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Vermont; General Obligation

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Vermont GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA+' rating, and stable outlook, on Vermont's general obligation (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.

Vermont, with a 2010 population estimate of 625,000, 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 fiscal 2011 budget, as enacted, closed an estimated $153 million budget gap (approximately 14% 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. In addition to the stabilization funds, officials project that the general fund will end the year with an additional $27 million balance that will be carried over into fiscal 2012, and the education fund will carry over about $4.5 million into fiscal 2012. The enacted 2011 budget closed the projected gap primarily through reductions in human service appropriations, reductions in pension appropriations due to changes made to the teachers' pension system, and a $38 million expense reduction bill. The latest consensus revenue forecast was done in January 2011, which resulted in a 6.9% increase in the revenue projections for the general fund. The 2011 budget did not rely on a projected Federal Medical Assistance Percentage extension to fund recurring expenditures, and will use the approved funding for one-time uses.

The governor's proposed fiscal 2012 budget projects the closure of a $176 million budget gap without the use of budget stabilization reserves or broad-based tax increases. The budget contains $27 million of additional revenues from the most recent revenue forecast and $83 million of general fund reductions. The reductions include a $23 million decrease in the general fund transfer to the education fund and $12 million of savings through changes to contracts, health insurance, and retirement benefits.

Officials project that the state's next debt issuance will be in fall 2011 of about $90 million.

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 in the current environment of potential revenue pressures.

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 2010, or 48% of total general fund revenues, which was a 5.1% decline from fiscal 2009; this tax also declined from 2008 to 2009. The next largest sources of general fund revenue in fiscal 2010 were:

- Sales and use ($209.1 million or 20% of total general fund revenues), which declined 2% from 2009 and 5% from 2008 to 2009; and
- Meals and rooms ($118.5 million or 11%), which increased slightly in both fiscals 2009 and 2010.

The education fund relies primarily on a statewide property tax (66% of 2010 education fund revenues plus transfer from the general fund), and an appropriation from the general fund (about 24%). The education fund budget stabilization fund was $3.1 million at the end of fiscal 2010.

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 2010 with an $11.3 million balance.

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 the state 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 2000-2009, its population grew by 2.1% compared with the nation's 9.1%. State per capita personal income in 2009 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 February 2011 rate dropped to 5.6%. 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 0.5% annual labor force growth over next decade, 42nd in the U.S., and projects that this will be an impediment to long-term economic growth. The firm also projects 1.3% per year employment growth for 2011-2016, lagging the 1.8% U.S. growth, and ranking 45th in the country. However, the firm also projects that strong health care demand will positively influence that sector of the economy, which provides relatively more jobs in Vermont than in the nation as a whole.

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 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 $1.04 billion in fiscal 2010, which was a $66 million decline from the prior year. However, the year 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 fiscal 2010 general fund revenue projection decreased revenues in July 2009 but then increased the projections in the next two quarterly meetings. Vermont achieved budget savings in fiscal 2010 through a wage reduction in its latest collective bargaining contract with its largest union. The internal service fund has an accumulated unreserved fund deficit of $28.3 million, which is due to claim liabilities from when the Medicaid fund was altered under a waiver from the federal government. State officials project that the state will receive federal assistance in eliminating this deficit.

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, 2010, Vermont's tax-supported debt was about $770 per capita, 2.0% of personal income, and 1.9% of gross state product. The fiscal 2010 tax-supported debt service was about 2.9% 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, the state has consistently adhered to them. 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' funding ratios improved somewhat as of June 30, 2010. As of that date, the funded ratio for the combined teachers and state employee pension systems was 72.7%, with a $1.01 billion unfunded actuarial accrued liability. The actual pension contributions in fiscals 2009 and 2010 were 98% and 101%, respectively, of the actuarial required contributions (ARCs) for VSTRS, and 87% and 84%, respectively, of the ARCs for VSRS.

Subsequent to the issuance of the most recent actuarial report, the state implemented pension changes that officials project 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 $15.3 million to $48.2 million. The other postemployment benefits (OPEB) ARC was also projected to be reduced by these changes.

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, 2010, was $917.3 million, and $703.8 million for VSTRS. The actuarial annual OPEB cost in fiscal 2010 was $58.9 million for VSRS, of which the state paid 38% under pay-as-you-go funding. The VSTRS also uses pay-as-you-go funding, but the state does not break out the actual fiscal 2010 employer contribution, instead including it through the pension fund without an explicit appropriation. The actuarial annual OPEB cost for VSTRS in fiscal 2010 was $60.3 million. Officials also project that benefits changes negotiated with the teachers' union will reduce the VSTRS OPEB cost by about $15 million for fiscal 2011. The state has established an OPEB trust fund for VSRS, but has only deposited $8 million in it, for a 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