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STATE OF VERMONT
OFFICE OF THE STATE TREASURER

TO: Capital Debt Affordability Advisory Committee

FROM: Scott Baker, Director of Financial Reporting

RE: Minutes of Meeting on Wednesday, August 22, 2012

CDAAC Members Attending
DAVID COATES, CPA, Managing Partner, KPMG (Retired), and VT Business Roundtable
LAURA DAGAN, CFA, Chairman, Dwight Asset Management (Retired)
ROBERT GIROUX, Executive Director, Vermont Municipal Bond Bank
BETH PEARCE, Chair, Vermont State Treasurer
TOM SALMON, CPA, Vermont State Auditor
JEB SPAULDING, Secretary of Administration
JOHN VALENTE, ESQ., Chair, Vermont Municipal Bond Bank

Members of the General Assembly
SENATOR JOE BENNING (Caledonia)
SENATOR JOHN CAMPBELL (Windsor)
SENATOR WILLIAM CARRIS (Rutland)
REPRESENTATIVE ALICE EMMONS (Windsor)
SENATOR ROBERT HARTWELL (Bennington)
REPRESENTATIVE MARY HOOPER (Washington)
REPRESENTATIVE JOAN LENES (Chittenden)
REPRESENTATIVE TERRY MACAIG (Chittenden)

Also Attending
STEVE WISLOSKI, Deputy State Treasurer
SCOTT BAKER, State Treasurer's Office
CATHERINE BENHAM, Associate Fiscal Officer, Legislative Joint Fiscal Office
TOM HUESTIS, Managing Director, Public Resources Advisory Group
JOE JUHASZ, Deputy State Auditor
STEVE KLEIN, Chief Fiscal Officer, Legislative Joint Fiscal Office
WANDA MINOLI, Principal Assistant, Department of Buildings and General Services
MICHAEL OBUCHOWSKI, Commissioner, Department of Buildings and General Services
JIM REARDON, Commissioner, Finance and Management
DAVID TAUBE, Reporter, The Rutland Herald and Barre-Montpelier Times-Argus
WENDY WILTON, Rutland City Treasurer

1. Opening remarks and approval of minutes

Ms. Pearce called the meeting to order at 1:00 p.m. The meeting was held in the 4th Floor Governor's Conference Room, 109 State Street, Montpelier.

Ms. Pearce reviewed the purpose of CDAAC and the role of the Committee. She said that over the years, the Committee has periodically reviewed and adjusted its methodology to determine how much debt can be prudently issued, and with PRAG becoming the State's new financial advisor, it was appropriate to review the methodology again. This is especially true particularly given the volatility in debt issuance by other states, and in the triple-A states peer group over the last several years.

Mr. Valente motioned, Mr. Coates seconded, and the Committee unanimously approved the minutes of the July 19, 2012 meeting by voice vote.

2. Comments from Institutions Committee Chairs (Representative Emmons and Senator Hartwell)

Representative Emmons stated that the current two year process is helpful for planning purposes, and has especially helped with the issues around Tropical Storm Irene. She said that there are real capital needs around the State, and the Legislature wants to make sure that these needs, as well as commitments to the local communities are met. She wants to ensure that money goes to farmers, the State Hospital and the Waterbury Complex. Senator Hartwell strongly supported Representative Emmons and reiterated that there are needs around the State.

3. Review of CDAAC Report methodology, statute, and prior-year changes

Mr. Huestis said that using the existing CDAAC methodology to determine debt issuance capacity has been impacted by volatility in both year-over-year debt issuance amounts, and in the peer group of triple-A rated states. In particular, States with three triple-A ratings have issued more debt than those, such as Vermont, with only two triple-A ratings. He said that the rating agencies have become relatively less focused on debt, and more focused on pension and OPEB unfunded liabilities. They are also looking at instances where recommendations are not being followed, or where governance has broken down, such disagreements between executive and legislative branches. Moody's has also proposed adjustments to U.S. state and local government reported pension data. Ms. Pearce commented that the Moody's change did attract considerable attention from industry groups such as the National Association of State Auditors, Comptrollers and Treasurers (NASACT), and that the comment period has been moved out until the end of September.

Representative Emmons felt that we should score rather favorably given that we balance our budget, pay our bills, have agreement between the Legislative and Executive branches, and meet the commitments of our capital needs.

Mr. Huestis said that those are the points that have been made in meetings with the rating agencies, and that they view Vermont favorable in this regard, especially considering S&P's recent upgrade of the Transportation bonds from AA to AA+.

Mr. Spaulding said that some things are within our control such as being prudent with the amount of debt issued, and the fact that the Governor has always followed the CDAAC recommendation.

4. Discussion of Waterbury Office Complex and State Hospital

Mr. Spaulding said the gap between the funding available (exclusive of FEMA reimbursement) and the optimum plan for rehabilitating the Waterbury Office Complex and the State Hospital is approximately $120 million. It may be another 2-4 weeks until the State knows what we will be getting from FEMA. The optimum plan is basically what the Legislature approved – the State Hospital plan includes 14 beds in Brattleboro, 10 in Rutland, and 24 in Berlin, and a temporary facility in Morrisville. The State is moving ahead with this plan. The Waterbury Complex includes demolishing a couple of dozen buildings, developing a new building, and moving the heat plant out of the flood area. This will result in a smaller, more energy efficient workplace. The current price tag for the complex is about $125 million. The best hope is to gain significant participation from FEMA. All possibilities are being explored at this point, but in the end, this will be a decision made with the Legislature, not the Administration alone.

Representative Emmons said that the complex is a vital economic engine for the Waterbury community, and we owe it to them to do our best to send our employees back. She said that we have made our commitment, and we must follow through. Senator Hartwell agreed with her comments and said that we should not let this go on any longer than necessary.

5. Capital projects update from Buildings and General Services

Commissioner Obuchowski said that everybody was put on notice that there are pressures on the Capital Bill, and that much of the money will be dedicated to the recovery from Irene. However, BGS will be keeping their commitment to major maintenance on State buildings.

Ms. Pearce said that the Treasurer's Office has worked with Finance & Management to produce a list of projects which has residual amounts due from bond proceeds. This list will be reviewed, and some may be re-allocated.

Mr. Wisloski said that for the CDAAC report, we will assume our next bond issuance will be $102.286 million – this is the remainder of the 2 year authorization plus $5.9 million of authorized but unissued amount.

6. Review of methodology, debt ratio projections and preliminary debt affordability estimates

Mr. Wisloski said that the CDAAC's long-term goal was to reduce and stabilize the State's debt outstanding to a reasonable debt level, and then increase capacity at a modest level going forward compared to other triple-A rated states. Currently, debt per capita (DPC) is $796 for Vermont (the median for all 50 states is $1,100). The DPC is one of the three critical ratios that the rating agencies measure, along with debt as percentage of personal income, and debt service as percentage of general fund and transportation fund revenue. The DPC has traditionally been the constraining metric; Vermont has stayed well within the other two metrics.

Ms. Pearce reviewed the history of the methodology used. She said that prior to 2009, the DPC was inflated annually at 2.7%, but starting in 2009 was compared to a peer group comprising states with at least one triple-A rating. The resulting inflator from this peer group comparison would have been 5.3%, but the Committee deemed this to be too aggressive and proposed a 60% "haircut" factor to adjust for Vermont's relatively more modest expected economic growth and substantially lower population growth.

Ms. Pearce said that the Committee's duty is to review the size and affordability of net tax supported debt that may be prudently authorized, balancing the State's capital budgeting requirements while at the same time preserving the State's strong credit ratings, low borrowing costs and access to the capital markets.

Mr. Huestis said that the large amount of bond issuance in 2010, and consequently the smaller amount in 2011 have skewed the numbers and made the results of the current methodology misleading. He also said that the effects of dropping Minnesota from the peer group (due to a downgrade) had a dramatic effect on the results. He said that although there was not a real problem with the methodology used in the past, the volatility of the peer group (amount of issuance and peer members) caused the process to break down.

Mr. Wisloski handed out several example debt capacity estimates using different variables including a base case, eliminating the 60% DPC inflator haircut, adding Minnesota (which lost its triple-A ratings in 2011) back to the triple-A peer group, and using a 10-year average versus a 5-year average for the DPC inflator. The scenarios showed capacity estimates ranging from $60.98 million per year (or $121.96 million for the FY2014-15 biennium) for the base case, to $80.17 million (or $160.34 million for the FY2014-15 biennium) in the case where the reduction 2011 bond issuance was smoothed using the 10-year average increase in issuance. Mr. Huestis emphasized that examples were not recommendations; rather, they were to illustrate how the current methodology's debt capacity estimate varied widely based upon very narrow and outlier parameters, and, given the relative strength of the State's economic performance during the same timeframe, did not accurately reflect the State's capacity to issue debt.

Ms. Pearce explained that we need to review the current methodology to make it less volatile in response to single-year issuance and triple-A states peer group changes. A conversation ensued regarding what new methodology to use. It was agreed that the Treasurer's Office would work with PRAG, and report back to the Committee with recommendations at the next meeting.

7. Public comment and adjournment

Ms. Pearce asked whether any members of the public in the meeting or attending on the phone wished to comment; none did.

The Committee unanimously voted to adjourn the meeting at 4:00 p.m.