2013.

- A 2008 JFO estimate noted that the funding gap for transportation as a whole, at an optimum level of investment, is approximately $203 million annually (this amount represents a 2008 up date from the 2007 study cited by the Snelling Center).

- AOT consultants have estimated that current transportation revenues will fall short over the next 30 years by between $4.2 million and $8.7 million, the range primarily dependent upon inflation assumptions.

- The Federal Highway Trust Fund is all but depleted.

In addition to transportation needs, other infrastructure pressures exist including school buildings, parks, public buildings, telecommunications, and others. A comprehensive infrastructure needs assessment is required including a prioritization of these needs based on agreed-upon "need," economics, and cash flows (based on inflation factors). In the meantime, some short-term re-prioritization within the existing capital appropriations is indicated, as outlined in section V of the report.

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[2] The Snelling Center for Government, Vermont Roads and Bridges: To Fix or Abandon?, September 2008, pages 7-10.

BRIDGES & CULVERTS LONG-TERM ASSESSMENT & FUNDING OPTIONS REPORT 11/15/08: *Report Conclusion*

VI. Conclusion

Based on the following reality:

- Current revenue and spending patterns are not sufficient to address the deteriorating condition of Vermont Bridges;
- The longer this situation remains unaddressed, the more Vermonters will have pay to repair and replace failing bridges;
- Finance experts have stated unequivocally that bonding alone, without concomitant additional revenues, will not solve Vermont's bridge problems;
- The State is committed to protecting its favorable debt profile and ratings;
- An expanded effort to rehabilitate and replace, where necessary, Vermont's failing bridges would provide jobs and economic stimulus for Vermonters in a time of severe economic stress;
- The current depressed economic conditions are highly likely to provide a limited window of lower interest and construction inflation costs in the near to medium term;
- Vermont's per gallon gasoline tax rate was last adjusted in 1997, while the number of gallons of gasoline sold annually has declined over the last five years, and
- Vermont's total motor fuels taxes and fees should remain competitive with other New England states:

The Office of the State Treasurer recommends the following for consideration, in addition to the other options outlined in this report:

- A $150-180 million bridge rehabilitation and replacement bonding program in issuances phased in over the next decade, beginning with a $30-50 million issuance in year one, depending on readiness of projects;
- Funded by a Motor Fuels Distributor Infrastructure Assessment (MFDIA) of five cents per gallon (gasoline and diesel fuels - raises approximately $20 million annually) with a double-barreled backstop of Vermont full faith and credit;
- Revenues from MFDIA to be deposited in a restricted bridge rehabilitation and replacement fund to be used for debt service, relevant capital projects, and a capital reserve; and
- Additional consideration of GARVEE bonds for targeted bridges with the most compelling cost of construction inflation characteristics.

The advantages of the MFDIA funding approach include:

- Reduced costs to taxpayers over time, since savings from accelerated rehabilitation (reduced deterioration) and inflation avoidance will exceed the interest costs on borrowing supported by the MFDIA;
- Adequate revenues to pay the debt service on the bonds, without further depletion of the already declining revenues to pay for the care and maintenance of Vermont's transportation infrastructure;
- The lowest cost of interest rates stemming from the double-barreled backstop of Vermont's Triple-A rated full faith and credit;
- The likelihood this approach would not be additive to state net tax supported debt, since it relies on a newly identified revenue source, and would not negatively impact debt ratios and other capital financing priorities; and
- An administratively simple approach, since the MFDIA would be collected in the same fashion as the current motor fuels taxes and fees.

The State Treasurer's Office serves as the State's banker and chief investment officer. The office handles money that belongs to all of the citizens of Vermont. The Treasurer's Office is committed to managing these funds honestly, efficiently and responsibly, and to maintaining Vermont's hard-earned reputation as a fiscally sound and disciplined state.

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