MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aaa to Vermont's $100M 2015 GO Bonds

Global Credit Research - 23 Sep 2015

Maintains Aaa on $585M GO bonds

VERMONT (STATE OF)
State Governments (including Puerto Rico and US Territories)
VT

Moody's Rating

ISSUE		RATING
General Obligation Refunding Bonds Series 2015C		Aaa
Sale Amount	$25,000,000	
Expected Sale Date	10/05/15	
Rating Description	General Obligation	
General Obligation Bonds, 2015 Series A (Vermont Citizen Bonds)		Aaa
Sale Amount	$25,000,000	
Expected Sale Date	10/05/15	
Rating Description	General Obligation	
General Obligation Bonds Series 2015B		Aaa
Sale Amount	$50,000,000	
Expected Sale Date	10/05/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, September 23, 2015 --Moody's Investors Service has assigned a Aaa rating to the State of Vermont's $25 million Series 2015A General Obligation Bonds (Vermont Citizen Bonds), $50 million Series 2015B General Obligation Bonds, and $25 million Series 2015C General Obligation Refunding Bonds. The outlook is stable.

Moody's maintains a Aaa rating on roughly $585.2 million of GO debt.

The 2015 bonds are scheduled to price the week of Oct. 5.

SUMMARY RATING RATIONALE

The Aaa rating reflects Vermont's strong financial management, which features conservative fiscal policies, consistent governance, and a proven commitment to maintaining healthy reserve balances. The state's debt is modest, and its economy, while small for a state, is vibrant. The rating also recognizes Vermont's sizeable unfunded pension liabilities, which we consider the state's biggest long-term challenge.

OUTLOOK

The stable outlook reflects the state's proven ability to continue operating on a balanced basis and maintaining a solid rainy day fund balance regardless of economic cycles. The outlook also anticipates slow progress toward achieving stronger funding of the state's pension liabilities.

WHAT COULD MAKE THE RATING GO DOWN

Slower-than-actuarially scheduled progress in improving pension funding

Faster-than-anticipated growth in unfunded pension liabilities

Departure from the state's history of conservative financial management

Emergence of structurally imbalanced budgets

STRENGTHS

Proven track record of maintaining healthy reserves regardless of economic cycles

Vibrant economy

Moderate debt profile

CHALLENGES

Large unfunded pension liabilities

Likely slow progress toward improving pension funding

Small economy relative to other states

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY: SMALL BUT VIBRANT ECONOMY

Vermont's economy, while small, is vibrant. Bolstered by key industries including health care, tourism, technology-related manufacturing, and food and agriculture, Vermont has the third-lowest unemployment rate in the US (3.6% as of July, compared with 5.3% nationwide).

The $30 billion economy (by far the smallest among 50 states) in this state of roughly 625,000 people is robust. Per capita income is above-average at roughly 103% of US PCI, and income growth is moving in a positive direction; Vermont's PCI was below US PCI as recently as 2010.

We expect moderate growth in gross state product over the next few years as the state's economy remains in expansion mode. Longer term, unfavorable demographics and high business costs will be difficult hurdles to overcome, and Vermont will underperform the nation in job and income growth.

FINANCIAL OPERATIONS AND RESERVES: PROVEN RECORD OF MAINTAINING STRONG RESERVES

The state's commitment to maintaining healthy reserves is a key credit strength and one of the main pillars of its Aaa rating. The state funds a budget stabilization reserve at 5% of appropriations for its operating funds (general, transportation, and education), the statutory maximum.

Notably, the state has funded reserves to the statutory maximum since 2004, avoiding any draws throughout the recession, and continuing to build them as revenues grow.

The state's roughly $2.7 billion of operating funds revenues consist mainly of a statewide education property tax (36% of revenues), a personal income tax (24%), and a 6-cent sales tax (13%). These tax revenues are growing: the income tax is forecast to climb 8% in fiscal 2016 after a 5% rise in 2015, and the sales tax projected to grow nearly 5% in 2016 following 3% growth in 2015.

Although Vermont's revenues are subject to economic volatility, we expect the state to adjust well to economic cycles thanks to a comprehensive consensus planning regime as well as a firm commitment to a sound fiscal position.

Liquidity

Vermont's strong budget stabilization reserves help to ensure ample cash. The state does not resort to cash-flow borrowing to provide liquidity throughout the year.

The state's unrestricted cash position for all funds on a pooled basis throughout the year averages about $250 million, or nearly 10% of operating fund revenues. As of June 30, unrestricted cash of $379 million was equal to 14% of operating fund revenues.

DEBT AND PENSIONS: MODERATE DEBT, HEAVY UNFUNDED PENSIONS

Vermont's $585 million of General Obligation debt, plus roughly $33 million of highway revenue bonds secured by gasoline taxes, equate to a modest $954 per capita, which is below-average. Debt is also modest measured relative to gross state product (2% versus 2.2% median) and relative to per capita income (2.1% versus 2.5% median).

Debt is likely to remain modest. The state's Capital Debt Affordability Advisory Committee has recommended new-money borrowing of $72 million annually, implying small increases to debt outstanding as current debt matures at a rate of roughly $45 million annually.

Debt Structure

The state's GO debt is all fixed rate.

Debt-related Derivatives

The state is not party to any debt-related derivatives.

Pensions and OPEB

Vermont's net pension liabilities are on the high side, and this is the one factor where the state scores poorly relative to peers in the top rating category.

The state contributes to two defined-benefit pension plans, one for state employees and one for teachers. All employer contributions to these plans come from the state (the state makes no contributions to the municipal pension plan).

As of the 6/30/2014 actuarial valuation, the actuarial accrued liabilities of the state's two plans totaled $4.7 billion while the actuarial value of assets totaled $3.2 billion, implying an unfunded actuarial liability of $1.5 billion.

Based on standard Moody's adjustments to pension liabilities, we estimate the adjusted net pension liability as of fiscal 2013 at $3.5 billion. The three-year average adjusted net pension liability is roughly 65% of governmental revenues, which is above the state median of 53%.

Positively, Vermont is on a path to achieve full funding of its actuarial pension liability by 2038. Like many paths to full funding that are based on a fixed share of payroll, Vermont's plan assumes larger contributions in later years than in early years. The state's funding plan will result in unfunded liabilities growing through negative amortization until 2022 before the unfunded liability begins to decline as contributions increase. As such, the ANPL score is likely to worsen over the next few years.

OPEB

The state also provides other post-employment benefits (OPEB), which have an actuarial unfunded liability of about $1.8 billion. The annual OPEB cost is $110 million, or 4% of operating revenues.

GOVERNANCE

We consider Vermont's fiscal management to be strong. It utilizes consensus forecasting for estimating revenues, has increased the frequency of its forecasting during economic downturns, and passes on-time budgets. The state's willingness to continue allocating money to its rainy day funds also reflects well on management.

KEY STATISTICS

Per capita income relative to US average: 103%

Industrial diversity: 0.73

Employment volatility: 71

Available balances as % of operating revenues (5-year average): 8%

Net tax supported debt to governmental revenues: 11%

3-year average adjusted net pension liability to governmental revenues: 69%

OBLIGOR PROFILE

Vermont is the second-smallest state by population, which is about 625,000. Located in the New England region, Vermont is primarily rural. Its gross state product of $30 billion is by far the smallest among the 50 states.

LEGAL SECURITY

The 2015 bonds are general obligations of the state. The full faith and credit of the state are pledged to payment of debt service on the bonds.

USE OF PROCEEDS

Proceeds of the Series 2015A and Series 2015B bonds will provide new money for a variety of purposes including state buildings, education, and public safety. The 2015C bonds will be used to advance refund the state's 2005C, 2007A, and 2007D bonds for estimated net present value savings of 4.9%.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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