FITCH RATES VERMONT'S $102MM GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-23 September 2015: Fitch Ratings has assigned an 'AAA' rating to the following state of Vermont general obligation (GO) bonds:

--$26.565 million GO bonds, 2015 series A (Vermont Citizen Bonds) (negotiated);
--$50.765 million GO bonds, 2015 series B (competitive);
--$24.46 million GO refunding bonds, 2015 series C (competitive).

The bonds are expected to sell the week of Oct. 5, 2015; 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 $585.2 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 strong fiscal management practices anchor the state's credit quality and offset risks posed by its relatively narrow economy. The state's revenue stream is diverse and 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: Vermont's debt levels are at the low end of the moderate range and are expected to remain so based on the state's careful affordability planning process. 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. The state's combined debt and unfunded pension liabilities pose a slightly above-average burden, but one that Fitch views as manageable.

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 moderate 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, and performance is exposed to several key large employers. The state's population is older, but more well-educated than the national average. 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 in line with the national trend, as through August, the state had recovered 135% of the jobs it lost while the national rate was 145%. On a non-seasonally adjusted basis, Vermont's 1.4% three-month moving average of year-over-year (yoy) employment growth trailed the national 2.1% rate.

Unemployment levels remain well below those of the nation, at 3.6% in August 2015 compared to 5.1% for the country, but the state's labor force has been flat to declining indicating some weakness in the labor market. The recent sale by IBM of its 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 2014 per capita personal income of $47,330 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

Fiscal management practices are strong, including a consensus revenue process that forecasts revenues at least twice a year, monthly revenue monitoring and a practice of accumulating excess resources in separate reserve funds for each of the state's three major operating funds.

Vermont's fiscal profile remains stable with recent performance indicating solid yoy growth, despite a downward revenue forecast revision at the start of fiscal 2015. Consistent with Fitch's expectations, the state took prompt action to address the modest shortfall at the start of fiscal 2015. Within three weeks of the $28 million general fund negative forecast revision (2.1% of forecast revenues) in July 2014, the state enacted a rescission plan to address the gap with a mix of one-time and recurring revenue and expense actions.

In January 2015, the state further revised its revenue forecast downward by another $10 million. Ultimately, preliminary fiscal 2015 general fund revenues ended 1.3%, or $17.9 million, ahead of the January 2015 forecast. Versus fiscal 2014, general fund revenues grew 3.6% and personal income tax (PIT) revenues notched particularly strong growth of 5.2%. This contrasts with fiscal 2014 when year-end results fell short of the January forecast and contributed to a notable downward forecast revision in July 2014.

For fiscal 2016, the state's consensus forecast from July 2015 is for continued general fund revenue growth of 4.2%. PIT growth is again particularly robust at 8.2% - excluding the effects of tax law changes, Fitch estimates the baseline growth forecast at a still-healthy 5%, reflecting the consensus economic outlook for continued economic improvement. Fitch notes the tax law changes, while general modest in dollar amount, add an element of uncertainty to the revenue forecast. 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 2015 remained fully funded and are expected to remain so through the current fiscal year ending June 30, 2016. 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 $6.8 million (or 0.5%) at the end of fiscal 2015. Vermont projects the BR will increase notably to $10.1 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 2016.

LOW DEBT, HIGHER PENSION LIABILITIES

Vermont's net tax-supported debt profile reflects a moderate burden, straightforward structure, and rapid amortization. As of June 30, 2015, pro forma net tax-supported debt (including the 2015 series A and B) equaled 2.3% of 2014 personal income, which is in line with the states' median.

In 1990, the state established a Capital Debt Affordability Advisory Committee (CDAAC), establishing an important policy mechanism to manage the state's debt burden. The committee annually recommends proposed debt authorizations, based on analysis of the state's capacity. After recommending a modest decrease in the recommended authorization for fiscal 2016 and 2017, at its September 2015 meeting, the committee recommended keeping authorization stable. 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. The state assumes responsibility for retirement pensions not only of state workers, but of local school teachers. 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; these include closing the amortization periods of both plans. 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 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 plus unfunded pension liabilities (as of Fitch's 2014 state pension update report) was an above-average, but still manageable, 9.7% of personal income.

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Fitch recently published an exposure draft of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015). The draft includes a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to fewer than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published by Jan. 20, 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from CreditScope, IHS, and FRED, Federal Reserve Bank of St. Louis.

Applicable Criteria
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033

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