STANDARD & POOR'S

Global Credit Portal®
RatingsDirect®

February 22, 2012

Vermont; General Obligation

Primary Credit Analyst:
Henry Henderson W, Boston (1) 617-530-8314; henry_henderson@standardandpoors.com

Secondary Contact:
Robin Prunty, New York (1) 212-438-2081; robin_prunty@standardandpoors.com

Table Of Contents

Vermont; General Obligation

Credit Profile		
US$69.185 mil GO rfdg bnds ser 2012 D due 08/15/2025		
Long Term Rating	AA+/Stable	New
US$30.0 mil GO bnds ser 2012 B dtd 02/21/2012 due 08/15/2032		
Long Term Rating	AA+/Stable	New
US$25.0 mil GO bnds (Citizen bnds) ser 2012 A due 08/15/2021		
Long Term Rating	AA+/Stable	New
US$10.0 mil GO bnds (Federally Taxable) ser 2012 C due 08/15/2032		
Long Term Rating	AA+/Stable	New
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' long-term rating to Vermont's series 2012 A-D general obligation bonds (GO) and affirmed its 'AA+' rating, and stable outlook, on the state's GO bonds outstanding.

The ratings reflect our opinion of the state's:

- Strong financial management that has helped it maintain a good financial position in an environment of declining revenue; and
- Rapid GO debt amortization.

The state's GO bonds are secured by the state's full faith and credit pledge. The series A, B, and C bond proceeds will be used for various capital projects. The series D bond proceeds will be used for refunding, with net present value savings of around 8%.

Vermont, with a 2010 population of 625,700, is in northern New England, bordered by Canada to the north, and the U.S. states of New York, Massachusetts, and New Hampshire to the west, south, and east.

The state ended fiscal 2011 with fully funded reserves in the general fund, transportation fund, and education fund, and an operating surplus of $65.6 million. The surplus was primarily due to above-target revenues in: personal income taxes ($19 million above target) and corporate income taxes ($9 million above target). On a year-over-year basis, revenues increased by $118.4 million, or 11% from fiscal 2010 levels. The primary use of the surplus was to reserve $60 million in a human caseload reserve for a potential increase in social services cases, and $30 million of that reserve was appropriated in the fiscal 2012 budget.

The fiscal 2012 budget, as enacted, closed an estimated $176 million budget gap (approximately 15% of revenues), and officials project the three stabilization reserves for the general fund, transportation fund, and education fund will end the year at fully funded 5% levels. The state's consensus revenue committee, known as the Emergency Board, met in January 2012 and decreased the revenue projection by $2 million for fiscal 2012 and $9.3 million for fiscal 2013 compared with the previous estimate. These estimates reflect an expectation for lower economic performance relative to the earlier projection.

Through January 2012, the year-to-date general fund revenues were 0.7% below the current estimate for year, but the revenues for January alone were 3.5% below the estimate. Personal income taxes are the largest share of general fund revenues, and were 0.8% below the target for year to date and 3.6% below target for the month. Officials attribute the January revenue declines partially to a decline in consumption taxes due to a lack of snow that has resulted in an estimated 10% to 15% decline in tourist visits. However, officials project that revenues will likely to remain below target for the remaining winter months due to this lack of snow. Nevertheless, the damage for Tropical Storm Irene did not have a significant impact on revenue collections in the beginning of fiscal 2012.

The governor's proposed fiscal 2013 budget projects the closure of a $50.5 million budget gap (4.0% of revenues) without the use of budget stabilization reserves or broad-based tax increases. To close the gap, the budget contains $50.3 million of human services program reductions. As part of the 2013 budget process, the governor has recommended increasing the general fund stabilization target to 5.25% for the end of fiscal 2013, from the current level of 5%.

The state sustained significant damage from Tropical Storm Irene, and has begun to reserve funds for Federal Emergency Management Agency payments. Officials project that they will not need to issue more debt than the amount currently recommended by the state's capital affordability committee in order to provide funds for storm repair, but expect to reprioritize the existing authorizations. Officials project that the state's next debt issuance will be in summer of 2012 for transportation projects.

Based on the analytical factors we evaluate for states, on a scale of '1' (strongest) to '4' (weakest), we have assigned a composite score of '1.7'.

Outlook

The stable outlook reflects Standard & Poor's expectation that Vermont's prudent financial and debt management practices will allow it to maintain what we view as a sound financial position. We will continue to monitor the state's ability to maintain its financial position and also its pension and retiree healthcare funding levels. Downside risk for the rating includes the potential for significant reductions in federal funding that currently flows to the state. Standard & Poor's will continue to monitor the federal consolidation efforts stemming from the Budget Control Act. Once these are identified, we will evaluate their effect on the state's finances and officials' responses to these revenue reductions.

Government Framework

Vermont does not have a constitutional or statutory requirement to enact or maintain a balanced budget, but it has consistently maintained sound finances. In our view, the state has significant flexibility to increase the rate and base of its major tax revenues, which include income taxes, sales taxes, and a statewide property tax that funds the state's support of local education. We view the state's revenue sources as diverse. Voter initiatives cannot affect the state. Vermont maintains the ability to adjust disbursements in order to maintain sufficient liquidity. Debt service can be paid without a budget, but there is no other legal priority for debt.

Revenue structure

Vermont's tax structure is broad, and its revenue sources are diverse across several operating funds. The general fund relies on unrestricted revenues from personal and corporate income, sales and use, and meal taxes. The personal income tax generated $526.6 million in fiscal 2011, or 47% of total general fund revenues, after a 4.7% increase for fiscal 2011 that followed declines in fiscals 2009 and 2010. The next largest sources of general fund revenue in fiscal 2011 were:

- Sales and use ($217.1 million or 19% of total general fund revenues), which increased by 3.8% after declines in fiscals 2009 and 2010; and
- Meals and rooms ($122.4 million or 10%), which rose by 3.4% for fiscal 2011 after slight increases in fiscals 2009 and 2010.

The education fund relies primarily on a statewide property tax (70% of 2011 education fund revenues plus transfer from the general fund), and an appropriation from the general fund (20%). The education stabilization reserve ended the year at the statutory maximum of 5% or $30.3 million.

The transportation fund relies primarily on federal-match grant revenues, a motor vehicle license fee, and a motor fuel tax. The transportation budget stabilization fund ended fiscal 2011 at the statutory maximum of 5%, or $10.4 million.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.6' to Vermont's government framework.

Financial Management

Financial Management Assessment: 'Strong'

Standard & Poor's considers Vermont's financial management practices "strong" under its FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Much of Vermont's debt and financial management practices are embedded in state statute. These, along with internally developed policies, guide the state's long-term budget and capital planning, debt management, and investing practices.

The state has a well-established consensus revenue estimating process. According to statute, the joint fiscal office and administration provide their respective revenue estimates for the general, transportation, and federal funds for the current and next succeeding fiscal year to the Vermont Emergency Board.

Vermont law also requires a long-term capital plan. The governor submits a capital budget annually to the General Assembly based on debt management provisions outlined by the state's capital debt affordability advisory committee. The committee's estimate is nonbinding, but the state legislature has never authorized new long-term GO debt in excess of the committee's estimated amount. The state has formal debt management policies, including a statutory debt affordability analysis developed by the capital debt affordability advisory committee that Vermont integrates into the operating budget development process and updates at least annually. Vermont has not entered into any interest rate swaps and does not have an adopted swap management policy. Statutory restrictions and adopted administrative policies govern investment management, and the office of the state treasurer monitors compliance.

Budget management framework

The state has multiple tools to assist financial management. Vermont monitors revenues and publishes results monthly; and the emergency board meets at least twice annually, in July and January, to evaluate the revenue forecast and make adjustments, if necessary. The state forecasts also include Medicaid revenues and spending. These consensus forecasting meetings can be convened more frequently, and have been held quarterly for about the past two years, due to the recession and the potential impact on revenues and expenditures. The emergency board includes the governor and the legislative chairs of the house and senate fiscal appropriations committees. The forecasting process includes traditional economic and revenue forecasting, which the state performs with the assistance of outside economists, for the current and next succeeding fiscal year, as well as a less detailed forecast for the next eight years. The state also forecasts Medicaid revenues and spending.

The governor has statutory authorization to adjust the budget within certain revenue and expenditure change limits when the Vermont Legislature is not in session. Vermont maintains stabilization reserve funds at statutory levels to reduce their effect on annual revenue variations. In 1993, the state created separate budget stabilization reserves within the general and transportation funds. The amount in each of these reserves is not to exceed 5% of previous-year appropriations. The state created an education fund budget stabilization reserve in fiscal 1999 with provisions for slightly lower reserves at 3.5%-5.0% of expenditures. Vermont statute requires annual funding of such reserves.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.0' to Vermont's financial management.

Economy

The state's population has recently grown more slowly than the nation as a whole; for 2000-2010, its population grew by 2.8% compared with the nation's 9.7%. State per capita personal income in 2010 was slightly below the nation, at 98% of the national level. Throughout the current recession, Vermont's unemployment rates have been better than national levels; the state's peak rate was 7.3% in May 2009, and the 2011 rate dropped to 6.2%. The state's age dependency ratio was lower than that of the U.S., indicating a ratio of fewer children and elderly to each working-age adult, which we consider a positive factor.

IHS Global Insight projects that the state's private-sector job growth will grow by 0.7% per quarter, which would be the second-slowest in the nation. In addition, the firm projects that the state's unemployment rate will not decline significantly by the end of calendar 2012.

The major private employers in the state include Fletcher Allen Health Care, the operator of the largest hospital in the state (about 6,700 employees), and IBM (about 5,000). The IBM plant manufactures computer chips for consumer electronics. Other sectors with more than 1,000 employees include retail, retail banking, manufacturing, higher education, health care, and tourism. In addition, the University of Vermont system employs more than 3,000.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.9' to Vermont's economy.

Budgetary Performance

The state maintains separate budget stabilization funds in its general, transportation, and education funds that are available to offset undesignated fund deficits. The statutory maximum for the three stabilization reserves is 5% of the prior year budgetary appropriations, and the education stabilization fund also has a statutory minimum of 3.5% of the prior year appropriation. The governor has proposed increasing the general fund maximum to 5.25% beginning in fiscal 2013. The three stabilization funds have been at their statutory maximums since fiscal 2007. The state pools the cash reserves for these major funds, which results in sufficient liquidity for operations during the fiscal year. Officials indicated that the state has not externally borrowed for liquidity since 2004.

General fund revenues were $1.17 billion in fiscal 2011 -- an increase from the prior year -- and Vermont ended with the budget stabilization reserves for the general, transportation, and education funds fully funded at their statutory maximum levels of 5% of the prior year's appropriations. The internal service fund has an accumulated unreserved fund deficit of $22.7 million, which is due to accounting for properties in the property management fund, and this deficit will be reduced over time.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.3' to Vermont's budgetary performance.

Debt And Liability Profile

Debt

As of June 30, 2011, Vermont's tax-supported debt was about $790 per capita, 2.0% of personal income, and 1.9% of gross state product. The fiscal 2011 tax-supported debt service was about 2.5% of general governmental expenditures. Vermont's debt portfolio is conservative, in our view, consisting of only fixed-rate debt and without any exposure to interest rate swaps. We consider the debt amortization to be rapid, with officials retiring more than 70% of GO debt over the next 10 years. The state has a debt affordability committee that annually recommends a maximum amount of debt issuance for the next fiscal year, and while the committee's recommendations are not binding, Vermont has consistently adhered to them. Officials do not expect debt issuance to increase significantly due to Tropical Storm Irene damage, but believe that the current authorizations can be reallocated for those uses within the current authorized amounts. Debt service can be paid without a budget, but there is no other priority for the payment of debt before other general state expenditures.

Pensions

Vermont maintains three statutory pension plans: the state teachers' retirement system (VSTRS), with about 10,500 active members; the state employees' retirement system (VSRS), which includes general state employees and state police and has about 7,800 active members; and the municipal employees' retirement system, with about 6,600 active members. The state appropriates funding for the first two systems; the municipal system is supported entirely by municipal employers and employees. The pension systems' funded ratio for the combined teachers and state employee pension systems ratios declined somewhat as of June 30, 2011, to 70.4% from 72.7% a year earlier. The combined unfunded actuarial accrued liability was $1.2 billion. The actual pension contributions in fiscals 2010 and 2011 were 103% and 94%, respectively, of the actuarial required contributions (ARCs) for VSTRS, and 81% of the fiscal 2010 and 2011 VSRS ARCs. Officials indicate that the state budgeted for full pension ARC payments in recent years but attribute the underfunding of the VSRS pension ARC to midyear payroll reductions that negatively affected the funding formulas. The state has a true-up process that increases the ARC in an amount equal to the underfunding from two years before, but despite that process, the VSRS ARC has continued to be underfunded in recent years. However, officials project that the salary projections for fiscal 2013 are conservative enough to result in full ARC funding, including the prior year's underfunded amount.

The state implemented pension changes that reduced the VSTRS pension ARC for fiscal 2011 and future years. The primary changes were a longer eligibility period to qualify for normal retirement and an increase in the retirement contribution made by all teachers. After these changes, officials project that the ARC for fiscal 2011 was reduced by about $15 million. Officials also projected the other postemployment benefits (OPEB) ARC to be reduced by these changes. Subsequent to these changes, the pension systems' actuaries updated the experience studies for the systems, and as a result, lowered the interest rate assumptions, which increased the ARC beginning in fiscal 2013. The new interest rate assumption is based on the "select and ultimate" method, which assumes a blend of annual interest earnings between 6.25% and 9.0%, and which results in an expected annual rate of return of 8.1% for VSRS and 7.9% for VSTRS.

Other postemployment benefit liabilities

Vermont offers postemployment medical insurance, dental insurance, and life insurance benefits to retirees of the single-employer VSRS and the multiemployer VSTRS. The unfunded OPEB liability for VSRS as of June 30, 2011, was $998.6 million and for VSTRS was $780.0 million. The actuarial annual OPEB cost in fiscal 2011 was $68.3 million for VSRS, of which the state paid 40% under pay-as-you-go funding. The VSTRS also uses pay-as-you-go funding, but the state does not break out the actual employer contribution, instead including it through the pension fund without an explicit appropriation. The actuarial annual OPEB cost for VSTRS in fiscal 2011 was $43.5 million, a reduction of about $17 million from fiscal 2010, primarily due to benefits changes negotiated with the teachers' union that reduced the VSTRS OPEB cost by about $15 million for fiscal 2011. The state has established an OPEB trust fund for VSRS, but as of June 30, 2011, it only contained $11.2 million of assets, for a 1.1% actuarial asset funded ratio. The separate multiemployer Vermont Municipal Employees Health Benefit Fund for local government is administered by the state, but has no liability to the state, and is not included in our OPEB calculations.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '2.4' to Vermont's debt and liability profile.

Related Criteria And Research

USPF Criteria: State Ratings Methodology, Jan. 3, 2011