FitchRatings

FITCH RATES VERMONT'S $111MM GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-06 November 2014: Fitch Ratings assigns an 'AAA' rating to the following state of Vermont general obligation (GO) bonds:

--$25 million GO bonds, 2014 series A (Vermont Citizen Bonds);
--$50 million GO bonds, 2014 series B;
--$36 million GO refunding bonds, 2014 series C.

The bonds are expected to sell the week of Nov. 17, 2014; the series A bonds through negotiation and the series B and C bonds through competitive bid.

In addition, Fitch affirms the 'AAA' rating on the state's outstanding $560.85 million GO bonds.

The Rating Outlook is Stable.

SECURITY
The bonds are general obligations of the state of Vermont backed by the state's full faith and credit.

KEY RATING DRIVERS

CONSERVATIVE FINANCIAL MANAGEMENT: Vermont's revenue stream is diverse and revenue estimates are updated at least twice a year. The state takes timely action to maintain balance, and budget stabilization reserves have been maintained at statutory maximum levels despite periods of declining revenue.

MODERATE LONG-TERM LIABILITY BURDEN: The state's combined debt and unfunded pension liabilities pose a slightly above-average burden, but one that Fitch views as manageable. Vermont's debt levels are at the low end of the moderate range and are expected to remain so, as affordability planning is employed. Funded ratios for Vermont's pension systems declined in recent years. Positively, the state regularly budgets for its full projected actuarially calculated annual required contribution (ARC) and has enacted plan modifications with the goal of gradually improving the funded status of the plans.

RELATIVELY NARROW ECONOMY: Vermont's economy has diversified but remains narrow with above-average exposure to the cyclical manufacturing sector. While statewide educational attainment and unemployment levels compare favorably to the nation, the state's median age is well above the national level.

RATING SENSITIVITIES
The rating is sensitive to shifts in Vermont's fundamental credit characteristics, particularly its moderate long-term liability profile and fiscal discipline.

CREDIT PROFILE
Vermont's 'AAA' rating reflects its low debt burden, maintained through adherence to debt affordability guidelines, as well as conservative financial management and maintenance of sound reserves. Outstanding debt, which is nearly entirely GO and matures rapidly, has increased slightly in recent years but the debt burden remains moderately low. Debt plus unfunded state pension liabilities as percentage of personal income is slightly above the states' median, but the burden is

very manageable as the state regularly budgets its full projected pension ARC payments. Vermont budgets conservatively, taking prompt action to address projected budget gaps. Its diverse revenue stream includes a state property tax for education, a relatively unique feature for state governments.

LIMITED ECONOMY, STILL RECOVERING

The relatively narrow state economy is characterized by larger-than-average reliance on tourism, health and educational services, and manufacturing. The state's relatively small population is older, but more well-educated than the rest of the country. During the recession, Vermont's peak-to-trough monthly employment loss of 4.8% (seasonally adjusted levels) was less severe than the national 6.3% decline. The recovery has been similarly more gradual than the national trend, as through September, the state had recovered 76.2% of the jobs it lost while the national recovery rate was 112.3%. On a non-seasonally adjusted basis, Vermont's 0.5% three-month moving average of year-over-year (yoy) employment growth trailed the national 1.9% rate.

Unemployment levels remain well below those of the nation, at 4.4% in September 2014 compared to 5.9% for the country, but the state's labor force has been flat to declining indicating some weakness in the labor market. The recent sale of IBM's chip manufacturing business to GlobalFoundries is a positive for the state as it should stabilize employment at one of the state's largest factories. Wealth levels are on par with the nation as 2013 per capita personal income of $45,483 was just slightly ahead of the U.S. Vermont's total personal income growth has been line with national growth in recent years.

STABLE FISCAL PROFILE

Vermont's fiscal profile has largely recovered from the recession and remains stable despite a downward revenue forecast revision at the start of this fiscal year. Revenue performance from the state's major general fund tax sources in fiscals 2009 and 2010 was decidedly negative, though the state took prompt action to maintain balance. Revenue performance improved markedly in fiscal 2011 and this trend continued through 2013 with yoy general fund revenue growth of 7.7% in fiscal 2013. The state reported fiscal 2013 ended with a $21.6 million general fund operating surplus, led by personal income tax (PIT) revenues which increased 10.7%. Prudently, the state recognized that income acceleration due to federal tax law changes inflated PIT collections in fiscal 2013, therefore forecasting much more moderate PIT growth in the enacted fiscal 2014 budget. After enactment, in July 2013 and January 2014, the state revised its revenue estimates upwards based on positive returns through the first half of the year.

Fiscal 2014 general fund revenues ended the year up 3.1% ahead of the prior year, but below the 3.4% rate projected in the state's January 2014 revenue forecast after disappointing second-half results. PIT increased 1.6% over the prior year, while sales and use tax (SUT) decreased 0.6%. The PIT increase was $22.1 million below the January 2014 forecast of 4.9% yoy growth. While part of the SUT decline was attributable to an increased allocation to the education fund, the state also saw a modest $1.7 million shortfall versus the January 2014 estimate. Importantly, the preliminary fiscal 2014 general fund results were in line with the forecast used for the enacted budget so the state did not need to make expense adjustments.

A reduction in the state's fiscal 2015 revenue outlook opened up a revenue gap, but the state took prompt action to address the modest shortfall. At its July meeting, the state's revenue forecasting body (Emergency Board) revised fiscal 2015 revenues downward due to a slightly more negative economic outlook and the below-forecast results for fiscal 2014. The state crafted its fiscal 2015 budget on the higher January 2014 forecast. Fitch notes positively that within three weeks of the $28 million general fund forecast revision (2.1% of forecast revenues), the state enacted a recission plan to address the gap with a mix of one-time and recurring revenue and expense actions. The plan does not use any of the state's general fund budget reserves. Fitch views the current forecast as moderately aggressive given the assumption of robust 6.8% yoy growth in the PIT. Monthly revenue monitoring and the annual January forecast update should provide the state with ample time to make adjustments to maintain balance if necessary.

Budget stabilization reserves (BSR) in each of the state's three major operating funds as of the close of fiscal 2014 were fully funded and are expected to remain so through the current fiscal year ending June 30, 2015. In addition to the general fund BSR, capped at 5% of prior year appropriations, Vermont also maintains a general fund balance reserve (BR; replacing the former revenue shortfall reserve). The BR also has a cap of 5% of prior year appropriations, and stood well below that at $5 million (or 0.4%) at the end of fiscal 2014. Vermont projects the BR will remain stable at $4.4 million at the end of the current fiscal year. The state also projects the BSRs for the education and transportation funds, its other major operating funds, will remain fully funded at 5% of appropriations at fiscal year-end 2015.

LOW DEBT, HIGHER PENSION LIABILITIES

Vermont's tax-supported solid debt profile reflects a moderate burden, straightforward structure, and rapid amortization. Above-average unfunded pension liabilities offset these strengths, though the state has demonstrated its commitment to fully funding the projected pension ARC. As of June 30, 2014, pro forma net tax-supported debt (including the 2014 series A and B) equaled 2.3% of 2013 personal income, which is in line with the states' median. In 1990, the state established a Capital Debt Affordability Advisory Committee (CDAAC) to annually recommend debt authorizations based on a capacity analysis. After recent modest increases in the state's debt burden, the CDAAC's September 2014 preliminary recommendation is to modestly decrease the recommended authorization for fiscal 2016 and 2017 versus prior years. The state has never exceeded the committee's recommended levels. Fitch views the CDAAC as a useful check as the state has no other constitutional or statutory limitations on debt issuance.

Vermont has budgeted and appropriated full projected ARC payments into its pension systems since fiscal 2007, but the unfunded liability remains above-average relative to the state's economic resources. In recent years, the state implemented a series of changes to benefits, employee contributions, and actuarial assumptions to improve the funded status and reduce the long-term liabilities. Impressively, Vermont also made $35 million in additional contributions on top of full ARC payments in the last two years, using annual operating surpluses. As of June 30, 2014, the state's Vermont State Retirement System (VSRS) was 68.7% funded on a Fitch-adjusted basis (77.9% reported). Similarly, the teachers' plan (for which the state is wholly responsible) was just 53.2% funded on a Fitch-adjusted basis (59.9% reported). Fitch anticipates funded ratios will remain relatively stable and gradually improve, subject to investment performance, as the state continues to make full ARC payments. Combined net-tax-supported debt (as of June 30, 2014) plus unfunded pension liabilities (as of June 30, 2014) was an above-average, but still manageable, 9.7% of 2013 personal income.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from IHS.

Applicable Criteria and Related Research:
--'Fitch Rates Virginia College Bldg Auth's $291MM Revs 'AA+'; Outlook Stable' (Oct. 17, 2014);
--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

Applicable Criteria and Related Research:
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033