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Fitch rates Vermont's $90 million general obligation bonds "AAA"

Fitch Ratings has assigned an 'AAA' rating to the following State of Vermont general obligation (GO) bonds: $20.225 million GO bonds, 2013 series A (Vermont Citizen Bonds); $46.41 million GO bonds, 2012 series B; $18.68 million GO refunding bonds, 2013 series C.The bonds are expected to sell the week of Nov. 4, 2013, 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 $546.06 million GO bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the state of Vermont secured by the state's full faith and credit.

KEY RATING DRIVERS

LOW DEBT LEVELS: Vermont's debt levels are low and are expected to remain so as affordability planning is employed. The state's debt profile reflects nearly exclusive use of GO debt and rapid principal amortization.

CONSERVATIVE FINANCIAL MANAGEMENT: Vermont's revenue stream is diverse and revenue estimates are updated 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.

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, median resident age levels are well above the national average.

PENSION SYSTEM MODIFICATIONS IMPLEMENTED: The funded ratios for Vermont's pension systems have declined in recent years, though the state has funded its actuarially required contributions and made modifications to benefits and employee contribution level that could gradually improve them.

RATING SENSITIVITIES

The rating is sensitive to shifts in fundamental credit characteristics, particularly its low debt profile and fiscal discipline.

CREDIT PROFILE

Vermont's 'AAA' rating reflects its low debt burden, which is maintained through adherence to debt affordability guidelines, as well as its 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 below the median for U.S. states rated by Fitch. The state budgets conservatively, and its diverse revenue stream includes a state property tax for education.

Budget stabilization reserves (BSR) in each of the state's three major operating funds as of the close of fiscal 2013 were fully funded and are expected to remain so through the current fiscal year ending June 30, 2014. In addition to the general fund BSR, capped at 5% of prior year appropriations, additional general fund reserves include a 0.5% fund to offset federal funding reductions and the new general fund balance reserve (replacing the former revenue shortfall reserve). The balance reserve also has a cap of 5% of prior year appropriations, and reached nearly $12 million, or 1% of appropriations at the end of fiscal 2013.

LIMITED ECONOMY, STILL RECOVERING

The relatively narrow state economy is supported by larger-than-average employment in tourism, health and educational services, and manufacturing. The state has a relatively small income base with an older and well-educated population. During the recession, Vermont's peak-to-trough monthly employment loss of 8.1% was less severe than the national 8.5% decline. The recovery has been similarly more gradual than the national trend, but the gap narrowed this year. Through August, Vermont's three-month moving average of year-over-year (YOY) non-farm employment gain of 1.5% only slightly trailed the 1.7% national rate. Unemployment levels remain well below those of the nation, at 4.6% in August 2013 compared to 7.3% for the country. 2012 per capita personal income of $44,545 was in line with the national level, though Vermont's total personal income growth since the end of the recession in 2009 slightly lags the national rate (12.9% versus 13.7%).

IMPROVING FISCAL PROFILE

Vermont's fiscal profile has largely recovered from the recession. Revenue performance from the state's major general fund tax sources in fiscal years 2009 and 2010 was decidedly negative, though the state took prompt action to maintain balance through expenditure reductions, the use of carried forward balances, and application of federal stimulus funds; achieving operating surpluses in the state's general fund in each year. Revenue performance improved markedly in fiscal 2011, with 11.1% growth in personal income tax (PIT) revenues and 4.7% growth in sales and use tax revenues (SUT), and the state closed the fiscal year with a $65 million general fund operating surplus on a $1.2 billion budget. Recovery continued into fiscal years 2012 and 2013 with YOY general fund revenue growth of 3.8% and 7.7%, respectively. Fiscal 2013 ended with a $21.6 million general fund operating surplus, led by PIT revenues which increased a sharp 10.7%. Prudently, the state recognizes that income acceleration due to federal tax law changes likely inflated PIT collections in fiscal 2013, thereby forecasting much more moderate PIT growth of 3.9% in the enacted fiscal 2014 budget. The SUT projection indicates even slower 0.4% growth, though this is partially due to an increased allocation of sales tax revenues to the state's education fund from the general fund.

LOW DEBT, HIGHER PENSION LIABILITIES

Vermont's tax-supported debt is nearly exclusively GO, and it amortizes rapidly. The state's debt burden is low. As of June 30, 2013, net tax-supported debt equaled 2.1% of 2012 personal income. Debt has declined since the 1990s as a result of a focus on debt affordability, though Vermont's recent annual issuances moved the rate back up slightly. Fitch expects debt ratios to remain low to moderate relative to other states; the current median debt ratio for states rated by Fitch is 2.7%.

Vermont continues to appropriate actuarially required contributions (ARC) to its pension systems although funded ratios declined in recent years in part due to asset valuation declines, and below-average funded ratios. The state in recent years has implemented a series of changes to benefits, employee contributions, and actuarial assumptions. As of June 30, 2012, the state's Vermont State Retirement System was 69.3% funded on a Fitch-adjusted basis. Similarly, the teachers plan (for which the state is wholly responsible) was just 56.1% funded on a Fitch-adjusted basis. 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 (as of June 30, 2013) plus unfunded pension liabilities (as of June 30, 2012) was an above-average, but still manageable, 8.6% of 2012 personal income.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:

--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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U.S. State Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033

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