STANDARD & POOR'S Global Credit Portal

Research

Vermont; General Obligation

22-Jan-2010

Current Ratings

Credit Profile		
US$52. mil GO bnds due 08/15/2029		
Long Term Rating	AA+/Stable	New
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating, and stable outlook, to **Vermont**'s series 2010A general obligation (GO) bonds and affirmed its 'AA+' rating, with a stable outlook, on the state's existing GO debt. The 2010A bonds will be sold either as taxable Build America Bonds or tax exempt bonds, at the winning bidder's option.

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
- Low debt burden and rapid debt amortization.

The state's GO bonds are secured by the state's full faith and credit pledge.

Vermont, with a population estimate of 621,240, 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's population has recently grown more slowly than the nation as a whole; for 2003-2008, its population grew by 1.1% compared with the nation's 4.6%. State median household and per capita effective buying income indicators in 2008 were about equal to those of the nation, at 97% and 98%, respectively, of national levels. Throughout the current recession, the state's unemployment rates have been better than national levels; the state's peak rate was 7.4% in May 2009, and the October rate dropped to 6.5%.

Fiscal 2009 ended with the budget stabilization reserves for the general, transportation, and education funds fully funded at their statutory 5% maximum levels; in addition, the general fund had additional reserves for revenue shortfalls and human service caseload increases. The national economic slowdown resulted in an 8% year-over-year decline in fiscal 2009 general fund revenues and in four separate downward general fund revenue revisions during fiscal 2009. There was positive revenue variance over the revised forecast in the inheritance and estate tax, which ended the year $14.1 million higher than forecast and in corporate income tax, which was $5.0 million above forecast. These positive variances offset a $2.3 million negative variance in other general fund revenues, such as personal income tax and sales tax. These results enabled $14.8 million to be reserved for potential revenue shortfalls in fiscal 2010.

Similar to the fiscal 2009 forecast, the state's quarterly revenue forecasts have reduced the fiscal 2010 forecast by $45.8 million, or 4% of the original January 2009 forecast, and the fiscal 2011 forecast has been reduced by $42.3 million, or

3.8%. The transportation and education funds--which are two of the state's other major funds--also experienced forecast reductions, though with smaller percentage reductions. The most recent revenue reduction was in mid-November 2009, which resulted in a $25.6 million reduction in projected revenues, or a 2.4% reduction, partially offset by the budgeted use of $14.8 million of prior year reserves. The administration has submitted a gap-closing proposal for fiscal 2010 that includes the November 2009 revenue revisions and appropriates most of the human service caseload reserve. The state recently achieved budget savings through a wage reduction in its latest collective bargaining contract with its largest union.

Officials estimate a $150 million budget gap for fiscal 2011 (approximately 14% of revenues), primarily due to $80 million of projected expenditure increases, including increased expenditures for human service caseloads and pension payments and a $70 million structural gap from reduced American Recovery and Reinvestment Act stimulus funding. This projection does not assume any additional revenues from a second federal stimulus bill. The governor and some legislative leaders recently released a proposal to reduce expenditures by $38 million in fiscal 2011 and $72 million in fiscal 2012.

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

The state's net debt ratios are, in our opinion, a low $730 per capita, or 1.8% of personal income.

Outlook

The stable outlook reflects Standard & Poor's expectation that Vermont's prudent financial and debt management practices will allow it to maintain a sound financial position. We will continue to monitor the state's ability to maintain its sound financial position in the current environment of decreased revenues.

Economy

According to IHS Global Insight Inc., Vermont's recent employment figures have been volatile, but overall job losses appear to be on a decelerating trend. IHS projects job losses to continue through the first quarter of 2010, but does not expect the pace of contraction to reach the recent highs. However, the firm projects that the employment will not return to the pre-recession level until 2014. During the next 10 years, however, IHS projects the state's labor market to grow at the second-fastest pace of the six New England states.

The education and health services sector accounts for 20% of state jobs, 41% higher than the national average, while the leisure and hospitality sector accounts for 11%, 8% higher than the national average. The leisure and hospitality sector is concentrated in tourism related to the fall foliage and winter ski seasons, though there has been an effort to expand the tourism season into the summer, including the addition of summer activities at some ski areas. Tourism-related revenues from sales, meals, gasoline, and lodging taxes provide significant revenue streams to the state's operating budget. Tourism from Canada has boosted the state's economy recently, but it is somewhat dependent on exchange rates and the strength of Canada's economy.

The largest segment of the state's economy is in Chittenden County, which includes Burlington, Vt., with a population estimate of 39,000, the center of the state's only metropolitan statistical area. The state's leading private employers are Fletcher Allen Hospital (approximately 6,700 full- and part-time employees) in Burlington and IBM Corp. (approximately 5,000 employees). The manufacturing sector accounts for 11% of the state's employment, 15% higher than national rates, and is concentrated in high-tech manufacturing due to IBM's presence. IHS estimates 70% of all state exports are high-tech manufactured goods, much of it produced at IBM's Essex Junction, Vt. facility. Canada is by far the largest foreign importer of Vermont exports, at 44%.

Finances: Reserves At Statutory Limits Despite Revenue Declines

Vermont's strong fiscal controls contributed to the maintenance of a favorable financial position with reserves maintained at statutory limits despite revenue declines during the year. Fiscal 2009 ended with the budget stabilization reserves for the general, transportation, and education funds all fully funded at their statutory 5% maximum levels. The general fund budget stabilization reserve was $60.0 million, and there were additional general fund reserves for revenue shortfalls ($14.8 million) and human service caseload increases ($16.3 million). The internal service fund has an accumulated unreserved fund deficit of $27.7 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.

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, all of which declined in fiscal 2009. The personal income tax generated $530 million of revenues in fiscal 2009, or 50% of total general fund revenues, which was a 15% decline from fiscal 2008. The next three largest sources of general fund revenue in fiscal 2009 were:

- Sales and use ($214 million or 20% of total general fund revenues), which declined 5% from 2008;
- Meals and rooms ($117 or 11%), which declined by 3%; and
- Corporate taxes ($66 million or 6%), which declined by 11%.

The education fund relies primarily on a statewide property tax (66% of 2009 revenues), an appropriation from the general fund (33%), and sales tax revenue (9%); total education fund revenues declined by 6% from fiscal 2008. The education fund budget stabilization fund was $31.0 million at the end of fiscal 2009

The transportation fund relies primarily on federal-match grant revenues, a motor vehicle license fee, and a motor fuel tax; total transportation fund revenues declined by 9% from the previous year. The transportation budget stabilization fund ended fiscal 2009 with an $11.3 million balance.

Debt

In our view, Vermont's debt portfolio is conservative, consisting entirely of fixed-rate bonds and no exposure to interest rate swaps. We consider debt amortization rapid, with officials retiring 76% of total GO debt in the next 10 years. Fiscal 2009 debt service accounted for 6% of general fund revenues, which we consider low. Vermont's debt burden has remained a credit strength during the past several years, with the state retiring more debt than it issues. The state's debt affordability committee recommended the issuance of a maximum of $70.0 million in fiscal 2010 and $71.8 million for fiscal 2011.

Pension And Other Postemployment Benefit Liabilities

Pension liabilities

Vermont maintains three statutory pension plans: the state teachers' retirement system (STRS), with 10,800 active members; the state employees' retirement system (VSRS), which includes general state employees and state police and has 8,100 active members; and the municipal employees' retirement system, with 6,530 active members. The state appropriates funding for the first two systems; the municipal system is supported entirely by municipal employers and employees. Due to investment losses, the pension systems' funding ratios declined significantly as of June 30, 2009, similar to other pension systems. As of that date, the funded ratio for the teachers' system was 65.4%, which resulted in an unfunded actuarial accrued liability (UAAL) of $727.8 million. The state employees' system funded ratio was 78.9%, with a UAAL of $326.5 million.

Other Postemployment Benefit Liabilities (OPEB)

Vermont also offers postemployment medical insurance, dental insurance, and life insurance benefits to retirees of STRS and VSRS. Assuming no prefunding, the unfunded OPEB liability as of June 30, 2009 was $872.2 million for STRS with a fiscal 2010 annual required contribution of $59.0 million, which state officials project to increase to $266.2 million in fiscal 2040. For VSRS, without prefunding, the OPEB UAAL was $807.2 million, with a fiscal 2010 annual required contribution of $58.0 million, which officials project to increase to $267.6 million in fiscal 2040. The state has established an OPEB trust fund for VSRS, but has only deposited a limited amount of funds in that trust fund.

Related Research

USPF Criteria: **GO Debt**, Oct. 12, 2006

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

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