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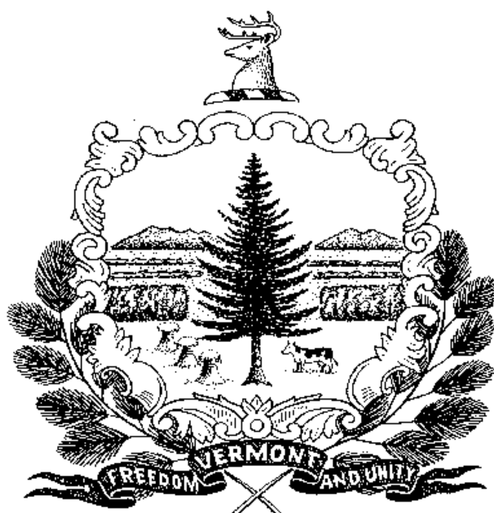
# CAPITAL DEBT AFFORDABILITY ADVISORY COMMITTEE

# State of




# Vermont

## RECOMMENDED ANNUAL NET TAX-SUPPORTED DEBT AUTHORIZATION

**September 2010**

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# 1. OVERVIEW

## Purpose

In accordance with the legislation, as amended, creating the Capital Debt Affordability Advisory Committee of the State of Vermont (the "Committee" or "CDAAC"), the Committee is required to present to the Governor and the General Assembly each year, no later than September 30, a recommendation as to the maximum amount of net tax-supported debt that the State may prudently issue for the ensuing fiscal year. The recommendation is presented in accordance with certain debt affordability guidelines and other matters that may be relevant to the proposed debt to be authorized.

## Recommendation

The Committee proposes that no more than $76,580,000 be authorized for the State's 2012 fiscal year. This recommendation, representing a 6.6% increase from the $71,825,000 fiscal year 2011 recommendation, is consistent with the approach that the Committee and the State have taken in the recent past; in particular, an amount is established for the ensuing fiscal year that allows the State to comply with the established affordability guidelines, and then that authorization figure is carried forward for each of the following nine years, in accordance with the enabling legislation – with this recommended level, in each and every year, the State, based on the accompanying numerical analysis, will be able to remain within the State's affordability parameters. The numerical presentations within this report are based upon the presumption that the recommended $76,580,000 will be authorized for fiscal 2012.

Among the reasons that CDAAC is proposing $76,580,000 in general obligation debt authorization for fiscal 2012 are the following:

1. Authorization of this level of debt in 2012 and thereafter allows the State to maximize the amount of capital funding and, at the same time, to comply with its triple-A debt guidelines.

2. It produces a meaningful increase in the amount of capital funding for State purposes, based on the level of past debt authorizations.

3. Economic conditions, including reduced employment, reduced equity markets performance, and State revenue constraints, are putting budgetary pressures on the State's expenditures, limiting the growth that fixed costs, including debt service payments, should absorb of State resources.

4. Authorization of this level of debt in 2012 is consistent with the current expectations of the rating agencies; we believe that the message will be received that the State continues to manage its debt issuance program in a prudent and restrained manner.

## Alternate Recommendation

For the first time, CDAAC is also submitting an alternate recommendation for the State's consideration. After extensive deliberations, the Committee believes that it would be appropriate for Vermont to consider a two-year debt authorization ($153,160,000) for fiscal year 2012 and 2013. This authorization would more closely align with the current biennial legislative session, and is driven by both near-term and long-term considerations.

*Near-Term:*

- (i) Historically low interest rates;
- (ii) Need to get certain large-scale capital projects (i.e., State Hospital) underway;
- (iii) Current lower cost of construction in the State;
- (iv) Use of capital program to inject funding into the State economy.

*Long-Term:*

- (i) Increased coordination between construction process and debt authorization process;
- (ii) Ability to pursue large-scale projects on a multi-year debt authorization basis.

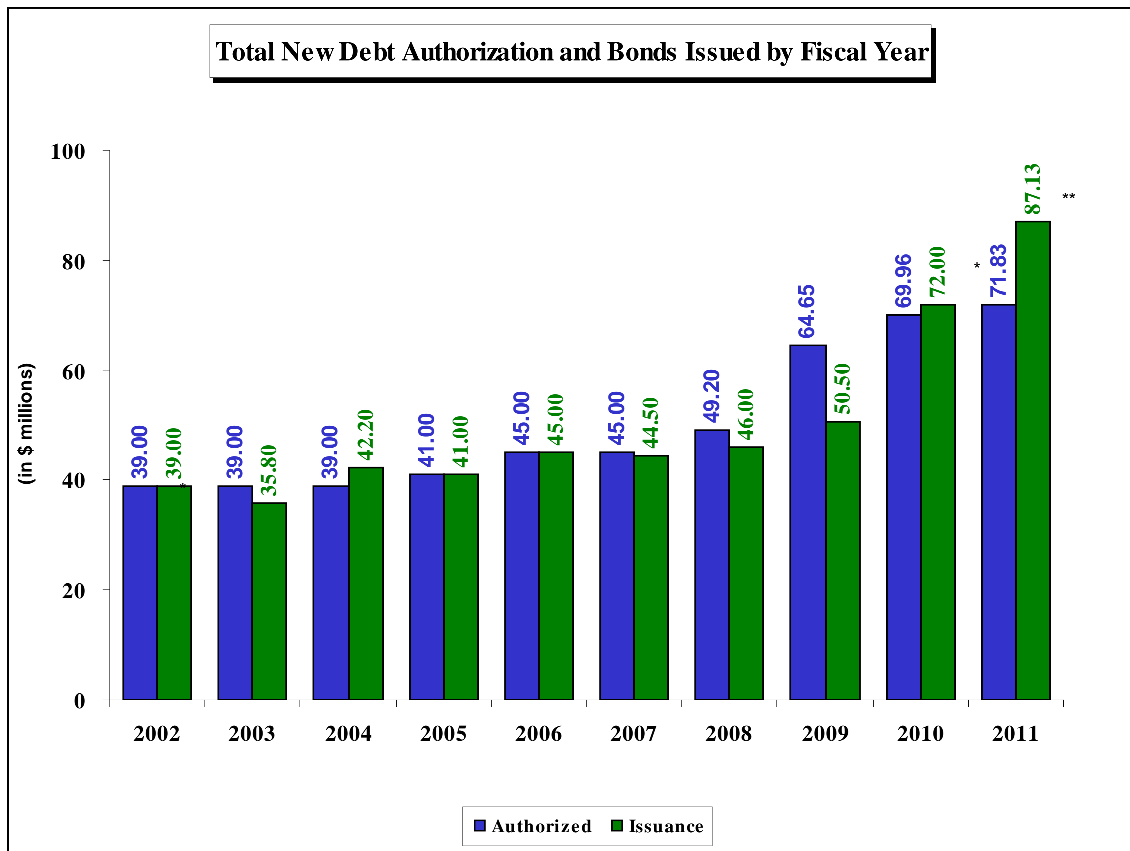
Depending on the success of this new approach, the State may choose to utilize this biennium authorization feature in the future. This recommendation intends for the two-year authorization to be identical to the sum of the recommended one-year authorization for fiscal 2012 and the assumed equal authorization for fiscal 2013; it cannot be emphasized enough that any additional authorization above this amount during the fiscal 2012-2013 period would violate the intent of this alternative recommendation. However, as a cautionary note, it should be emphasized that by pursuing this new approach, the State will not meet its debt affordability guideline (projected Moody's 5-year median on a debt per capita basis for triple-A rated states) in fiscal 2012 to the extent the State issues more than $109,940,000. However, the guideline can be met for the subsequent fiscal years. It should also be noted that if the State decides to pursue this course of debt authorization in future years, it is likely that this non-compliance will be associated with the debt authorization for the first year of each subsequent two-year program. For credibility reasons, it will be of critical importance that the State not authorize additional bonds in the second year.

## Nature of Vermont "Net Tax-Supported Debt"

As a matter of practice, while the CDAAC legislation, as amended, refers to an authorization of "net tax-supported debt," the amount of "net tax-supported debt" for the State means only general obligation debt, and this report assumes only general obligation debt for authorization purposes. As indicated elsewhere in this report, the rating agencies will most likely include the State's transportation infrastructure bonds, recently issued by Vermont, as part of "net tax-supported debt"; however, the CDAAC report does not assume that such indebtedness is part of "net tax-supported debt," resulting in only general obligation debt being considered.

## Recent Debt Authorizations

In fiscal year 2010, $72,000,000 of new money debt was issued, representing all of the $69,955,000 authorized for that year plus $2,045,000 of authorized but unissued debt remaining from 2008 and 2009. During fiscal year 2011, $87,130,000 of debt is assumed to be sold, the total amount of the original 2011 recommended authorization ($71,825,000) plus $15,305,000 of authorized, but unissued debt remaining from 2008 and 2009. We believe the State's historical practice to annually extinguish all or a large portion of the authorized amount of debt so that there doesn't exist a rising residual amount of authorized but unissued debt has enhanced the State's credit position with favorable responses from the rating agencies. The following chart presents the amounts of G.O. debt that have been authorized and issued by the State since fiscal year 2002.




** As approved by CDAAC.*
*** Anticipated to be issued.*
*Note: Annual issuances do not include refunding bonds.*

As shown above, the State has experienced a remarkable increase in debt authorizations over the last ten years. For the period, 2002-2004, the aggregate debt authorization amounted to $117,000,000, but for the last three year period, 2009-2011, the amount equaled $206,440,000. If the State adopts CDAAC's primary recommendation of $76,580,000, then the last three-year total would be $218,360,000, an increase of nearly 87% over the 2002-2004 period.

## 2. DEBT GUIDELINES

The State of Vermont currently enjoys triple-A ratings from both Fitch Ratings and Moody's Investors Service. As discussed in another part of this report, the triple-A rating by Fitch Ratings occurred in conjunction with a recalibration (generally meaning increased ratings), conducted by the rating agency earlier this year. Moody's raised the State's rating to triple-A in February, 2007. In addition, Standard & Poors Corporation assigns Vermont to a AA+ category.

For a number of years, Vermont has pursued a strategy to achieve a triple-A rating from all three nationally recognized credit rating agencies. In order to facilitate the achievement of this goal, CDAAC and the State have employed debt load guidelines, as follows:

### Debt Per Capita

The Committee has adopted a guideline for the State to equal or perform better than the 5-year mean and median of triple-A rated states on the basis of debt per capita. At present, the targets are $923 for the mean and $849 for the median. Based on data from Moody's Investors Service, Vermont's 5-year mean and median debt per capita figures are lower than the 5-year mean and median for triple-A rated states. Using the 5-year Moody's median for triple-A rated states and increasing it by 2.98% annually (60% of annual increase for peer group), combined with the assumption that the State will issue $87,130,000 during fiscal year 2011 and $76,580,000 in 2012-2021, Vermont will continue to be equal to (in 2018) or below the Moody's 5-year mean and 5-year median for triple-A rated states during fiscal years 2011-2021, inclusive (see "Historical and Projected Debt Ratios"). It should be emphasized that the debt numbers for Vermont have generally been stabilizing while those of the other triple-A rated states, on a composite basis, have been rising.

At this point, it should be pointed out that the 5-year median debt per capita guideline is the principal limitation affecting overall compliance with the State's triple-A peer group. The State can comply with the other three guidelines with a greater degree of coverage than is experienced with the 5-year median debt per capita.

### Debt As A Percent of Personal Income

The Committee also adopted a guideline for the State to equal or perform better than the 5-year mean and 5-year median of triple-A rated states on the basis of debt as a percent of personal income. At present, the targets are 2.7% for both the mean and the median. Based on data from Moody's Investors Service, Vermont's debt as a percent of personal income figure is better than the 5-year mean and 5-year median for triple-A rated states. Moreover, considering the 2010 figures alone, Vermont's relative comparison improves even more, with a widening gap between Vermont's figure and those of the triple-A rated states. Assuming that the State will issue $87,130,000 in fiscal year 2011 and

$76,580,000 in fiscal years 2012-2021, Vermont should be able to comply with the 5-year mean and 5-year median for triple-A rated states (see "Historical and Projected Debt Ratios").

### Debt Service As A Percentage of Revenues

This guideline does not create a compliance requirement for triple-A rated states. Rather, it is an absolute guideline, not a comparative one. CDAAC's adopted standard is a ratio of no greater than 6% for annual general obligation debt service as a percent of the annual aggregate of General and Transportation Funds. At present, this ratio equals approximately 5.6%, down from last year's 5.7%. With the projected issuance of general obligation debt at the $76,580,000 annually, this ratio is estimated to vary from 4.9% to 5.4% over the next ten years. Therefore, at present and for the foreseeable future, it is anticipated that the State will satisfy this standard.

### Adjustment To Debt Per Capita Inflator; Effect On Recommendation

As indicated above, the debt per capita statistics, among the various debt guidelines, establish the annual limitation on the amount of general obligation debt that the State should authorize annually.

In order to achieve a realistic perspective on the future direction of the 5-year debt per capita median for triple-A rated states, it was necessary to inflate this guideline from year to year. CDAAC has determined that it would be most appropriate to adopt an inflator, based on a percentage of the 4.97% growth factor for the peer group. The 4.97% inflator was calculated by averaging the annual increases in the median debt per capita from 2006 through 2010. Because Vermont's triple-A ratings have historically resulted from prudent debt and financial management as opposed to strong economic factors, an inflator of less than 100% of Vermont's triple-A peers was deemed appropriate. A number representing only 60% of the growth factor, or 2.98%, was selected as being consistent with the State's debt management practices and the expectations of the rating agencies and financial community. At this level, the recommended authorization for fiscal 2012 would be $76,580,000 for the period extending through 2021, pursuant to legislative mandate.

It should be emphasized that the 60% inflation factor is not to be considered fixed. As described elsewhere in this report, there are too many matters in play at present that could conceivably alter this number. First, should the agencies continue to increase the number of triple-A rated states, the composition of our peer group will be altered. Second, Moody's has stated on several occasions in its credit reports that if the rating agency were to see a deterioration in the State's relative rankings with respect to debt per capita and debt as a percent of personal income, Vermont's triple-A rating could fall. Therefore, it will be imperative for CDAAC to monitor the State's performance in these comparisons annually to determine if the inflation factor should be adjusted from time to time.

# STATE OF VERMONT

## APPROACH TOWARD ESTABLISHING DEBT RATIO GOALS

### Comparative Mean Debt Ratios[1]

| Per Capita | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| All States | $1,060 | $1,101 | $1,158 | $1,195 | $1,297 |
| Triple-A | 879 | 922 | 951 | 899 | 966 |
| **VERMONT** | **707** | **706** | **707** | **692** | **709** |
| | | | | | |
| **% of Pers. Inc.** | **2006** | **2007** | **2008** | **2009** | **2010** |
| All States | 3.2% | 3.2% | 3.2% | 3.1% | 3.2% |
| Triple-A | 2.8 | 2.7 | 2.7 | 2.4 | 2.6 |
| **VERMONT** | **2.2** | **2.1** | **2.0** | **1.8** | **1.8** |

### Listing of Triple-A Rated States By Rating Agency

| 2010 Triple-A Rated States | Fitch | Moody's | S&P |
|---|---|---|---|
| Delaware | Yes | Yes | Yes |
| Florida | Yes | No | Yes |
| Georgia | Yes | Yes | Yes |
| Indiana | No | Yes | Yes |
| Iowa | Yes | Yes | Yes |
| Maryland | Yes | Yes | Yes |
| Minnesota | Yes | No | Yes |
| Missouri | Yes | Yes | Yes |
| New Mexico | N/R | Yes | No |
| North Carolina | Yes | Yes | Yes |
| South Carolina | Yes | Yes | No |
| Tennessee | Yes | Yes | No |
| Texas | Yes | Yes | No |
| Utah | Yes | Yes | Yes |
| Virginia | Yes | Yes | Yes |
| **VERMONT** | Yes | Yes | No |

[1] Based on data provided by Moody's Investors Service. Indiana carries a Municipal Issuer Rating from S&P, assigned in 2008 and it is first reflected in 2009 numbers – this is a GO bond equivalent rating. Moody's rated Indiana triple-A in 2010 as part of their Ratings Recalibration effort. The Fitch rating for Indiana (AA+) is for lease revenue bonds. Iowa carries a Municipal Issuer Rating of triple-A from Fitch – an implied GO rating. S&P assigned its respective rating on Iowa in 2009 and it is first reflected in 2009 numbers. Fitch raised Florida, Iowa, Vermont, Tennessee and Texas all to triple-A in 2010 as part of their Ratings Recalibration effort. Moody's raised Indiana, Iowa, New Mexico, Tennessee and Texas to triple-A in 2010 as part of their Ratings Recalibration effort. S&P raised no state ratings in 2010. New Mexico, Tennessee and Texas are reflected only in the 2010 numbers. Sixteen states are currently rated triple-A by one or more of the nationally recognized rating agencies: Triple-A ratings assigned as follows: Delaware and Florida (2005), Georgia, Maryland, Minnesota, Missouri, North Carolina, South Carolina, Utah, Virginia and Vermont (2007), Indiana (2008), Iowa (2009), New Mexico, Tennessee and Texas (2010). See chart on "Debt Per Capita" for complete listing of triple-A states and respective ratings.

**STATE OF VERMONT**

**MOODY'S INVESTORS SERVICE**
**DEBT PER CAPITA**

| Triple-A Rated States[1] | As of 8/2/10 Moody's | As of 3/26/10 S&P | As of 7/7/10 Fitch | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| Delaware | Aaa/Stable | AAA/Stable | AAA/Stable | $1,845 | $1,998 | $2,002 | $2,128 | $2,489 |
| Florida | Aa1/Negative | AAA/Negative | AAA/Negative | 976 | 1,020 | 1,005 | 1,115 | 1,123 |
| Georgia | Aaa/Stable | AAA/Stable | AAA/Stable | 784 | 916 | 954 | 984 | 1,120 |
| Indiana | Aaa/Stable | AAA/Stable | AA+/Stable | 474* | 657* | 478 | 482 | 492 |
| Iowa | Aaa/Stable | AAA/Stable | AAA/Stable | 110* | 104* | 98* | 79 | 73 |
| Maryland | Aaa/Stable | AAA/Stable | AAA/Stable | 1,169 | 1,171 | 1,297 | 1,507 | 1,608 |
| Minnesota | Aa1/Stable | AAA/Stable | AAA/Stable | 746 | 827 | 879 | 866 | 1,037 |
| Missouri | Aaa/Stable | AAA/Stable | AAA/Stable | 496 | 613 | 675 | 670 | 780 |
| New Mexico | Aaa/Stable | AA+/Stable | Not Rated | 1,222* | 1,435* | 1,429* | 1,394* | 1,398 |
| No. Carolina | Aaa/Stable | AAA/Stable | AAA/Stable | 804 | 728 | 898 | 832 | 765 |
| So. Carolina | Aaa/Stable | AA+/Stable | AAA/Stable | 661 | 630 | 966 | 899 | 917 |
| Tennessee | Aaa/Stable | AA+/Stable | AAA/Stable | 234* | 213* | 221* | 233* | 318 |
| Texas | Aaa/Stable | AA+/Stable | AAA/Stable | 307* | 415* | 481* | 520* | 520 |
| Utah | Aaa/Stable | AAA/Stable | AAA/Stable | 707 | 621 | 542 | 447 | 957 |
| Virginia | Aaa/Stable | AAA/Stable | AAA/Stable | 601 | 692 | 764 | 782 | 895 |
| **MEAN[2]** | ___________ | ___________ | __________ | **879** | **922** | **951** | **899** | **966** |
| **MEDIAN[3]** | ___________ | ___________ | __________ | **765** | **778** | **898** | **849** | **917** |
| VERMONT[4] | Aaa/Stable | AA+/Stable | AAA/Stable | 707 | 706 | 707 | 692 | 709 |

**Triple-A Rated States**
**5-Year Average Mean and 5-Year Median Excluding Vermont:**
**MEAN: $923 Vermont: $704**
**MEDIAN: $849 Vermont: $707**

[1] Indiana carries a Municipal Issuer Rating from S&P, assigned in 2008 and it is first reflected in 2009 numbers – this is a GO bond equivalent rating. Moody's rated Indiana triple-A in 2010 as part of their Ratings Recalibration effort. The Fitch rating for Indiana (AA+) is for lease revenue bonds. Iowa carries a Municipal Issuer Rating of triple-A from Fitch – an implied GO rating. S&P assigned its respective rating on Iowa in 2009 and it is first reflected in 2009 numbers. Fitch raised Florida, Iowa, Vermont, Tennessee and Texas all to triple-A in 2010 as part of their Ratings Recalibration effort. Moody's raised Indiana, Iowa, New Mexico, Tennessee and Texas to triple-A in 2010 as part of their Ratings Recalibration effort. S&P raised no state ratings in 2010. New Mexico, Tennessee and Texas are reflected only in the 2010 numbers. Sixteen states are currently rated triple-A by one or more of the nationally recognized rating agencies: Triple-A ratings assigned as follows: Delaware and Florida (2005), Georgia, Maryland, Minnesota, Missouri, North Carolina, South Carolina, Utah, Virginia and Vermont (2007), Indiana (2008), Iowa (2009), New Mexico, Tennessee and Texas (2010).
[2] These calculations exclude all Vermont numbers.
[3] These calculations exclude all Vermont numbers.
[4] Vermont raised to triple-A in 2007 and reflected in the 2007 numbers.
* Indicates that the state was not rated triple-A by any of the three rating agencies during the year shown. Amount not used in calculating the mean or median for the year.

**STATE OF VERMONT**

**MOODY'S INVESTORS SERVICE**
**DEBT AS % OF PERSONAL INCOME**

| Triple-A Rated States | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Delaware | 5.3% | 5.5% | 5.2% | 5.4% | 6.2% |
| Florida | 3.2 | 3.1 | 2.8 | 2.9 | 2.9 |
| Georgia | 2.7 | 3.0 | 3.0 | 3.0 | 3.3 |
| Indiana | 1.4* | 2.1* | 1.5 | 1.5 | 1.5 |
| Iowa | 0.4* | 0.3* | 0.3* | 0.2 | 0.2 |
| Maryland | 3.0 | 2.8 | 3.0 | 3.3 | 3.4 |
| Minnesota | 2.1 | 2.2 | 2.3 | 2.1 | 2.4 |
| Missouri | 1.6 | 1.9 | 2.1 | 2.0 | 2.2 |
| New Mexico | 4.7* | 5.3* | 4.8* | 4.6* | 4.4 |
| North Carolina | 2.8 | 2.4 | 2.8 | 2.5 | 2.3 |
| South Carolina | 2.5 | 2.3 | 3.3 | 2.9 | 2.9 |
| Tennessee | 0.8* | 0.7* | 0.7* | 0.7* | 0.9 |
| Texas | 1.0* | 1.3* | 1.4* | 1.4* | 1.4 |
| Utah | 2.7 | 2.3 | 1.9 | 1.5 | 3.2 |
| Virginia | 1.7 | 1.8 | 1.9 | 1.9 | 2.1 |
| **MEAN[1]** | **2.8** | **2.7** | **2.7** | **2.4** | **2.6** |
| **MEDIAN[2]** | **2.7** | **2.3** | **2.8** | **2.3** | **2.4** |
| VERMONT | 2.2 | 2.1 | 2.0 | 1.8 | 1.8 |

## Triple-A Rated States

**5-Year Average Mean and 5-Year Median Excluding Vermont:**
**MEAN: 2.7% Vermont: 2.0%**
**MEDIAN: 2.7% Vermont: 2.0%**

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[1] These calculations exclude all Vermont numbers.
[2] These calculations exclude all Vermont number
* Indicates that the state was not rated triple-A by any of the three rating agencies during the year shown. Amount not used in calculating the mean or median for the year.

Government Finance Associates, Inc.

## Historical and Projected Debt Ratios

| Fiscal Year (ending 6/30) | Net Tax-Supported Debt Per Capita (in $) | | | Net Tax-Supported Debt as Percent of Personal Income | | | Net Tax-Supported Debt Service as Percent of Revenues [5] | | |
|---|---|---|---|---|---|---|---|---|---|
| | State of Vermont | Moody's Median | State's Rank [4] | State of Vermont | Moody's Median | State's Rank [4] | State of Vermont [2] | Moody's Median | State's Rank [4] |
| Actual [1] | | | | | | | | | |
| 1999 | 953 | 505 | 10 | 4.2 | 2.0 | 10 | 7.2 | n.a. | n.a |
| 2000 | 925 | 540 | 9 | 3.8 | 2.2 | 10 | 7.0 | n.a. | n.a |
| 2001 | 828 | 541 | 15 | 3.3 | 2.1 | 14 | 6.8 | n.a. | n.a. |
| 2002 | 813 | 573 | 18 | 3.0 | 2.3 | 14 | 6.5 | n.a. | n.a. |
| 2003 | 861 | 606 | 16 | 3.0 | 2.2 | 17 | 6.7 | n.a. | n.a. |
| 2004 | 724 | 701 | 24 | 2.5 | 2.4 | 25 | 6.0 | n.a. | n.a. |
| 2005 | 716 | 703 | 25 | 2.3 | 2.4 | 27 | 5.4 | n.a. | n.a. |
| 2006 | 707 | 754 | 29 | 2.2 | 2.5 | 28 | 5.1 | n.a. | n.a. |
| 2007 | 706 | 787 | 28 | 2.1 | 2.4 | 30 | 5.1 | n.a. | n.a. |
| 2008 | 707 | 889 | 32 | 2.0 | 2.6 | 33 | 5.0 | n.a. | n.a. |
| 2009 | 692 | 865 | 34 | 1.8 | 2.5 | 35 | 5.5 | n.a. | n.a. |
| 2010 | 709 | 936 | 36 | 1.8 | 2.5 | 36 | 5.7 | n.a. | n.a. |
| Current [2] | 746 | n.a. | n.a. | 1.9 | n.a. | n.a. | 5.6 | n.a. | n.a. |
| Projected (FYE 6/30) [3] | | State Guideline [6] | | | State Guideline [7] | | | State Guideline | |
| 2011 | 807 | 874 | | 2.0 | 2.7 | | 5.4 | 6.0 | |
| 2012 | 847 | 900 | | 2.0 | 2.7 | | 5.2 | 6.0 | |
| 2013 | 888 | 927 | | 1.9 | 2.7 | | 5.0 | 6.0 | |
| 2014 | 923 | 955 | | 1.9 | 2.7 | | 5.2 | 6.0 | |
| 2015 | 963 | 983 | | 1.9 | 2.7 | | 4.8 | 6.0 | |
| 2016 | 1,002 | 1,013 | | 1.9 | 2.7 | | 4.8 | 6.0 | |
| 2017 | 1,039 | 1,043 | | 1.9 | 2.7 | | 4.8 | 6.0 | |
| 2018 | 1,074 | 1,074 | | 1.9 | 2.7 | | 4.8 | 6.0 | |
| 2019 | 1,104 | 1,106 | | 1.9 | 2.7 | | 4.8 | 6.0 | |
| 2020 | 1,130 | 1,139 | | 1.9 | 2.7 | | 4.8 | 6.0 | |
| 2021 | 1,150 | 1,173 | | 1.8 | 2.7 | | 4.9 | 6.0 | |
| 5-Year Moody's Mean for Triple-A States | | 923 | | | 2.7 | | | n.a. | |
| 5-Year Moody's Median for Triple-A States | | 849 | | | 2.7 | | | n.a. | |

(1) Actual data compiled by Moody's Investors Service, reflective of all 50 states.
(2) Calculated by Government Finance Associates, Inc.
(3) Projections assume the issuance of $87,130,000 of G.O. debt during fiscal year 2011 and $76,580,000 of G.O. debt annually thereafter through 2021, inclusive, as discussed in this report.
(4) Rankings are in numerically descending order (i.e., from high to low debt).
(5) Revenues are adjusted beginning in fiscal year 1998 reflecting "current law" revenue forecasts based on a consensus between the State's administration and legislature.
(6) State Guideline equals the 2010 5-year Moody's median for triple-A states of $849 increasing annually at 2.98%.
(7) The 5-year Moody's median for triple-A States (2.7%) has not been increased for the period 2011-2021 since the annual number is quite volatile, ranging from 2.3% to 2.8% over the last five years.

## 3. DEBT STATISTICS

### "Dash Board" Indicators

| | Vermont[a] | Median Triple-A States |
|---|---|---|
| Net Tax-Supported Debt: | $464,341,000 | $4,678,127,000[c] |
| Debt As A Percent Of Gross State Product: | 1.73% | 2.08%[c] |
| Debt Per Capita: | $746 | $917[c] |
| Debt As A Percent Of Personal Income: | 1.9% | 2.4%[c] |
| Debt Service As A Percent Of Operating Revenue[b]: | 5.6% | N/A |
| Rapidity Of Debt Retirement: | 44.95% (In 5 years) | N/A |
| | 72.13% (In 10 Years) | N/A |
| | 91.01% (In 15 Years) | N/A |
| | 100.00% (In 20 Years) | N/A |
| Proposed 2012 Debt Authorization: | $76,580,000 | N/A |
| Initial Year Limitation: (5-Year Per Capita Median For Triple-A Rated States) | 2018 | N/A |

(a) Debt statistics for Vermont are as of June 30, 2010.
(b) Aggregate of State's General Fund and Transportation Fund.
(c) Moody's: 2010 State Debt Medians Report

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## Net Tax-Supported Debt Outstanding

The State's aggregate net tax-supported principal amount of debt increased from $440.6 million as of June 30, 2009 to $464.3 million as of June 30, 2010, an increase of 5.38%. The table below sets forth the sources of the change in net tax-supported debt outstanding from fiscal year 2009 to fiscal year 2010 (in thousands):

| | |
|---|---|
| Net Tax-Supported Debt as of 6/30/09 | $440,633 |
| G.O. New Money Bonds Issued | 72,000 |
| G.O. Refunding Bonds Issued | 38,830 |
| Less: Retired G.O. Bonds | (48,042) |
| Less: Refunded G.O. Bonds | (39,080) |
| Net Tax-Supported Debt as of 6/30/10 | $464,341 |

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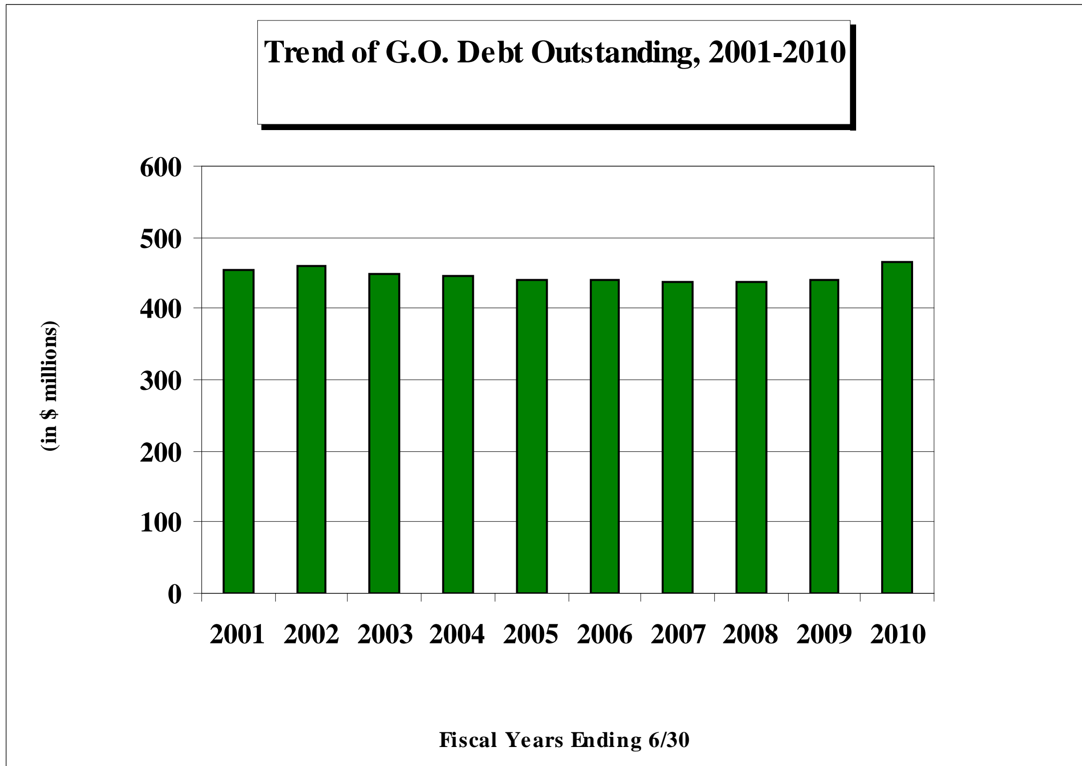
## Debt Statement

As of June 30, 2010 ($ Thousands)

| | |
|---|---|
| **General Obligation Bonds*[1]:** | |
| General Fund | 440,430 |
| Transportation Fund | 20,086 |
| Special Fund | 3,825 |
| | |
| **Contingent Liabilities:** | |
| VEDA Mortgage Insurance Program | 9,000 |
| VEDA Financial Access Program | 1,000 |
| VEDA Tech/Small Business Loan Program | 1,000 |
| | |
| **Reserve Fund Commitments:** | |
| Vermont Municipal Bond Bank | 531,470 |
| Vermont Housing Finance Agency | 155,000 |
| VEDA Indebtedness | 100,000 |
| Vermont Student Assistance Corporation | 50,000 |
| Vermont Telecommunications Authority | 40,000 |
| Univ. of Vermont/State Colleges | 100,000 |
| | |
| **Gross Direct and Contingent Debt** | 1,451,811 |
| Less: | |
| Contingent Liabilities | (11,000) |
| Reserve Fund Commitments | (976,470) |
| **Net Tax-Supported Debt** | **464,341** |

* Includes original principal amounts of Capital Appreciation Bonds.

[1] Does not include (i) the expected issuance of the 2010 Series D and E Bonds, (ii) general obligation bonds that were refunded, (iii) $8,655,768, which is the accreted value of the capital appreciation bonds, less the original principal amount of such bonds, and (iv) the present value of outstanding capitalized leases in the amount of $108,802. In addition, the State entered into an approximately $4.7 million capitalized lease to fund an energy services contract in fiscal year 2009. Payments due under this lease are budgeted to be funded from energy savings realized under the related contract, which savings are guaranteed by the contractor.




**G.O. DEBT OUTSTANDING, 2001-2010**
**(As of June 30, in $ millions)**

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| TOTAL | 454.9 | 460.5 | 448.2 | 444.7 | 440.3 | 440.0 | 438.4 | 438.6 | 440.7 | 464.3 |

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## General Obligation and General Fund Supported Bond Debt Service Projections

The State's projected annual G.O. debt service and debt outstanding are presented on the following pages and summarized below. The projected debt service (at 6% interest rate) assumes the issuance of $87,130,000 in G.O. debt during fiscal year 2011; for fiscal years 2012-2021, the table assumes the issuance of $76,580,000 annually.

**TOTAL PROJECTED GENERAL OBLIGATION DEBT SERVICE AND DEBT OUTSTANDING (In Thousands of Dollars)**

| Fiscal Year Ending | G.O. Debt Service | G.O. Bonds Outstanding |
|---|---|---|
| 6/30/2010 | 70,747 | 464,341 |
| 6/30/2011 | 70,309 | 503,878 |
| 6/30/2012 | 73,376 | 530,325 |
| 6/30/2013 | 74,268 | 557,635 |
| 6/30/2014 | 80,664 | 581,280 |
| 6/30/2015 | 77,902 | 608,645 |
| 6/30/2016 | 80,847 | 635,440 |
| 6/30/2017 | 83,736 | 661,580 |
| 6/30/2018 | 87,000 | 686,520 |
| 6/30/2019 | 91,886 | 708,605 |
| 6/30/2020 | 95,769 | 728,655 |
| 6/30/2021 | 101,242 | 744,800 |

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The table below sets forth the State's existing principal amounts outstanding and annual debt service requirements, as of June 30, 2010, without the issuance of any additional general obligation debt. Please refer to the table on the previous page for the State's projected principal amounts outstanding and annual debt service requirements assuming the issuance of G.O. debt, which includes the issuance of $87,130,000 G.O. debt during fiscal year 2011. For fiscal year 2012, CDAAC is recommending $76,580,000 of G.O. authorization.

**PROJECTED GENERAL OBLIGATION NET TAX-SUPPORTED DEBT**
**As of June 30, 2010**
**(in $ thousands)**

| | GENERAL OBLIGATION BONDS (STATE DIRECT DEBT) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | General Fund | | Transportation Fund | | Special Fund | | Total | |
| Fiscal Year | Beginning Principal Outstanding | Debt Service* | Beginning Principal Outstanding | Debt Service | Beginning Principal Outstanding | Debt Service | Beginning Principal Outstanding | Total Debt Service |
| 2011 | 440,430 | 65,805 | 20,086 | 3,478 | 3,825 | 1,026 | 464,341 | 70,309 |
| 2012 | 396,388 | 59,790 | 17,375 | 3,372 | 2,985 | 626 | 416,748 | 63,788 |
| 2013 | 353,791 | 53,406 | 14,679 | 2,482 | 2,505 | 628 | 370,975 | 56,517 |
| 2014 | 315,130 | 51,936 | 12,765 | 2,415 | 2,000 | 629 | 329,895 | 54,980 |
| 2015 | 276,657 | 41,787 | 10,853 | 2,095 | 1,470 | 633 | 288,980 | 44,514 |
| 2016 | 245,502 | 37,403 | 9,203 | 1,947 | 910 | 636 | 255,615 | 39,986 |
| 2017 | 217,538 | 33,411 | 7,652 | 1,884 | 320 | 336 | 225,510 | 35,631 |
| 2018 | 192,479 | 30,176 | 6,101 | 1,709 | 0 | 0 | 198,580 | 31,885 |
| 2019 | 169,626 | 28,357 | 4,649 | 1,630 | 0 | 0 | 174,275 | 29,987 |
| 2020 | 147,714 | 26,754 | 3,231 | 560 | 0 | 0 | 150,945 | 27,314 |
| 2021 | 126,597 | 25,922 | 2,813 | 541 | 0 | 0 | 129,410 | 26,463 |

* Debt service has been calculated using the net coupon rates on the $40,800,000 2010 Series A Bonds (Build America Bonds), taking into account the 35% interest subsidy from the federal government. The entire amount of the Build America Bonds is allocated to the General Fund.

On the following page is a table showing the projected G.O. debt service, G.O. bond principal payments, and G.O. bonds outstanding during each of the fiscal years, 2011 through 2021, inclusive. This table shows the projected issuance of $87,130,000 in fiscal year 2011 and $76,580,000 during fiscal years 2012-2021, inclusive.

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| EXISTING AND PROJECTED NET TAX-SUPPORTED G.O. DEBT SERVICE ($000) | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FY | Current D/S | 2011 Issue 87.130M | 2012 Issue 76,580M | 2013 Issue 76,580M | 2014 Issue 76,580M | 2015 Issue 76,580M | 2016 Issue 76,580M | 2017 Issue 76,580M | 2018 Issue 76,580M | 2019 Issue 76,580M | 2020 Issue 76,580M | 2021 Issue 76,580M | Total Est. D/S |
| 2011 | 70,309 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 70,309 |
| 2012 | 63,788 | 9,588 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 73,376 |
| 2013 | 56,517 | 9,326 | 8,425 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 74,268 |
| 2014 | 54,980 | 9,065 | 8,195 | 8,425 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 80,664 |
| 2015 | 44,514 | 8,803 | 7,965 | 8,195 | 8,425 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 77,902 |
| 2016 | 39,986 | 8,541 | 7,735 | 7,965 | 8,195 | 8,425 | 0 | 0 | 0 | 0 | 0 | 0 | 80,847 |
| 2017 | 35,631 | 8,280 | 7,506 | 7,735 | 7,965 | 8,195 | 8,425 | 0 | 0 | 0 | 0 | 0 | 83,736 |
| 2018 | 31,885 | 8,013 | 7,276 | 7,506 | 7,735 | 7,965 | 8,195 | 8,425 | 0 | 0 | 0 | 0 | 87,000 |
| 2019 | 29,987 | 7,752 | 7,046 | 7,276 | 7,506 | 7,735 | 7,965 | 8,195 | 8,425 | 0 | 0 | 0 | 91,886 |
| 2020 | 27,314 | 7,491 | 6,816 | 7,046 | 7,276 | 7,506 | 7,735 | 7,965 | 8,195 | 8,425 | 0 | 0 | 95,769 |
| 2021 | 26,463 | 7,229 | 6,586 | 6,816 | 7,046 | 7,276 | 7,506 | 7,735 | 7,965 | 8,195 | 8,425 | 0 | 101,242 |

| EXISTING AND PROJECTED NET TAX-SUPPORTED G.O. BOND PRINCIPAL PAYMENTS ($000) | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FY | Current Principal | 2011 Issue 87.130M | 2012 Issue 76,580M | 2013 Issue 76,580M | 2014 Issue 76,580M | 2015 Issue 76,580M | 2016 Issue 76,580M | 2017 Issue 76,580M | 2018 Issue 76,580M | 2019 Issue 76,580M | 2020 Issue 76,580M | 2021 Issue 76,580M | Total Est. Principal |
| 2011 | 47,593 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 47,593 |
| 2012 | 45,773 | 4,360 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 50,133 |
| 2013 | 41,080 | 4,360 | 3,830 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 49,270 |
| 2014 | 40,915 | 4,360 | 3,830 | 3,830 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 52,935 |
| 2015 | 33,365 | 4,360 | 3,830 | 3,830 | 3,830 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 49,215 |
| 2016 | 30,105 | 4,360 | 3,830 | 3,830 | 3,830 | 3,830 | 0 | 0 | 0 | 0 | 0 | 0 | 49,785 |
| 2017 | 26,930 | 4,360 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 0 | 0 | 0 | 0 | 0 | 50,440 |
| 2018 | 24,305 | 4,355 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 0 | 0 | 0 | 0 | 51,640 |
| 2019 | 23,330 | 4,355 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 0 | 0 | 0 | 54,495 |
| 2020 | 21,535 | 4,355 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 0 | 0 | 56,530 |
| 2021 | 21,610 | 4,355 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 3,830 | 0 | 60,435 |

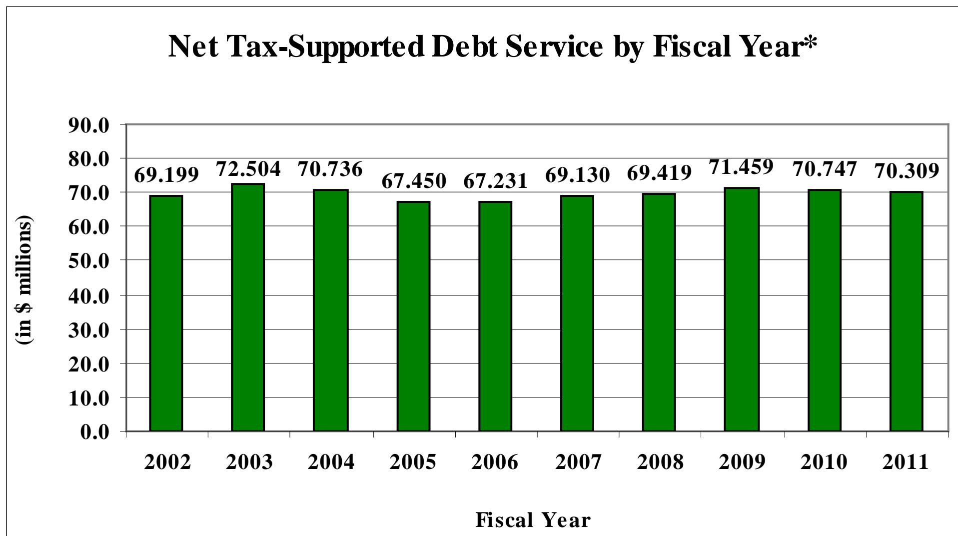
| EXISTING AND PROJECTED NET TAX-SUPPORTED G.O. BONDS OUTSTANDING ($000) | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FY | Current Debt | 2011 Issue 87.130M | 2012 Issue 76,580M | 2013 Issue 76,580M | 2014 Issue 76,580M | 2015 Issue 76,580M | 2016 Issue 76,580M | 2017 Issue 76,580M | 2018 Issue 76,580M | 2019 Issue 76,580M | 2020 Issue 76,580M | 2021 Issue 76,580M | Total Est. Debt |
| 2010 | 464,341 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 464,341 |
| 2011 | 416,748 | 87,130 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 503,878 |
| 2012 | 370,975 | 82,770 | 76,580 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 530,325 |
| 2013 | 329,895 | 78,410 | 72,750 | 76,580 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 557,635 |
| 2014 | 288,980 | 74,050 | 68,920 | 72,750 | 76,580 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 581,280 |
| 2015 | 255,615 | 69,690 | 65,090 | 68,920 | 72,750 | 76,580 | 0 | 0 | 0 | 0 | 0 | 0 | 608,645 |
| 2016 | 225,510 | 65,330 | 61,260 | 65,090 | 68,920 | 72,750 | 76,580 | 0 | 0 | 0 | 0 | 0 | 635,440 |
| 2017 | 198,580 | 60,970 | 57,430 | 61,260 | 65,090 | 68,920 | 72,750 | 76,580 | 0 | 0 | 0 | 0 | 661,580 |
| 2018 | 174,275 | 56,615 | 53,600 | 57,430 | 61,260 | 65,090 | 68,920 | 72,750 | 76,580 | 0 | 0 | 0 | 686,520 |
| 2019 | 150,945 | 52,260 | 49,770 | 53,600 | 57,430 | 61,260 | 65,090 | 68,920 | 72,750 | 76,580 | 0 | 0 | 708,605 |
| 2020 | 129,410 | 47,905 | 45,940 | 49,770 | 53,600 | 57,430 | 61,260 | 65,090 | 68,920 | 72,750 | 76,580 | 0 | 728,655 |
| 2021 | 107,800 | 43,550 | 42,110 | 45,940 | 49,770 | 53,600 | 57,430 | 61,260 | 65,090 | 68,920 | 72,750 | 76,580 | 744,800 |

## Net Tax-Supported Debt Service by Fiscal Year

- The State's general obligation debt service requirement ("D/S") for fiscal year 2011 will be $70.309 million, 0.62% less than the $70.747 million paid in fiscal year 2010. This decrease comes after annual decreases ranging from 0.3% to 7.6% over the period fiscal 2000 – fiscal 2007, except for an anomaly of a 4.8% increase in fiscal year 2003

| (in $ thousands) | |
|---|---|
| Net Tax-Supported D/S Paid in FY 2010 [(1)] | $70,747 |
| Decrease in D/S Requirement FY 2010-2011 [(1)] | (6,107) |
| D/S Increase Due to G.O. Debt Issued in FY 2010 [(2)] | 5,669 |
| Net Tax-Supported D/S Due in FY 2011 | $70,309 |

(1) Includes $39,080,000 Bonds refunded during FY 2010.
(2) The debt service amount shown takes into account the 35% interest subsidy from the federal government (calculated to be $667,565 during FY 2011), payable on the $40,800,000 Build America Bonds as part of the 2010 Series A bond issue.




**Consists of General Obligation Bonds.*

## 4. ECONOMIC AND FINANCIAL FORECASTS

This section of the report is based on the economic analysis provided by the New England Economic Partnership ("NEEP") for the State of Vermont and certain projections provided by Economic and Policy Resources, Inc. ("EPR"). NEEP's report, "Vermont Economic Outlook," dated May 2010 (a copy of which is included in the appendices), states that "the May 2010 Vermont forecast update represents a small, but measurable upgrade from the last forecast completed in November of 2009. The forecast calls for a historically restrained and uneven paced recovery for most macro variables. Much of the reason for the restrained pace of recovery is tied to the still struggling housing and labor markets. Each continues to contend with the lingering effects of the 'Great Recession' and represents key forecast risks going forward.

"The U.S. and Vermont economies likely reached a bottom in the fall of calendar year 2009, and have begun the transition to recovery as of the spring of calendar year 2010. Most key indicators show measurable and positive changes – including initial gains in output, housing prices and sales, and construction activity. Labor market improvements have been slow to materialize both in Vermont and at the U.S. level. However, it does appear that the jobs recovery began in the Vermont economy at least one to two quarters before the U.S. – even if only about 1,000 payroll jobs have been added in Vermont since the state's labor market turning point. The Vermont unemployment rate remains the lowest in New England and one of the lowest in the nation. More substantial labor market improvements in Vermont, as usual, are expected to lag other macroeconomic variables in the state, with unemployment rates remaining at elevated levels until calendar year 2012.

"Despite the encouraging sign that the economy has indeed turned a corner and the process of recovery has begun, the recovery is likely to be a relatively slow and unsure one. This is because the recovery faces an unusually long list of headwinds, if not outright obstacles, to its slow and still fragile progression. Among the more prominent risks-obstacles are: the still uncertain housing market, the fragile but improvements in labor markets, and the daunting fiscal challenges on the state and local government levels. There also has been little evidence of increased lending to small businesses, a critical ingredient for the current turnaround to develop into a sustainable upturn. In addition, the recent, sustained rise in energy prices also poses a serious risk to the recovery, and no one is really quite sure how the withdrawal of the unprecedented level of fiscal and monetary stimulus will work out. Add to that, concerns about high levels of public debt and the mounting fiscal problems in Greece and other vulnerable countries in the European Union, and the U.S., New England and Vermont recoveries still clearly remain 'at risk.' This formidable list of headwinds and obstacles to the recovery indicates that emerging economic recovery is in no way 'out-of-the-woods.' A 'double-dip recession' or a return to a second significant period of economic decline cannot be entirely ruled out."

As shown in the table on the following page, EPR's population estimate for 2010 in Vermont is about 0.13% greater than its forecast for 2009, and its estimates of future

population growth average about 0.36% annually from 2011 through 2021. Personal income in Vermont increased 3.34% from 2009 to 2010 and is projected to achieve an average annual growth rate of 4.72% from 2011 through 2021. Estimated full valuation increased 2.97% from 2009 to 2010 and is projected to achieve an average annual growth rate of 2.78% from 2011 through 2021, inclusive. EPR's current and projected General Fund and Transportation Fund revenues are shown in the table on the following page.

## Current and Projected Economic Data [(1)]

| Year | Population (in thousands) | Personal Income (in $ billions) | E.F.V. (in $ millions) |
|---|---|---|---|
| 2008 | 621.0 | 24.03 | 58,472 |
| 2009 | 621.8 | 23.94 | 58,273 |
| 2010 | 622.6 | 24.74 | 60,006 |
| 2011 | 624.2 | 25.58 | 62,328 |
| 2012 | 626.1 | 26.99 | 65,049 |
| 2013 | 628.0 | 28.62 | 67,374 |
| 2014 | 630.1 | 30.10 | 69,205 |
| 2015 | 632.2 | 31.59 | 71,016 |
| 2016 | 634.4 | 33.11 | 72,700 |
| 2017 | 636.8 | 34.61 | 74,310 |
| 2018 | 639.4 | 36.14 | 75,974 |
| 2019 | 642.1 | 37.72 | 77,677 |
| 2020 | 644.9 | 39.38 | 79,378 |
| 2021 | 647.6 | 41.10 | 81,087 |

(1) These figures were prepared by EPR, except Effective Full Valuation. Projected Effective Full Valuation was based on Real Vermont Gross State Product annual growth rates provided by EPR.

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As shown in the table below, total revenue for fiscal year 2010 is $55.9 million less than in fiscal year 2009, a decrease of 4.3%. Fiscal year 2011 total revenue is forecast to increase by $57.27 million, or 4.57%; the average annual revenue growth rate during the fiscal year period, 2011 through 2021, inclusive, is projected to be approximately 4.62%.

## Current and Projected Revenues [(2)]

| Fiscal Year | General Fund (in $ millions) | Transportation Fund (in $ millions) | Total Revenue (in $ millions) |
|---|---|---|---|
| 2009 | 1,104.0 | 203.6 | 1,307.6 |
| 2010 | 1,038.4 | 213.3 | 1,251.7 |
| 2011 | 1,090.4 | 218.5 | 1,308.9 |
| 2012 | 1,174.0 | 227.8 | 1,401.8 |
| 2013 | 1,244.7 | 235.2 | 1,479.9 |
| 2014 | 1,301.7 | 243.4 | 1,545.1 |
| 2015 | 1,358.5 | 252.8 | 1,611.3 |
| 2016 | 1,421.2 | 263.9 | 1,685.1 |
| 2017 | 1,479.2 | 271.5 | 1,750.7 |
| 2018 | 1,545.7 | 283.2 | 1,828.9 |
| 2019 | 1,610.3 | 294.2 | 1,904.5 |
| 2020 | 1,677.3 | 302.7 | 1,980.0 |
| 2021 | 1,743.3 | 312.1 | 2,055.4 |

(2) Amounts shown are "current law" revenue forecasts, based on a consensus between the State's administration and legislature. The official forecast is shown as of July 29, 2010.

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# 5. OTHER DEBT FACTORS

## Composition of Operating Revenue

The use of debt service as a percent of operating revenue is a common indicator employed by municipal analysts, including the rating agencies. One problem with its use for comparability purposes is the absence of commonalty among states as to the particular revenues that are included in operating revenues. As a general matter, for the State of Vermont, operating revenues for the rating agencies' purposes have consisted of the combined General and Transportation Funds. Often, over the years, monies have moved from one of these funds to the other, and there has been general flexibility in their uses for meeting financial operations of the State. Furthermore, the rating agencies and representatives of the State have had various communications over time to reach a consensus as to the appropriate State revenues that should be employed for this purpose, and as a result of these discussions, the rating agencies and the State reached an agreement that the combined General and Transportation Funds should constitute operating revenue for the development of the debt service load indicator.

## Moral Obligation Indebtedness

As the State's rating has improved, the value of its moral obligation has also grown. It is therefore apparent that there has been greater pressure on the State to raise the size of its existing moral obligation commitments and/or to assign the moral obligation pledges to State borrowers. However, without some form of containment, it is possible that an ever-increasing moral obligation debt load could, over time, erode the State's debt position.

In accordance with the appropriate provisions from the enabling statute that created CDAAC, the Committee has already been authorized to consider "any other long-term debt of instrumentalities of the state not secured by the full faith and credit of the state, or for which the state legislature is permitted to replenish reserve funds." Therefore, it is not inconsistent for CDAAC to develop guidelines for Vermont regarding the size and use of the State's moral obligation debt.

In recent years, CDAAC has adjusted its debt load guidelines to take into account the comparative debt load statistics for triple-A rated states throughout the country. Unfortunately, none of the rating agencies prepare comparative data on the respective triple-A rated states on moral obligation or contingent debt. Moreover, there is little consistency among the triple-A rated states regarding the size, nature and role of such debt. The types of contingent debt are quite varied among the states, including state guarantees of local school debt, back-up support for revenue obligations, etc. Because of the mixture of contingent debt applied by triple-A states, it would not be possible to employ guidelines that are similar to the general obligation guidelines that have been utilized by CDAAC in connection with its annual recommendation of long-term general obligation debt to be authorized by the State legislature.

Over the last four years, a number of actions have been taken by the State legislature that increased the State's moral obligation exposure, consisting of the following:

$55,000,000 increase for Vermont Housing Finance Agency
$50,000,000 program for Vermont Student Assistance Corporation
$40,000,000 program for Vermont Telecommunications Authority
$65,000,000 program for University of Vermont
$35,000,000 program for Vermont State Colleges
$30,000,000 increase for Vermont Economic Development Authority

A new form of moral obligation support was created in 2009 for both VHFA and VSAC. Normally, the State's moral obligation support attaches to a debt service reserve fund that must be filled up by the State if the agency draws down on the fund. However, for both VSAC and VHFA, the State is committed to increase certain reserves if individual trusts do not provide requisite parity levels. This provision for a pledged equity moral obligation for VHFA was constrained within VHFA's overall ($155 million) moral obligation authority. The pledged equity program for the two agencies was adopted to allow each agency to more effectively deal with the market problems that surfaced in 2008.

There had been, for several years, discussions within CDAAC regarding the establishment of guidelines for limiting the amount of moral obligation debt that the State should authorize. In an accompanying chart, the State's net tax-supported debt statement, consisting entirely of the State's GO outstanding indebtedness, is presented, as of June 30, 2010, at $464,341,000. Using 225% of GO debt for establishing a limit of moral obligation debt, the State would have had $68,297,250 in additional moral obligation capacity. Using 200% of GO debt for establishing a limit of moral obligation debt, the State would have had ($47,788,000) in negative capacity; in other words, at 200%, the State could not comply with the administrative guideline.

At this point, CDAAC believes that a range of 200-225% is appropriate in determining the amount of moral obligation commitments that should be outstanding in comparison to the State's general obligation debt. Since CDAAC has not recommended legislative action to codify any statutory limits on the incurrence of moral obligation debt, CDAAC will continuously monitor the developing size of moral obligation commitments and report the results.

With the exception of VEDA, which has specific plans for utilizing its enhanced moral obligation commitment, the new authorizations shown above have not been part of financing strategies for the particular agencies. At some point, should a major infrastructure requirement or other critical financing need arise that would be appropriately funded through a financing agency, the State may, as appropriate, consider rescinding the existing, but unused moral obligation authority and have it transferred – taking into account the limited availability for the State to provide additional moral obligation capability as a result of the 200-225% administrative limits.

## Comparative Debt Load Standing Among States

The Committee follows a series of debt guidelines, reflecting the State's comparative current and prospective performance in terms of debt load measures (i.e., debt per capita and debt as a percent of personal income) against triple-A rated states. A more detailed discussion of these guidelines and the State's compliance with them is presented herein. According to Moody's Investors Service's most recent information, the State's relative position, among states, improved during the past year with respect to both net tax-supported debt as a percent of personal income (improving from 35th in 2009 to 36th in 2010) and net tax-supported debt per capita (improving from 34th in 2009 to 36th in 2020).

## Authorized, But Unissued Debt

In fiscal year 2009, Vermont sold only $50.5 million of its authorized $64.65 million; in fiscal year 2008, Vermont issued $46 million of an authorized amount of $49.2 million. This trend diverges from past practice whereby the State annually extinguished all or nearly all of the authorized amount of debt. This previous practice enhanced the State's credit position with favorable responses from the rating agencies. In fiscal 2010, the State actually sold $2,045,000 in an amount greater than the $69,955,000 of debt authorization for the year, leaving an authorized, but unissued figure of $15,305,000. If the remaining authorized, but unissued amount of $15,305,000 was divided into 2011 and 2012, it would not materially alter the recommended level, since the annual assumed amounts extend through 2021, pursuant to the legislation.

For this year's report, an assumption has been made that the authorized, but unissued amount is combined with the 2011 authorization of $71,825,000 for a combined issuance this fiscal year of $87,130,000 (see "Debt Guidelines").

It may be advantageous for the State's future debt management operations to reconsider, and perhaps cancel, slowly developing or marginal capital projects and for steps to be taken to adhere to Vermont's previous practice of matching annual debt authorizations with realistic annual debt issuances.

## Information and Technology Indebtedness

Information systems and technology innovation can lead to improved productivity and operating efficiencies. Toward this end, it is expected that the State will increase the amount of indebtedness that it will issue in the future for these important purposes. At present, it is not possible to provide a precise estimate of future authorizations that will be dedicated to information systems and technology innovation, but based on preliminary projections, it could constitute a significant portion of total debt authorizations. CDAAC does not have concerns about debt financing for such purposes in general, but emphasizes that the following consideration must be carefully monitored. Over the years, the State has sold 20-year debt, generally with level principal amounts, for capital projects that have had useful economic lives significantly exceeding the period of the related debt repayment. Since the useful lives of information systems and technology innovation may be somewhat shorter than those of traditional capital projects for which Vermont has

issued long-term debt in the past, it will be crucial for the State to continue to relate its debt repayment structure to the overall useful life profile for the underlying capital projects that are being financed, including any potentially shorter useful lives from the funding of information systems and technology innovation. The State has benefited from the existing repayment debt structure, as viewed by the rating agencies, since the useful lives of the capital projects have extended beyond the period of debt repayment; in a related manner, Vermont has also recaptured its debt capacity rapidly as a result of its amortization schedules - another factor that has been positively noted by the rating agencies. While the State makes adjustments to the projects for which it incurs long-term indebtedness, it will continue to be important for Vermont to adhere to those practices that have resulted in favorable rating agency responses.

## Transportation Infrastructure Bonds (TIBs)

The State has historically sold only general obligation bonds for its capital infrastructure purposes. On occasion, it has issued certificates of participation, backed ultimately by the State's general credit pledge, but it hasn't been an issuer of revenue bonds, supported by specific fees and charges. Of course, as characterized elsewhere in this report, several agencies in Vermont, such as VHFA, VSAC, and VEDA, do, in effect, sell bonds supported by specific fees and charges. Recently, however, the State did issue securities that clearly can be described as revenue bonds through the sale of Transportation Infrastructure Bonds ("TIBs"). The bonds are payable from new assessments on motor vehicle gasoline and motor vehicle diesel fuel, and the State is not obligated to use any other funds to cover debt service on TIBs.

The rating agencies have effectively indicated that they will place the TIB debt on the State's net tax-supported debt statement. The agencies state that the taxes to be used for the payment of TIB debt service consist of a type of tax that resembles taxes already collected by Vermont for general operating purposes. As such, the debt supported by the assessments, although new, should be considered as part of the State's general indebtedness. CDAAC does not agree with the approach of the rating agencies. Virtually, without exception, CDAAC has reached agreement with the rating agencies on presentation matters, but, in this case, CDAAC will respectfully not include TIBs in its "net tax-supported indebtedness" computations.

For purposes of illustration, however, it is relevant to quantify the impact of TIBs inclusion in the more critical debt ratios, as shown on the following page:

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| | With TIBs | Without TIBs |
| --- | --- | --- |
| Net Tax-Supported Debt: | $478,741,000 | $464,341,000 |
| Debt As A Percent of Gross State Product: | 1.79% | 1.73% |
| Debt Per Capita: | $769 | $746 |
| Debt As A Percent of Personal Income: | 1.94% | 1.88% |

It should be noted that the first TIBs issue closed on August 3, 2010, however, for the purposes of this analysis the TIBs are assumed to have closed on June 30, 2010.

## 6. RECENT EVENTS

The last two years have been memorable for the state and local credit markets. At one point in late 2008, the tax-exempt bond market actually closed down in most respects, a phenomenon that had not been experienced in modern times. Moreover, major new, taxable financing options became available for state and local borrowers, and the rating agencies made substantial changes in their systems. CDAAC does not believe that these adjustments in the credit markets should alter its current or prospective recommendations; however, the Committee realizes that it and the State will need to keep the changing debt finance environment in mind as the State develops its capital funding and debt management program.

### Taxable Bond Option

In response to the inability of the tax-exempt market to accommodate issuers of state and local indebtedness over a period of time during the recent financial crisis, Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA"), which empowered state and local governments to employ taxable bond options to expand the investor basis to taxable investors and to reduce the cost of capital. The most successful of these programs has been Build America Bonds ("BABs"), which provide a 35% interest rate subsidy to state and local governments that sell BABs. Indeed, the State of Vermont allowed investment bankers to bid on either a tax-exempt or taxable basis for its most recent competitively sold general obligation bonds. Except for the early maturities, the Vermont bond issue was sold as BABs. It should be noted that the debt service numbers, as presented herein and reflective of the taxable issuance, are net of the 35% interest subsidy provided by the federal government.

Other, similar taxable bond option programs, authorized by ARRA, consist of recovery zone economic development bonds that allow for a 45% interest subsidy from the federal government and qualified school construction bonds (“QSCB”) that supply as much as 100% of the total interest costs on the securities that are sold. At this point, the Vermont Municipal Bond Bank ("VMBB") is envisioned to be the primary issuer of recovery zone and QSCB bonds, although it is possible that to the extent the VMBB can not exhaust the full amount of the bond available to Vermont, the State may sell recovery zone bonds. A number of school districts in Vermont have already issued QSCB bonds to local financial institutions, and VMBB anticipates a public issue of such obligations later this year.

ARRA provided other issuer incentives, such as an expansion of private activity, tax-exempt debt, but from a debt management perspective, the taxable bond option programs at the federal level would have more of an effect on the State's debt management. Over the recent past, it has been proven that, in the current bond market, the taxable bond option is more favorably received than a federal tax credit program that had earlier been associated with the QSCB bonds.

## Recalibration of Ratings

Over the years, the nationally recognized rating agencies - namely, Fitch Ratings, Moody's Investors Service, and Standard & Poor's Corporation - have often been criticized for conducting a two-pronged approach to ratings. It was alleged that on the one hand, the agencies applied a probability of default standard to corporate and sovereign debt, but on the other hand, they used a credit value system for state and local borrowers. As a result, there was no way to compare the two rating scales. During the financial markets crisis, increased criticism for this approach was leveled at the rating agencies. It should be noted that Standard & Poor's Corporation has steadfastly indicated that it never had employed a two-pronged approach to its ratings.

Earlier this year, Fitch Ratings and Moody's Investors Service implemented a recalibration of its ratings, resulting in generally higher ratings for the state and local ratings sector. Since the State of Vermont already enjoyed a triple-A rating from Moody's, there was no impact by that agency's actions; however, Vermont was moved to the triple-A category from AA+ by Fitch Ratings. Standard & Poors Corporation has retained the State's rating at AA+.

The impacts of the recalibrations by Fitch and Moody's for the State of Vermont are largely two-fold. First, there has been an increase in the number of triple-A rated states; New Mexico, Tennessee and Texas are newly included in the State's peer group. Second, by the expansion of the peer group, the State can expect a less dramatic effect to its debt guidelines from year to year once the data from the new states have been incorporated into the debt affordability system. As shown elsewhere in this report, the 2010 peer group data did not alter the numbers measurably from previous years.

## Standard & Poor’s Methodology For U.S. State Ratings

In May, 2010, Standard & Poor's Corporation released, for the first time, a comprehensive presentation that sets forth in a systematic way a quantification approach to rating states. By assigning numerical values to its various rating critera, the agency has moved closer to the establishment of state ratings through a quantification approach. CDAAC has reviewed those provisions and found the methodology informative and helpful. The State has been aware, for many years, of the important categories of review by Standard & Poor's: Government Framework, Financial Management, Economy, Budgetary Performance and Flexibility, and Debt And Liability Profile. However, the State had not previously seen the manner in which the sub-categories within each major category was weighed. For the CDAAC report, certain new pieces of information from the Standard & Poor's methodology will be presented, such as debt as a per cent of state domestic product and relative rapidity of debt retirement, in summary fashion. CDAAC has been informed that the rating agency expects to set forth publicly in the near future any revisions to its methodology as a result of public comments received by the agency since the release.

## 7. ACKNOWLEDGEMENTS

We would like to express our gratitude to the State Treasurer's Office, the Department of Finance and Management, EPR, NEEP, and various officers and staff members of the State, whose assistance has been invaluable in completing this report. Certain computations and projections were made based on population, personal income, and revenue projections provided by EPR. The numbers presented herein have not been audited and are, therefore, subject to change, possibly in a substantial manner.

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## 8. PROVISIONS OF ENABLING LEGISLATION AND METHODOLOGY

The Committee is responsible for the submission of a recommendation to the Governor and the General Assembly of the maximum amount of new long-term, net tax-supported indebtedness (at this point, general obligation debt) that the State may prudently issue for the ensuing fiscal year. Such recommendation includes guidelines and other matters that may be relevant to the proposed debt to be authorized. The deadline for the Committee's annual recommendation is September 30th.

In 2008, the legislature, among other changes, replaced in the enabling legislation, "general obligation," with "net tax-supported indebtedness." At this point, all of the State's net tax-supported indebtedness actually consists of only general obligation debt. However, in practical terms, the State's debt load, as computed by the nationally recognized rating agencies, in determining the overall State debt, as reflected in the comparative debt statistics, is based, not just on a state's general obligation debt, but on its net tax-supported indebtedness. Now that the State has transportation infrastructure bonds ("TIBs") outstanding, the use of "net tax-supported indebtedness," instead of "general obligation," becomes more relevant; indeed, it is likely that the rating agencies will, in fact, start to include TIBs in the State's debt statement, although the State will likely decide, over time, not to include such indebtedness.

In making its recommendation, CDAAC has the responsibility to consider the following provisions of the enabling legislation:

*SUBPARAGRAPH (1):*

*The amount of state net state tax-supported indebtedness that, during the next fiscal year, and annually for the following nine fiscal years:*

*(A) will be outstanding; and*

*(B) have been authorized but not yet issued.*

*SUBPARAGRAPH (2):*

*A projected schedule of affordable state net state tax-supported bond authorizations for the next fiscal year and annually for the following nine fiscal years. The assessment of the affordability of the projected authorizations shall be based on all of the remaining considerations specified in this section.*

*SUBPARAGRAPH (3)*

*Projected debt service requirements during the next fiscal year, and annually for the following nine fiscal years, based upon:*

*(A) existing outstanding debt;*

*(B) previously authorized but unissued debt; and*

*(C) projected bond authorizations.*

*SUBPARAGRAPH (4)*

*The criteria that recognized bond rating agencies use to judge the quality of issues of state bonds, including but not limited to:*

*(A) existing and projected total debt service on net tax-supported debt as a percentage of combined general and transportation fund revenues, excluding surpluses in these revenues which may occur in an individual fiscal year; and*

*(B) existing and projected total net tax-supported debt outstanding as a percentage of total state personal income.*

*SUBPARAGRAPH (5)*

*The principal amounts currently outstanding, and balances for the next fiscal year, and annually for the following nine fiscal years, of existing:*

*(A) obligations of instrumentalities of the state for which the state has a contingent or limited liability;*

*(B) any other long-term debt of instrumentalities of the state not secured by the full faith and credit of the state, or for which the state legislature is permitted to replenish reserve funds; and*

*(C) to the maximum extent obtainable, all long-term debt of municipal governments in Vermont which is secured by general tax or user fee revenues.*

The effect of the above items, 5(A), 5(B) and 5(C), on State debt affordability is a function of the level of dependency for the repayment of this particular debt on the State's general operating revenues. With respect to this matter, the principle that the rating agencies follow should give us relevant guidance: Until such time that the State's guarantee or contingent obligation becomes actual (through a payment or a replenishment obligation being made), then such debt or guarantee is not included in the State's net tax-supported indebtedness. Similarly, to the extent that the State has not been called upon to pay for the debt components, as envisioned in Subparagraph (5)(C), then those items should not become quantifiable factors included in the affordability analysis.

- Contingent or Limited Liability Obligations (all figures as of June 30, 2010):

1. VEDA Mortgage Insurance Program: The State had a contingent liability of $9.0 million with respect to this Program.

2. VEDA Financial Access Program: The State had a contingent liability of $1.0 million with respect to this Program.

3. VEDA Tech/Small Business Loan Program: The State had a contingent liability of $1.0 million with respect to this Program.

- Reserve Fund Commitments (all figures as of June 30, 2010):

1. Vermont Municipal Bond Bank: The Bank had $531.47 million of debt outstanding secured by reserve fund commitments from the State. At present, there is no limit on the amount of reserve fund ("moral obligation") debt that the Bank may issue and have outstanding. The General Assembly is legally authorized, but not legally obligated, to appropriate money to maintain the reserve funds at their required levels. Since participating borrowers have always met their obligations on bonds of the Bank, the State has not been required to appropriate money to the reserve fund for this program.

2. Vermont Housing Finance Agency ("VHFA"): The VHFA had previously received a legislative commitment of $155 million of moral obligation debt secured by reserve fund fill-up mechanism from the State. It has not been necessary, over the years, for the State to appropriate money to fill up the debt service reserve fund. In 2009, the State authorized increased flexibility for VHFA's use of the moral obligation commitment specifically allowing for "pledged equity" contributions from the State's operating funds and increased flexibility in the use of the traditional debt service reserve structure.

3. It should also be noted that the State has authorized the VEDA to incur indebtedness in an amount of $100 million secured by the State's reserve fund commitment. Based upon VEDA's historical performance and the quality of the loans it has provided and expects to provide, it is not anticipated that it will be necessary for the State to appropriate money for the reserve fund.

4. Legislation was passed in 2007 to create the Vermont Telecom Authority to facilitate broadband and related access to an increased number of Vermonters. In this connection, the State has authorized $40 million of debt that has a moral obligation pledge from the State. The legislation requires that projects must be self-supporting in order to utilize the moral obligation support. Considering the fact that no debt has yet been issued by the Authority, the report has not included any portion of such debt in the State's net tax-supported debt computations.

5. Legislation was passed in 2008 to provide a moral obligation pledge from the State to the University of Vermont in the amount of $65 million and to the State Colleges in the amount of $35 million. It is not expected that the State will need to appropriate money to the respective reserve funds for these purposes.

6. As described in "Moral Obligation Indebtedness," the State has provided $50 million of moral obligation commitment by the State to VSAC. Such debt remains unissued.

- Municipal Debt:

In conformance with the standards followed by the rating agencies, this evaluation does not set forth or incorporate any debt obligations of Vermont municipalities. Should any such obligations be required to be payable by the State (e.g., through assumption or support of local debt as part of a financial emergency), a corresponding and appropriate amount related to the State's contribution would then be required to be included in the analysis. At present, no such liability has occurred, and, therefore, none has been included in this review.

*SUBPARAGRAPH (6):*

*The impact of capital spending upon the economic conditions and outlook for the state.*

In 2008, new language, "impact of capital spending upon the," was added to this subparagraph. It should be noted that CDAAC routinely considers this factor in the context of its deliberations. Indeed, in the early 1990s, CDAAC recommended significantly higher debt authorization during an economic downturn. There is always a concern at the rating agencies when a state meaningfully enlarges its debt program to ameliorate periodic economic downturns. The rating agencies will often advise that long-term annual costs, in the form of higher debt service and frequently higher administrative and operating expenses, can accompany such an increased debt program. As shown elsewhere in this document, an alternative authorization scenario would increase 2012's debt authorization in order to take advantage of weaker economic conditions, lower interest rates, and more attractive construction bids. The use of this approach will have to be balanced against the various benefits of the normal approach, reflected in the primary 2012 recommendation presented above.

*SUBPARAGRAPH (7):*

*The cost-benefit of various levels of debt financing, types of debt, and maturity schedules.*

This subparagraph was added to the enabling legislation in 2008.

CDAAC annually goes through an extensive analysis to determine the "cost-benefit of various levels of debt financing." The cost-benefit is demonstrated by CDAAC's determination of the amount of debt that the State should annually authorize and still

achieve compliance with CDAAC's articulated affordability guidelines. This evaluation is fundamental to CDAAC's responsibility in recommending annually the amount of net tax-supported indebtedness (i.e., general obligation, at present) that should be authorized by the State.

Second, with respect to the "types of debt," Vermont and its financing agencies have utilized a great variety of debt types. At present, revenue bonds are sold by the State (see "Transportation Infrastructure Bonds (TIBs)" elsewhere in this document), VSAC, VHFA, VEDA, among others. The State Treasurer's office has looked at a series of options for possible revenue bond issuance, but, because of Vermont's special circumstances, revenue bonds have generally not appeared to be a comprehensive answer to the State's direct infrastructure needs. Notwithstanding the fact that there have been no new revenue bond uses recently for funding Vermont infrastructure requirements, with the exception of TIBs, the State will continue to explore possible opportunities in this respect that would not cause debt load or debt management difficulties for Vermont.

Further, quasi-revenue bonds, such as moral obligation or reserve fund commitments, have also been employed by VMBB, VEDA, and VHFA, and such debt is now authorized for issuance by VTA, VSAC, UVM and State Colleges. There is a more extensive discussion of the State's moral obligation commitments elsewhere in this report. In addition, the State, in the past, has directly employed capital lease debt, largely in the form of certificates of participation; however, this type of debt was proven to be expensive and created an undue complexity for the State's net tax-supported debt statement, and the State decided in the late 1990s to refund the certificate of participation indebtedness with general obligation debt – with the rating agencies indicating at the time and subsequently their pleasure with the State's actions. At present, as indicated in a footnote to the State's debt statement, Vermont does have a $4.7 million capitalized lease, but the debt service payments on this lease are funded from energy savings, which are guaranteed by the contractor; as a result, this debt is not added to the State's net tax-supported indebtedness. The State will continue to review the extent to which efficient employment of lease financings can be achieved in Vermont's debt program without adversely affecting the State's debt management operations or credit position.

CDAAC and the State Treasurer's Office are constantly reviewing prospects for funding of required infrastructure through approaches that will not add to the State's net tax-supported indebtedness.

The maturity schedules employed for State indebtedness are directly tied to State statute. Moreover, as indicated elsewhere herein, Vermont's current debt repayment for its general obligation bonds allows the State to recapture debt capacity at an attractive pace. By shortening the debt service payments, it would have the effect of placing more fixed costs in the State's annual operating budget, leaving less funds available for discretionary spending. By lengthening debt payments, that would increase the aggregate amount of the State's outstanding indebtedness, which would cause Vermont's debt per capita and debt as a percentage of personal income to rise, reducing the State's ability to comply

with its affordability guidelines. Notwithstanding these limitations, there may be opportunities for the State in the future to adjust the maturity of its indebtedness to achieve various debt management goals over time.

*SUBPARAGRAPH (8):*

*Any projections of capital needs authorized or prepared by the agency of transportation, the joint fiscal office, or other agencies or departments.*

This subparagraph was added to the enabling legislation in 2008.

CDAAC is proceeding in its compliance with this provision. Material on various infrastructure capital requirements will be considered as this information is provided to CDAAC over time.

*Any other factor that is relevant to:*

*(A) the ability of the state to meet its projected debt service requirements for the next five fiscal years; or*

*(B) the interest rate to be borne by, the credit rating on, or other factors affecting the marketability of state bonds.*

There are numerous factors that can affect the State's affordability to incur future indebtedness, including the prospective State economy and the availability of adequate financial resources. Of course, it should be recognized that even though the debt load indices employed in this report are generally also used by the rating agencies for determining the amount of net tax-supported indebtedness that the State can effectively support, these indices do not take into consideration the possibility for deterioration in the State's financial results. For example, if the State were to confront a significantly increased or new financial liability that was not contemplated in the context of this analysis, the appropriateness of this debt load would become less certain. Similarly, if the State were to incur serious deficits or face a dangerously eroding economy, the ability of the State to incur debt in the future could be affected. These managerial and unpredictable aspects of debt affordability have not been considered in this analysis. It will be important for State officials to monitor Vermont's annual financial condition and results, together with the State's economic trends, in order to evaluate the State's credit position to determine whether annual issuance of debt should be adjusted to reflect a changing financial outlook and credit condition for the State under altered circumstances.

With respect to the interest rate and credit ratings assumed in the evaluation, the report has made conservative assumptions. For anticipated debt issuances, the interest rate on future State G.O. indebtedness is assumed at 6.00%, which is well above the interest rate at which the State could currently sell long-term general obligation bonds.

At the same time, we have assumed that the State will maintain its current ratings: "Aaa" from Moody's, "AA+" from S&P, and "AAA" from Fitch. Of course, a negative change in the State's ratings in the future could adversely affect the comparative interest rates that Vermont pays on its bond issues, thereby increasing the amount of the State's annual fixed costs for debt service. This effect could reduce the amount of long-term, net tax-supported indebtedness that the State can annually afford to issue.

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# 9. APPENDICES

A. 2010 State Debt Medians (Moody's Investors Service)

B. Fitch Ratings Credit Report

C. Moody's Investors Service Credit Report

D. Standard & Poor's Credit Report

E. Vermont Economic Outlook (New England Economic Partnership)

MOODY'S INVESTORS SERVICE

SPECIAL COMMENT

# 2010 State Debt Medians Report

Based on 2009 Data

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## State Debt Increase in 2009 Related to a Variety of Factors

State net tax-supported debt increased by 10.3% in 2009 to $460 billion from $417 billion in 2008 (see Figure 1), a substantial increase from the 2008 growth rate of 4.7%. The accelerated growth in net tax-supported debt resulted from a number of factors, including but not limited to:

» Pent up demand for municipal bonds in 2009 after most states halted and/or significantly reduced debt issuance during the market disruption experienced in the fall of 2008;

» Introduction of Build America Bond and Qualified School Construction Bonds through provisions of the American Recovery and Reinvestment Act of 2009, which created unprecedented incentives for municipal debt issuers;

» The need for budget relief as a result of the national recession; and

» A low interest rate environment.

Median net tax-supported debt per capita increased by 8.1% to $936 from $865, while net tax-supported debt as a percentage of personal income remained steady at 2.5%.

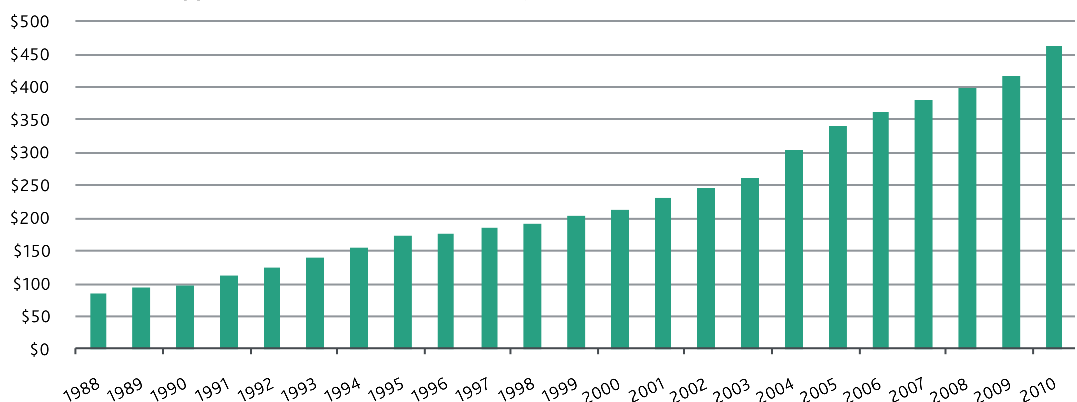
2009 was a notable year for debt issuance with a variety of unique factors contributing to the significant increase in debt including the aforementioned stabilization of the bond market following the fall 2008 market disruption, and the passage of the American Recovery and Reinvestment Act of 2009 (ARRA). With ARRA, the federal government helped to stabilize the municipal bond markets by introducing two new debt structures that substantially lowered the debt service costs for municipal issuers, Build America Bonds (BABs) and Qualified School Construction Bonds (QSCBs). Most BABs provide state or local governmental issuers with a federal subsidy equal to 35% of the total interest payable on the bonds substantially lowering debt service costs for issuers. QSCBs issued in 2009 provided a federal subsidy to investors through federal tax credits in an amount equal to 35% of the total coupon interest payable by the issuer. QSCBs can only be utilized for financing school capital construction costs. Most states have taken advantage of the BABs while only two, West Virginia and Colorado issued QSCBs in 2009.

The continuation of a low interest rate environment coupled with the effects of the recession on state finances also contributed to the growth in state debt. As we normally would see in a low interest rate environment, state governments refunded existing debt to achieve interest rate savings. However, during 2009, a significant portion of savings achieved from refundings was used to plug budget gaps. As states struggled to balance rising expenditure pressures with severely declining revenues, debt restructuring – in the form of issuing bonds to defer debt service -- became a common solution to address budgetary gaps. In addition to restructuring debt, some states simply issued long-term debt to fund operations. Most notably, the State of Connecticut closed its fiscal 2009 operating budget gap with use of deficit bonds in the amount of $947 million. The low interest rate environment also prompted states like New York to continue to refinance auction rate securities and variable rate demand bonds for which interest rates had risen during the credit crisis.

State debt issuance in 2010 (which will be the basis of our 2011 debt medians analysis) will likely increase as states continue to generate economic activity while taking advantage of low interest rates and the lower overall net cost of funds provided by the issuance of BABs and QSCBs. States will continue to look to long-term financing to alleviate budget pressure, particularly with the exhaustion of ARRA funding in fiscal 2011. Debt growth may also be impacted by state governments providing support of debt for lower levels of government in the absence of readily available bond insurance. This type of support may or may not have a direct impact on a state's debt burden depending on how the support is structured.

*FIGURE 1*

**Total Net Tax-Supported Debt of the 50 States ($B)**




Every year, Moody's prepares a special comment that presents an analysis of state debt medians. The 2010 Debt Medians report examines the condition of net state tax-supported debt as of calendar year-end 2009. As in prior years, the data presented (Figures 1, 2, 3 and Table 6) reflect the historical trend up to the immediately preceding year's state debt issuance while the data point label corresponds to the year in which the report is produced (i.e. The data labeled 2010 reflect debt as of calendar year-end 2009). Two measures of state debt burden – debt per capita and debt as a percentage of personal income – are commonly used by analysts to compare the debt burden of one state to another. Debt burden is one of many factors

*Net Tax-Supported Debt is defined as debt secured by state operating resources which could otherwise be used for state operations. Any debt to which state resources are pledged for repayment is considered to be net tax-supported debt.*

that Moody's uses to determine state credit quality. In considering debt burden, the focus is largely on net tax-supported debt, which Moody's characterizes as debt secured by state resources. Moody's also examines gross debt, which includes contingent debt liabilities that may not have direct tax support, but represent commitments to make debt service payments under certain conditions (e.g. state guarantees, bonds backed by state moral obligation pledges).

This year, we are also adding a table that reflects net tax-supported debt as a percent of gross domestic product, by state. This ratio is useful when comparing U.S. state credits to sovereign and subsovereign credits as debt-to-GDP is an important input into the ratings assigned to these sectors. This ratio is usually higher for governments outside of the U.S. because debt issuance outside of the U.S. is more centralized. Even so, comparison of this metric is an important part of our continued benchmarking against other sectors now that U.S. state credits are rated on the same scale as sovereign and subsovereign credits.

## Growth of Net Tax-Supported Debt Doubles

State total net tax-supported debt increased by 10.3% in 2009 to $460 billion, more than double the rate of increase recorded in the previous year. The accelerated rate of growth is reflective of the contrasting market conditions between 2009 and 2008. Debt issuance in 2008 was muted by a combination of factors, starting with the downgrade of collateralized mortgage obligations brought on by the softening real estate market and ultimately the lack of liquidity as some of the world's largest investment banks protected their balance sheets and credit tightened. In 2009, bond markets began to stabilize and bonds that were not issued as originally planned in 2008 were brought to market in 2009. The historically low interest rate environment encouraged states to borrow for economic stimulus. In the beginning of the year, states with auction rate securities refinanced those bonds to avoid the high interest costs associated with them. Later, states issued large amounts of fixed rate bonds to retire variable rate debt as liquidity agreements were not available in all situations and the expense of available liquidity outweighed the benefit of short-term interest rates. During 2009, states benefited from a lower cost of funds due to the debt structures introduced by ARRA which expanded the investor base of municipal issuers from the traditional holders of tax-exempt bonds to purchasers of taxable bonds.

Of the states that had the largest increases in net tax-supported debt, Utah experienced growth of 118% due to the state undertaking its single largest debt issuance ever of $1 billion in general obligation bonds to finance highway projects. A portion of the bonds were issued as Build America Bonds. It is important to note that, even with the near-term increase (some of the new debt amortizes over five years), Utah's overall net tax-supported debt is still low relative to other states, ranking 31st out of 50 in total net tax-supported debt for 2009.

One of the largest bond issues in 2009, the State of California's $3.2 billion of Economic Recovery Bonds issued in October 2009, was secured by a double barreled pledge of sales tax revenue and general obligation. The Economic Recovery Bonds were issued to provide budgetary relief for the state which continued to endure a deep recession. In total, California grew its debt burden by 31% in 2009 over the prior year. The State of Alaska also experienced a large 59% increase in debt. The state increased its issuance of general obligation debt by $165 million (the first new money general obligation bond issued by the state since 2003), as well as state lease obligations. Similar to Utah, Alaska has a lower debt burden relative to other states and, even with the 59% increase in total tax-supported debt, the state ranks 40th out of 50 in total net tax-supported debt for 2009.

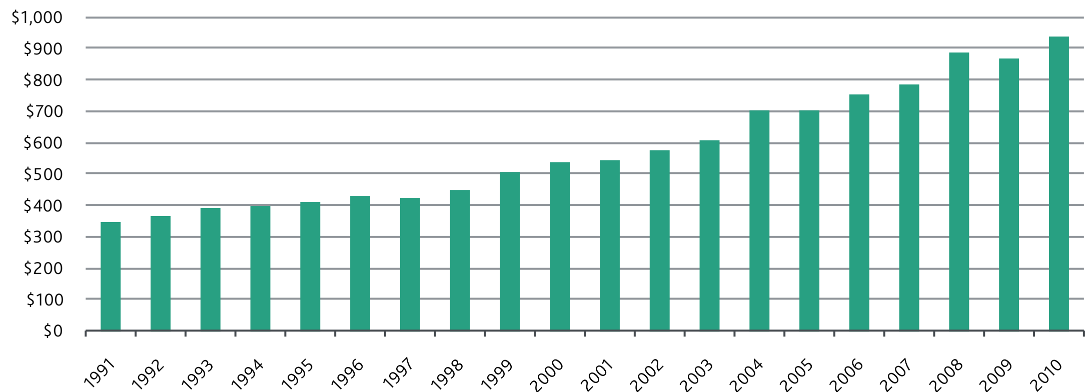
## Growth in Median Net Tax-Supported Debt Per Capita Over 8%

Median net tax-supported debt per capita at calendar year-end 2009 increased by 8.1% to $936 (see Figure 2). The large percentage growth is in line with the growth in total net tax-supported debt. Unlike last year, when most states experienced a decline in total debt burden due to postponement of debt issuance coupled with scheduled amortization of outstanding debt, in 2009 most states experienced robust growth in debt burden. Even states that have historically limited debt issuance embarked on substantial capital programs in 2009. Colorado issued roughly $330 million to provide funding for K-12 school construction and higher education capital support as well as other statewide capital needs.

Some states were notable in 2009 for having reduced debt burden. The State of Arkansas issued just $15.2 million in debt during 2009. The small debt issuance in conjunction with scheduled amortization of outstanding debt resulted in a 15% decline in the state's net tax-supported debt. The State of Nebraska, which historically has one of the lowest debt burdens of all states due to a constitutional limitation on issuance of general obligation debt, issued just under $15 million of certificates of participation in 2009 and experienced a decline of 10% in net tax-supported debt.

*FIGURE 2*

**Median Net Tax-Supported Debt Per Capita for 50 States**




## Median Net Tax-Supported Debt, as a Percent of Personal Income Remains Unchanged

Median net tax-supported debt, as a percent of personal income, remained steady at 2.5%, even with the overall increase in net tax-supported debt (Figure 3). Since 1995, median net tax-supported debt has averaged 2.3%, never exhibiting growth or declines of more than two tenths of a percentage point year-over-year.

*FIGURE 3*

Median Net Tax-Supported Debt as Percent of Personal Income for 50 States

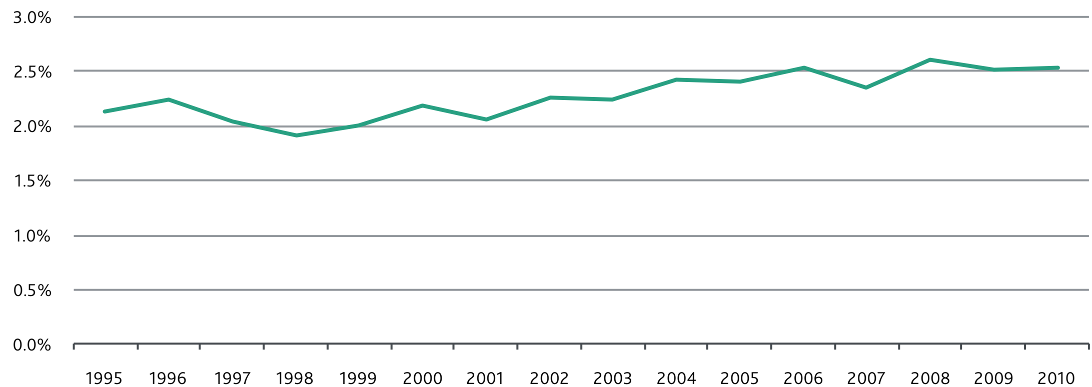
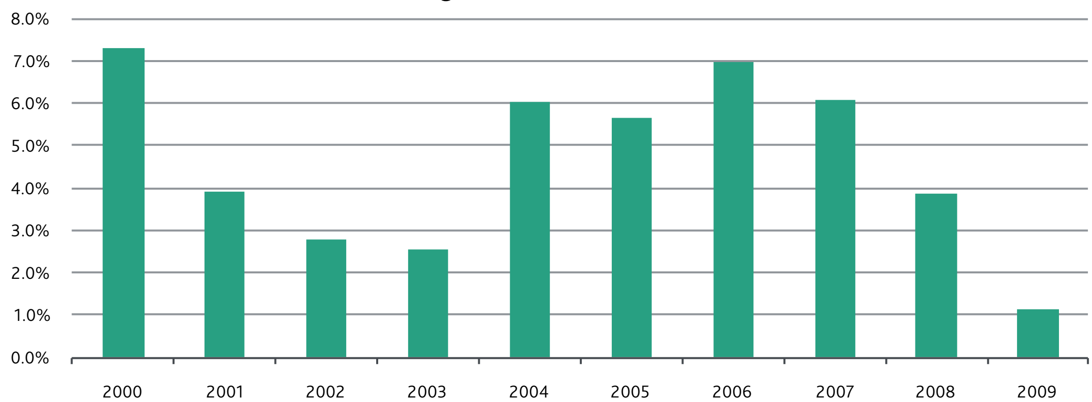



*FIGURE 4*

Personal Income Year-Over-Year % Change




## 2010 State Debt Outlook: Debt Issuance Expected to Continue Growth Trend

State debt issuance in 2010 is expected to increase, however the rate of growth is not expected to mirror the growth experienced in 2009. While there are signs that the national recession has abated, most states continue to experience budgetary strain which will continue to impact debt issuance. Generally speaking, states will continue to use long-term debt to finance capital needs as the ability to cash fund projects amid weak revenue growth and following dramatic budget reductions is no longer an option and states will continue to view long-term financing as a way of improving economic activity. The Build America Bonds and Qualified School Construction Bonds programs will continue to have a positive impact on debt issuance for the 2010 calendar year, as states continue to utilize these popular structures to lower overall cost of capital, thus providing a greater incentive to use long-term financing to fund capital projects as a means to invigorate the economy.

Some states have exhausted the debt issuing capacity permitted by their debt policies. The majority of states have a debt capacity tool in place to monitor leverage. These policies typically measure dept capacity in terms of debt service as a percent of general fund revenues. As state revenues have declined, debt capacity has also declined. In North Carolina, for example, according to the state's 2010 Debt Affordability Study, the state has reached its maximum target of limiting authorized debt service to 4% of general fund revenues. As a result, the current budget proposal for the state does not include any net tax-supported debt issuance for fiscal year 2011. Other states, such as Minnesota, are examining debt policies to see if they still make sense in the current economic and fiscal environment.

*TABLE 1*

## Net Tax-Supported Debt

PER CAPITA

| | | | RATING |
|---|---|---|---|
| 1 | Connecticut | $4,859 | Aa2 |
| 2 | Massachusetts | $4,606 | Aa1 |
| 3 | Hawaii | $3,996 | Aa1 |
| 4 | New Jersey | $3,669 | Aa2 |
| 5 | New York | $3,135 | Aa2 |
| 6 | Delaware | $2,489 | Aaa |
| 7 | California | $2,362 | A1 |
| 8 | Washington | $2,226 | Aa1 |
| 9 | Rhode Island | $2,127 | Aa2 |
| 10 | Oregon | $1,859 | Aa1 |
| 11 | Illinois | $1,856 | Aa3 |
| 12 | Wisconsin | $1,720 | Aa2 |
| 13 | Kentucky | $1,685 | Aa1* |
| 14 | Maryland | $1,608 | Aaa |
| 15 | Mississippi | $1,478 | Aa2 |
| 16 | New Mexico | $1,398 | Aaa |
| 17 | Alaska | $1,345 | Aa1 |
| 18 | Louisiana | $1,271 | Aa2 |
| 19 | Kansas | $1,140 | Aa1* |
| 20 | Florida | $1,123 | Aa1 |
| 21 | Georgia | $1,120 | Aaa |
| 22 | West Virginia | $1,079 | Aa2 |
| 23 | Minnesota | $1,037 | Aa1 |
| 24 | Utah | $957 | Aaa |
| 25 | Pennsylvania | $938 | Aa1 |
| 26 | Ohio | $933 | Aa1 |
| 27 | Nevada | $925 | Aa1 |
| 28 | South Carolina | $917 | Aaa |
| 29 | Virginia | $895 | Aaa |
| 30 | Alabama | $796 | Aa1 |
| 31 | Missouri | $780 | Aaa |
| 32 | North Carolina | $765 | Aaa |
| 33 | Maine | $760 | Aa2 |
| 34 | Michigan | $748 | Aa2 |
| 35 | Arizona | $736 | Aa2 |
| 36 | Vermont | $709 | Aaa |
| 37 | New Hampshire | $665 | Aa1 |
| 38 | Oklahoma | $570 | Aa2 |
| 39 | Idaho | $538 | Aa1* |
| 40 | Texas | $520 | Aaa |
| 41 | Indiana | $492 | Aaa* |
| 42 | Colorado | $400 | Aa1* |
| 43 | Montana | $358 | Aa1 |
| 44 | North Dakota | $327 | Aa1* |
| 45 | Tennessee | $318 | Aaa |
| 46 | Arkansas | $312 | Aa1 |
| 47 | South Dakota | $135 | NGO** |
| 48 | Wyoming | $77 | NGO** |
| 49 | Iowa | $73 | Aaa* |
| 50 | Nebraska | $15 | NGO** |
| | MEAN: | $1,297 | |
| | MEDIAN: | $936 | |
| | Puerto Rico | $10,167 | A3*** |

* Issuer Rating (No G.O. Debt)

** No General Obligation Debt

*** This figure is not included in any totals, means, or median calculations but is provided for comparison

*TABLE 2*

## Net Tax-Supported Debt

AS A % OF 2008 PERSONAL INCOME

| | | |
|---|---|---|
| 1 | Hawaii | 9.9% |
| 2 | Massachusetts | 9.2% |
| 3 | Connecticut | 8.7% |
| 4 | New Jersey | 7.2% |
| 5 | New York | 6.5% |
| 6 | Delaware | 6.2% |
| 7 | California | 5.6% |
| 8 | Kentucky | 5.4% |
| 9 | Washington | 5.3% |
| 10 | Oregon | 5.2% |
| 11 | Rhode Island | 5.2% |
| 12 | Mississippi | 5.0% |
| 13 | Wisconsin | 4.6% |
| 14 | Illinois | 4.4% |
| 15 | New Mexico | 4.4% |
| 16 | Louisiana | 3.6% |
| 17 | West Virginia | 3.5% |
| 18 | Maryland | 3.4% |
| 19 | Georgia | 3.3% |
| 20 | Alaska | 3.2% |
| 21 | Utah | 3.2% |
| 22 | Kansas | 3.0% |
| 23 | Florida | 2.9% |
| 24 | South Carolina | 2.9% |
| 25 | Arizona | 2.6% |
| 26 | Ohio | 2.4% |
| 27 | Alabama | 2.4% |
| 28 | Minnesota | 2.4% |
| 29 | Pennsylvania | 2.3% |
| 30 | Nevada | 2.3% |
| 31 | North Carolina | 2.3% |
| 32 | Maine | 2.2% |
| 33 | Missouri | 2.2% |
| 34 | Michigan | 2.1% |
| 35 | Virginia | 2.1% |
| 36 | Vermont | 1.8% |
| 37 | Idaho | 1.7% |
| 38 | New Hampshire | 1.6% |
| 39 | Oklahoma | 1.6% |
| 40 | Indiana | 1.5% |
| 41 | Texas | 1.4% |
| 42 | Montana | 1.1% |
| 43 | Arkansas | 1.0% |
| 44 | Colorado | 1.0% |
| 45 | Tennessee | 0.9% |
| 46 | North Dakota | 0.8% |
| 47 | South Dakota | 0.4% |
| 48 | Iowa | 0.2% |
| 49 | Wyoming | 0.2% |
| 50 | Nebraska | 0.0% |
| | MEAN: | 3.2% |
| | MEDIAN: | 2.5% |
| | Puerto Rico | 75.7%** |

** This figure is based on 2008 Personal Income. It is not included in any totals, means, or median calculations but is provided for comparison purposes only.

*TABLE 3*

## Total Net Tax Supported Debt ($000's)

| | | | RATING |
|---|---|---|---|
| 1 | California | $87,320,000 | A1 |
| 2 | New York | $61,259,793 | Aa2 |
| 3 | New Jersey | $31,951,013 | Aa2 |
| 4 | Massachusetts | $30,371,476 | Aa1 |
| 5 | Illinois | $23,957,015 | Aa3 |
| 6 | Florida | $20,819,974 | Aa1 |
| 7 | Connecticut | $17,093,853 | Aa2 |
| 8 | Washington | $14,832,717 | Aa1 |
| 9 | Texas | $12,892,508 | Aaa |
| 10 | Pennsylvania | $11,827,000 | Aa1 |
| 11 | Georgia | $11,011,066 | Aaa |
| 12 | Ohio | $10,766,277 | Aa1 |
| 13 | Wisconsin | $9,726,313 | Aa2 |
| 14 | Maryland | $9,166,095 | Aaa |
| 15 | Michigan | $7,461,594 | Aa2 |
| 16 | Kentucky | $7,269,586 | Aa1* |
| 17 | North Carolina | $7,174,650 | Aaa |
| 18 | Oregon | $7,110,604 | Aa1 |
| 19 | Virginia | $7,056,177 | Aaa |
| 20 | Louisiana | $5,708,165 | Aa2 |
| 21 | Arizona | $5,463,418 | Aa1 |
| 22 | Minnesota | $5,176,063 | Aa1 |
| 23 | Hawaii | $4,856,686 | Aa2 |
| 24 | Missouri | $4,672,127 | Aaa |
| 25 | Mississippi | $4,364,174 | Aa2 |
| 26 | South Carolina | $4,184,210 | Aaa |
| 27 | Alabama | $3,748,559 | Aa1 |
| 28 | Kansas | $3,213,826 | Aa1* |
| 29 | Indiana | $3,156,986 | Aaa* |
| 30 | New Mexico | $2,809,156 | Aaa |
| 31 | Utah | $2,665,545 | Aaa |
| 32 | Nevada | $2,446,111 | Aa1 |
| 33 | Rhode Island | $2,240,527 | Aa2 |
| 34 | Delaware | $2,202,968 | Aaa |
| 35 | Oklahoma | $2,100,583 | Aa2 |
| 36 | Colorado | $2,011,683 | Aa1** |
| 37 | Tennessee | $2,003,673 | Aaa |
| 38 | West Virginia | $1,962,926 | Aa2 |
| 39 | Maine | $1,002,485 | Aa2 |
| 40 | Alaska | $939,600 | Aa1 |
| 41 | Arkansas | $900,483 | Aa1 |
| 42 | New Hampshire | $880,871 | Aa1 |
| 43 | Idaho | $831,110 | Aa1* |
| 44 | Vermont | $441,017 | Aaa |
| 45 | Montana | $349,260 | Aa1 |
| 46 | Iowa | $219,279 | Aaa* |
| 47 | North Dakota | $211,822 | Aa1* |
| 48 | South Dakota | $109,528 | NGO** |
| 49 | Wyoming | $42,066 | NGO** |
| 50 | Nebraska | $27,032 | NGO** |
| | Totals | $460,009,6500 | |
| | MEAN: | $9,200,193 | |
| | MEDIAN: | $4,274,192 | |
| | Puerto Rico | $40,200,990*** | A3 |

* Issuer Rating (No G.O. Debt)

** No General Obligation Debt

*** This figure is not included in any totals, means, or median calculations but is provided for comparison purposes only.

*TABLE 4*

## Gross Tax Supported Debt ($000's)

| | | | GROSS TO NET RATIO |
|---|---|---|---|
| 1 | California | $96,059,000 | 1.10 |
| 2 | New York | $61,298,583 | 1.00 |
| 3 | New Jersey | $37,742,524 | 1.18 |
| 4 | Massachusetts | $31,588,631 | 1.04 |
| 5 | Florida | $28,982,074 | 1.39 |
| 6 | Connecticut | $24,560,913 | 1.44 |
| 7 | Illinois | $24,386,715 | 1.02 |
| 8 | Washington | $23,073,617 | 1.56 |
| 9 | Michigan | $22,203,691 | 2.98 |
| 10 | Texas | $19,055,178 | 1.48 |
| 11 | Minnesota | $17,901,463 | 3.28 |
| 12 | Pennsylvania | $17,231,600 | 1.46 |
| 13 | Ohio | $16,217,353 | 1.51 |
| 14 | Oregon | $15,372,119 | 2.16 |
| 15 | Wisconsin | $11,246,698 | 1.16 |
| 16 | Virginia | $11,034,158 | 1.56 |
| 17 | Georgia | $11,011,066 | 1.00 |
| 18 | Colorado | $10,189,322 | 5.07 |
| 19 | Maryland | $9,166,095 | 1.00 |
| 20 | Alabama | $8,093,610 | 2.16 |
| 21 | Louisiana | $7,848,648 | 1.37 |
| 22 | Utah | $7,750,004 | 2.91 |
| 23 | Kentucky | $7,269,586 | 1.00 |
| 24 | North Carolina | $7,174,650 | 1.00 |
| 25 | Hawaii | $6,841,854 | 1.32 |
| 26 | Arizona | $5,521,088 | 2.76 |
| 27 | Tennessee | $5,200,576 | 5.19 |
| 28 | Maine | $5,035,407 | 1.60 |
| 29 | Indiana | $5,026,801 | 1.04 |
| 30 | Missouri | $4,743,292 | 1.02 |
| 31 | South Carolina | $4,384,210 | 1.05 |
| 32 | Mississippi | $4,364,174 | 1.00 |
| 33 | Alaska | $4,057,000 | 4.32 |
| 34 | Arkansas | $4,023,296 | 4.47 |
| 35 | New Mexico | $4,017,156 | 1.43 |
| 36 | West Virginia | $3,898,597 | 1.99 |
| 37 | Delaware | $3,849,663 | 1.75 |
| 38 | Kansas | $3,471,816 | 1.08 |
| 39 | Rhode Island | $3,391,384 | 1.51 |
| 40 | Iowa | $3,187,813 | 14.54 |
| 41 | Nevada | $3,085,881 | 1.26 |
| 42 | New Hampshire | $2,227,956 | 2.53 |
| 43 | Oklahoma | $2,124,561 | 1.01 |
| 44 | Idaho | $1,636,330 | 1.97 |
| 45 | North Dakota | $1,358,676 | 6.41 |
| 46 | Vermont | $1,352,227 | 3.07 |
| 47 | Montana | $555,828 | 1.59 |
| 48 | South Dakota | $498,182 | 4.55 |
| 49 | Nebraska | $42,692 | 1.58 |
| 50 | Wyoming | $42,066 | 1.00 |
| | Totals | $610,395,823 | |
| | MEAN: | 12,207,916 | 2.24 |
| | MEDIAN: | 6,181,471 | 1.49 |
| | Puerto Rico | $44,688,990 | 1.11 |

** This figure is not included in any totals, means, or median calculations but is provided for comparison purposes only.

*TABLE 5*

## Net Tax-Supported Debt as % of Gross State Domestic Product

| | 2009 | NTSD TO STATE GDP RATIO | | 2010 | NTSD TO STATE GDP RATIO |
|---|---|---|---|---|---|
| 1 | Massachusetts | 7.98% | 1 | Massachusetts | 8.32% |
| 2 | Hawaii | 7.63% | 2 | Hawaii | 8.11% |
| 3 | Connecticut | 7.41% | 3 | Connecticut | 7.91% |
| 4 | New Jersey | 6.82% | 4 | New Jersey | 6.73% |
| 5 | New York | 5.15% | 5 | New York | 5.35% |
| 6 | Mississippi | 4.96% | 6 | Mississippi | 4.75% |
| 7 | Washington | 4.40% | 7 | Rhode Island | 4.73% |
| 8 | Kentucky | 4.15% | 8 | California | 4.73% |
| 9 | Rhode Island | 4.08% | 9 | Kentucky | 4.65% |
| 10 | Illinois | 3.92% | 10 | Washington | 4.60% |
| 11 | Oregon | 3.85% | 11 | Oregon | 4.40% |
| 12 | California | 3.68% | 12 | Wisconsin | 4.05% |
| 13 | New Mexico | 3.68% | 13 | Illinois | 3.78% |
| 14 | Wisconsin | 3.45% | 14 | Delaware | 3.56% |
| 15 | West Virginia | 3.29% | 15 | New Mexico | 3.52% |
| 16 | Maryland | 3.21% | 16 | Maryland | 3.35% |
| 17 | Delaware | 3.02% | 17 | West Virginia | 3.18% |
| 18 | Kansas | 2.79% | 18 | Florida | 2.80% |
| 19 | Florida | 2.76% | 19 | Georgia | 2.77% |
| 20 | South Carolina | 2.66% | 20 | South Carolina | 2.68% |
| 21 | Louisiana | 2.48% | 21 | Kansas | 2.62% |
| 22 | Georgia | 2.44% | 22 | Louisiana | 2.57% |
| 23 | Ohio | 2.39% | 23 | Utah | 2.43% |
| 24 | Alabama | 2.35% | 24 | Ohio | 2.28% |
| 25 | Pennsylvania | 2.22% | 25 | Arizona | 2.24% |
| 26 | Arizona | 2.13% | 26 | Alabama | 2.20% |
| 27 | Maine | 2.04% | 27 | Pennsylvania | 2.14% |
| 28 | Michigan | 2.02% | 28 | Minnesota | 2.08% |
| 29 | North Carolina | 1.96% | 29 | Maine | 2.02% |
| 30 | Minnesota | 1.79% | 30 | Missouri | 1.96% |
| 31 | Vermont | 1.75% | 31 | Alaska | 1.96% |
| 32 | Nevada | 1.74% | 32 | Michigan | 1.95% |
| 33 | Missouri | 1.73% | 33 | Nevada | 1.86% |
| 34 | Virginia | 1.58% | 34 | North Carolina | 1.79% |
| 35 | Idaho | 1.50% | 35 | Virginia | 1.78% |
| 36 | Oklahoma | 1.37% | 36 | Vermont | 1.73% |
| 37 | Alaska | 1.32% | 37 | Idaho | 1.58% |
| 38 | Indiana | 1.23% | 38 | New Hampshire | 1.47% |
| 39 | New Hampshire | 1.20% | 39 | Oklahoma | 1.43% |
| 40 | Utah | 1.16% | 40 | Indiana | 1.24% |
| 41 | Arkansas | 1.12% | 41 | Texas | 1.05% |
| 42 | Montana | 1.10% | 42 | Montana | 0.97% |
| 43 | Texas | 1.10% | 43 | Arkansas | 0.92% |
| 44 | North Dakota | 0.80% | 44 | Colorado | 0.81% |
| 45 | Colorado | 0.71% | 45 | Tennessee | 0.79% |
| 46 | South Dakota | 0.63% | 46 | North Dakota | 0.68% |
| 47 | Tennessee | 0.59% | 47 | South Dakota | 0.30% |
| 48 | Iowa | 0.18% | 48 | Iowa | 0.16% |
| 49 | Wyoming | 0.14% | 49 | Wyoming | 0.12% |
| 50 | Nebraska | 0.04% | 50 | Nebraska | 0.03% |
| | MEAN: | 2.63% | | MEAN: | 2.78% |
| | MEDIAN: | 2.18% | | MEDIAN: | 2.22% |

*Gross Domestic Product by State numbers have a 1-year lag.

*TABLE 6:*

## NET TAX-SUPPORTED DEBT AS A PERCENTAGE OF PERSONAL INCOME

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Alabama | 1.7 | 1.5 | 2.3 | 2.2 | 2.2 | 2.2 | 2.0 | 2.0 | 2.2 | 2.0 | 2.8 | 2.5 | 2.4 |
| Alaska | 0.5 | 0.0 | 1.0 | 0.4 | 0.4 | 0.3 | 3.0 | 2.8 | 2.6 | 2.7 | 2.4 | 2.2 | 3.2 |
| Arizona | 1.9 | 1.9 | 1.6 | 1.6 | 1.9 | 2.1 | 2.3 | 2.6 | 2.2 | 2.0 | 2.0 | 2.5 | 2.3 |
| Arkansas | 0.8 | 0.6 | 0.9 | 1.2 | 1.2 | 1.4 | 1.8 | 1.6 | 1.6 | 1.4 | 1.7 | 1.3 | 1.0 |
| California | 2.6 | 2.6 | 2.4 | 2.5 | 2.5 | 2.5 | 3.2 | 4.7 | 4.6 | 4.4 | 4.3 | 4.4 | 5.6 |
| Colorado | 0.1 | 0.0 | 0.03 | 0.4 | 0.7 | 0.9 | 0.9 | 1.0 | 0.9 | 0.9 | 0.8 | 0.8 | 1.0 |
| Connecticut | 8.7 | 8.7 | 8.1 | 8.0 | 8.0 | 8.2 | 8.4 | 8.5 | 8.0 | 7.8 | 7.3 | 8.2 | 8.7 |
| Delaware | 5.9 | 5.7 | 5.2 | 5.5 | 5.3 | 5.0 | 5.6 | 5.5 | 5.3 | 5.5 | 5.2 | 5.4 | 6.2 |
| Florida | 3.4 | 3.5 | 3.4 | 3.3 | 3.4 | 3.5 | 3.5 | 3.4 | 3.2 | 3.1 | 2.8 | 2.9 | 2.9 |
| Georgia | 2.9 | 2.9 | 2.8 | 2.6 | 2.9 | 2.9 | 2.9 | 2.8 | 2.7 | 3.0 | 3.0 | 3.0 | 3.3 |
| Hawaii | 10.7 | 11.2 | 11.6 | 11.0 | 10.4 | 10.9 | 10.4 | 11.1 | 12.1 | 10.6 | 9.9 | 9.4 | 9.9 |
| Idaho | 0.2 | 0.4 | 0.4 | 0.3 | 0.4 | 0.3 | 0.5 | 0.6 | 0.6 | 0.6 | 1.2 | 1.6 | 1.7 |
| Illinois | 2.7 | 2.6 | 2.6 | 2.7 | 2.8 | 3.2 | 5.8 | 6.2 | 5.9 | 5.5 | 5.2 | 4.6 | 4.4 |
| Indiana | 0.8 | 0.9 | 0.9 | 1.1 | 1.1 | 1.1 | 1.3 | 1.4 | 1.6 | 2.1 | 1.5 | 1.5 | 1.5 |
| Iowa | 0.5 | 0.5 | 0.4 | 0.4 | 0.6 | 0.6 | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 |
| Kansas | 1.7 | 2.0 | 2.4 | 3.1 | 3.0 | 3.0 | 3.3 | 4.0 | 3.8 | 3.7 | 3.5 | 3.2 | 3.0 |
| Kentucky | 3.9 | 3.7 | 3.5 | 4.4 | 4.3 | 4.4 | 4.4 | 4.0 | 4.5 | 4.3 | 4.7 | 4.8 | 5.4 |
| Louisiana | 2.6 | 2.6 | 2.4 | 2.5 | 2.4 | 2.7 | 2.6 | 2.4 | 3.1 | 4.9 | 4.3 | 3.3 | 3.6 |
| Maine | 1.9 | 1.9 | 2.1 | 2.0 | 1.9 | 1.8 | 1.8 | 2.2 | 2.0 | 1.9 | 1.9 | 2.2 | 2.2 |
| Maryland | 3.1 | 3.3 | 3.0 | 2.6 | 2.6 | 2.8 | 3.0 | 2.9 | 3.0 | 2.8 | 3.0 | 3.3 | 3.4 |
| Massachusetts | 7.8 | 7.8 | 8.0 | 8.5 | 8.5 | 8.5 | 8.5 | 8.5 | 9.8 | 9.4 | 9.8 | 8.9 | 9.2 |
| Michigan | 1.6 | 1.7 | 1.5 | 1.6 | 1.5 | 1.8 | 2.2 | 2.2 | 2.1 | 2.2 | 2.2 | 2.2 | 2.1 |
| Minnesota | 1.9 | 2.0 | 1.9 | 1.8 | 1.8 | 1.9 | 2.0 | 2.0 | 2.1 | 2.2 | 2.3 | 2.1 | 2.4 |
| Mississippi | 3.5 | 4.4 | 4.7 | 4.6 | 4.7 | 5.6 | 5.2 | 4.8 | 4.8 | 4.9 | 4.8 | 5.2 | 5.0 |
| Missouri | 1.0 | 1.0 | 1.0 | 1.1 | 1.3 | 1.3 | 1.6 | 1.5 | 1.6 | 1.9 | 2.1 | 2.0 | 2.2 |
| Montana | 1.4 | 1.7 | 1.7 | 1.7 | 1.6 | 1.4 | 1.3 | 1.1 | 1.4 | 1.5 | 1.2 | 1.2 | 1.1 |
| Nebraska | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Nevada | 1.6 | 1.8 | 1.8 | 1.8 | 1.7 | 1.4 | 2.0 | 2.0 | 2.2 | 1.7 | 2.0 | 2.2 | 2.3 |
| New Hampshire | 2.4 | 2.3 | 2.0 | 1.5 | 1.5 | 1.4 | 1.5 | 1.3 | 1.4 | 1.3 | 1.3 | 1.3 | 1.6 |
| New Jersey | 5.1 | 5.2 | 5.3 | 5.5 | 5.6 | 5.5 | 5.9 | 7.4 | 7.9 | 7.6 | 7.5 | 7.3 | 7.2 |
| New Mexico | 1.9 | 2.6 | 3.1 | 4.0 | 4.0 | 3.7 | 4.1 | 5.3 | 4.7 | 5.3 | 4.8 | 4.6 | 4.4 |
| New York | 6.5 | 6.6 | 6.4 | 6.2 | 5.9 | 5.9 | 6.7 | 7.2 | 6.7 | 6.7 | 6.3 | 6.3 | 6.5 |
| North Carolina | 1.0 | 1.2 | 1.4 | 1.4 | 1.4 | 1.6 | 2.0 | 2.5 | 2.8 | 2.4 | 2.8 | 2.5 | 2.3 |
| North Dakota | 0.8 | 0.6 | 0.7 | 0.9 | 0.9 | 0.9 | 0.9 | 0.6 | 1.2 | 1.0 | 1.1 | 1.0 | 0.8 |
| Ohio | 2.5 | 2.7 | 2.7 | 2.6 | 2.6 | 2.6 | 2.7 | 2.9 | 2.9 | 3.0 | 2.9 | 2.8 | 2.6 |
| Oklahoma | 0.8 | 1.2 | 1.3 | 1.4 | 1.3 | 1.2 | 1.2 | 1.2 | 1.4 | 1.5 | 1.5 | 1.5 | 1.6 |
| Oregon | 1.2 | 1.2 | 1.3 | 1.6 | 1.5 | 1.6 | 4.5 | 4.7 | 4.5 | 4.6 | 5.0 | 4.6 | 5.2 |
| Pennsylvania | 2.0 | 2.3 | 2.2 | 2.2 | 2.3 | 2.3 | 2.2 | 2.3 | 2.3 | 2.4 | 2.4 | 2.5 | 2.4 |
| Rhode Island | 6.6 | 6.5 | 6.2 | 5.3 | 5.2 | 5.0 | 4.4 | 4.3 | 4.1 | 4.6 | 4.7 | 4.5 | 5.2 |
| South Carolina | 1.6 | 1.6 | 1.6 | 1.8 | 2.5 | 2.4 | 2.4 | 2.2 | 2.5 | 2.3 | 3.3 | 2.9 | 2.9 |
| South Dakota | 1.5 | 1.5 | 1.5 | 1.2 | 0.9 | 0.7 | 0.9 | 0.9 | 0.7 | 0.8 | 0.9 | 0.8 | 0.4 |
| Tennessee | 0.9 | 1.0 | 1.0 | 1.2 | 0.9 | 0.8 | 0.8 | 0.7 | 0.8 | 0.7 | 0.7 | 0.7 | 0.9 |
| Texas | 1.4 | 1.3 | 1.2 | 1.0 | 0.9 | 0.9 | 0.8 | 1.0 | 1.0 | 1.3 | 1.4 | 1.4 | 1.4 |
| Utah | 3.1 | 3.6 | 3.3 | 2.8 | 3.0 | 2.9 | 3.5 | 3.2 | 2.7 | 2.3 | 1.9 | 1.5 | 3.2 |
| Vermont | 4.2 | 4.2 | 3.8 | 3.3 | 3.0 | 3.0 | 2.5 | 2.3 | 2.2 | 2.1 | 2.0 | 1.8 | 1.8 |
| Virginia | 2.1 | 2.0 | 2.1 | 1.9 | 1.8 | 1.7 | 1.7 | 1.8 | 1.7 | 1.8 | 1.9 | 1.9 | 2.1 |
| Washington | 4.8 | 4.6 | 4.6 | 4.4 | 4.4 | 4.8 | 4.9 | 4.9 | 4.9 | 5.1 | 5.1 | 5.1 | 5.3 |
| West Virginia | 2.8 | 3.4 | 3.3 | 4.2 | 4.0 | 4.1 | 3.6 | 4.6 | 4.4 | 3.9 | 3.9 | 3.6 | 3.5 |
| Wisconsin | 2.8 | 2.8 | 2.7 | 3.2 | 3.0 | 3.3 | 4.5 | 4.7 | 4.3 | 4.2 | 4.1 | 4.0 | 4.6 |
| Wyoming | 0.7 | 1.0 | 1.0 | 1.0 | 1.4 | 0.9 | 0.8 | 0.7 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 |
| **Median** | **1.9** | **2.0** | **2.2** | **2.1** | **2.3** | **2.2** | **2.4** | **2.4** | **2.5** | **2.4** | **2.6** | **2.5** | **2.5** |

## Moody's Related Research

### Special Comments:

- » Annual Sector Outlook for US State Governments, February 2010 (123172)
- » US States Credit Scorecard, February 2010 (122962)
- » US State and Local Governments Remain Inherently Resilient, Despite Growing Pressures, February 2010 (123154)
- » Variable Rate Issuance Down Despite Near Record Volume in US Municipal Market, February 2010 (123292)

### Rating Methodology:

- » Moody's State Rating Methodology, November 2004 (89335)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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MOODY'S
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FitchRatings
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# FITCH RATES $52MM VERMONT GOS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-15 January 2010: Fitch Ratings assigns an 'AA+' rating to the following State of Vermont general obligation (GO) bonds:

--$52 million 2010 series A.

The bonds, which may be sold as Build America Bonds, are expected to sell competitively on Jan 27.

In addition, Fitch affirms the following ratings at 'AA+':
--$440.6 million in outstanding State of Vermont general obligation bonds.

The Rating Outlook is Stable.

RATING RATIONALE:
--Vermont's debt profile reflects exclusive use of general obligation debt and amortizes rapidly.
--Debt ratios have declined in recent years and are now low; affordability planning is employed.
--The state's revenue stream is diverse, and reserve funds are fully funded.
--Vermont's economy has diversified but remains narrow and somewhat vulnerable to the cyclical manufacturing sector.

KEY RATING DRIVER(S):
--Maintenance of fiscal balance amid the current recession.
--Maintenance of a low to moderate debt burden.
SECURITY:
General Obligations of the State of Vermont, with the full faith and credit of the State pledged.

CREDIT SUMMARY:

Vermont's 'AA+' rating reflects its low debt burden which is maintained through adherence to debt affordability guidelines, conservative financial management with fully funded reserves, and its economy which is now less dependent on the manufacturing sector. Outstanding debt, which is entirely GO and matures rapidly, has declined from previously moderate levels. The state budgets conservatively, and its diverse revenue stream includes a state property tax for education. Reserves in each major operating fund, as of the close of fiscal 2009, were at full funding at 5% of prior-year appropriations. The relatively narrow state economy is supported by larger than average manufacturing (albeit less so than in the past), tourism, and health and educational services sector employment. Vermont has a relatively small income base with an older and well-educated population. Challenges include the need to address continued education and Medicaid spending pressures.

Vermont lost less than 1% of its jobs during the recession earlier this decade; by 2004, it had exceeded its pre-recession annual employment peak, in sharp contrast to the steep and protracted recession of the early 1990s. Employment growth since 2005 has lagged the nation and the decline registered in 2008 was steeper than that nationally. November 2009 employment data indicate state employment declined 2.6% from the November 2008 level, with the most significant declines occurring in the construction and manufacturing sectors. Manufacturing sector employment, led by an IBM facility near Burlington, still exceeds the national level on a percentage basis, though both employment and personal income reliance on this sector have dropped in recent years. State unemployment has historically been below the national level and Vermont's November 2009 unemployment rate of 6.4% is well below the national rate of 10% for the same month. Vermont has been challenged by the aging of its population; the median age of 41.5 years is well above the national 36.9 years and is exceeded only by Maine. Per capita personal income in 2008 totaled

$38,686, ranking Vermont 24th among the states, at 96% of the national level.

Conservative practices and well-stocked reserves sustained healthy finances during the recession earlier this decade, with the state using some reserves and reducing appropriations in fiscals 2002 and 2003 when revenues softened. Operations were subsequently favorable, and reserves were restored to their maximum level by the end of fiscal 2004. Surpluses in fiscals 2004 through 2008 were largely used for reserves, additional pension contributions, property tax relief, and carryovers into ensuing fiscal years. Fiscal 2009 general fund revenue expectations were reduced several times during the fiscal year and ultimately declined 8% from fiscal 2008 figures. Personal income tax receipts were down by a significant 14.8% while corporate income taxes and sales and use tax receipts were down by 9% and 3.4%, respectively. Measures to maintain balance during fiscal 2009 were promptly implemented and Vermont ended with an operating surplus of approximately $15 million. Fiscal 2010 revenue expectations were revised downward earlier this fiscal year, and $28 million in spending cuts, balance transfers and application of a portion of the prior year's surplus were employed to maintain balance. Through November, general fund revenues were meeting expectations. The fiscal 2011 executive budget proposal, expected next week, will address a budgetary gap of approximately $150 million.

Vermont's debt is exclusively GO, and it amortizes rapidly. The state's debt burden is low. As of June 30, 2009, net tax-supported debt of $441 million, equaling $709 per capita and 1.8% of 2008 personal income. Debt has declined since the 1990s as a result of debt affordability recommendations, and while annual issuance levels are expected to grow, debt ratios are expected to remain low to moderate. Vermont continues to appropriate required contributions to its pension systems although funded ratios have recently declined in part due to asset valuation declines.

Applicable criteria available on Fitch's website at 'www.fitchratings.com' include:

--'Tax-Supported Rating Criteria' (Dec. 21, 2009);
--'U.S. State Government Tax-Supported Rating Criteria', (Dec. 28, 2009).

Considerations for Taxable/Build America Bonds Investors

The following sector credit profile is provided as background for investors new to the municipal market.

State General Obligation Bonds:

The general obligation full faith and credit pledge is the broadest security a U.S. state government can provide to the repayment of its long-term borrowing, and therefore is the best indicator of its overall credit quality. State ratings generally fall within the two highest rating categories of 'AAA' or 'AA', with a few outliers. The top tier ratings reflect states' inherent strengths: states generally have broad economic and tax base resources and all possess sovereign powers under a federal government system, with substantial, although varying, control over revenue raising and spending. Given these inherent strengths, in only a few instances have economic concentration and long-term structural decline or the inability or unwillingness to address large financial challenges led to ratings below the 'AA' category. For additional information on State ratings, see U.S. State General Obligation Bond Rating Criteria dated Dec. 28, 2009.

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Moody's Investors Service

## New Issue: MOODY'S ASSIGNS Aaa RATING TO STATE OF VERMONT'S $52 MILLION GENERAL OBLIGATION BONDS 2010 SERIES A

Global Credit Research - 22 Jan 2010

### Aaa RATING AFFIRMED ON OUTSTANDING $440.6 MILLION GENERAL OBLIGATION DEBT; OUTLOOK IS STABLE

State
VT

**Moody's Rating**

| ISSUE | RATING |
|---|---|
| General Obligation Bonds, 2010 Series A | Aaa |

**Sale Amount** $52,000,000
**Expected Sale Date** 01/27/10
**Rating Description** General Obligation Bonds

### Opinion

NEW YORK, Jan 22, 2010 -- Moody's Investors Service has assigned a Aaa rating and stable outlook to the State of Vermont's $52 million General Obligation Bonds 2010 Series A. At this time we have also affirmed the Aaa rating assigned to the state's $440.6 million outstanding general obligation bonds. Proceeds of the current issue will be used to fund various capital projects around the state. Moody's highest rating level reflects Vermont's strong history of financial management, which includes conservative fiscal policies and the maintenance of healthy reserve balances that continue to provide a cushion against further revenue declines; and manageable debt profile that reflects the state's focused efforts to reduce its debt ratios and maintain well-funded pension systems.

The state's credit outlook is stable.

Credit strengths are:

*History of strong financial management and fiscal policies indicated by conservative budgeting practices.

*History of prompt action to reduce spending following revenue

weakening.

*Maintenance of budget reserve levels at statutory limit.

*Steady progress in reducing previously high debt ratios and maintaining an affordable debt profile.

Credit challenges are:

*Continuing budget pressure in the upcoming fiscal year and out-years

*Decline in job growth.

*Potential service pressures due to a population that is aging at a relatively rapid pace.

*Below average per capita income levels.

SIGNIFICANT REVENUE DECLINES IN 2009 LEAD TO BUDGET GAPS

As a result of revenue underperformance during fiscal 2009 the state of Vermont's general fund budget was reduced four times by a total of $66 million (or 5.8%) from the approved fiscal 2009 budget of $1.155 billion to the April 2009 final revenue estimate of $1.089 billion. However the state did realize a surplus of $14 million (roughly 1% of revenues) at the end of fiscal year 2009, a result of better than expected collections in the Inheritance and estate taxes category. The major revenue sources of the state (personal income, sales & use, and rooms & meals) finished slightly below forecast by a cumulative $2.3 million. Total fiscal 2009 revenues declined by 8% from fiscal 2008 revenues of $1.199 billion. During the course of fiscal 2009 the state faced a cumulate budget gap of $87 million. In order to solve the budget gaps the state used a mix of budget cuts (primarily in human services), revenue enhancements, and federal fiscal stimulus funds. The state also substantially reduced the size of the state workforce, reducing the number of employees by roughly 9%.

FY 2010 YEAR TO DATE REVENUES PERFORM AS FORECAST; FY 2011 BUDGET SHORTFALL OF $150 MILLION PROJECTED

The new January 2010 economic and revenue forecast produced by the state shows year-to-date revenues as of December performing essentially on target. Full year General Fund revenue estimates for fiscal 2010 have been revised upward by $5 million to $1.031 billion. The revised revenue figure still represents an overall decline of 6.5% from fiscal 2009 revenues. As in other states, Vermont benefited from the federal fiscal

stimulus package, which helped the state mitigate budget shortfalls during fiscal 2009, the current fiscal 2010 and to a certain extent fiscal 2011. Vermont has approximately $174 million of federal funds built into the fiscal 2010 budget (17% of fiscal 2010 sources). The federal funds were used primarily to backfill cuts in health and human services. Vermont is projecting a structural budget gap of $150 million for fiscal 2011 (14% of revenues projected to be available for fiscal 2011). The state's out-year projections show continued structural imbalance as a result of increased spending pressures and the elimination of the federal stimulus dollars.

FISCAL UNCERTAINTY BALANCED BY STATE'S TREND OF PROACTIVE FINANCIAL MANAGEMENT

While Vermont has taken swift actions to address budget deficits, it still faces substantial challenges in its out-year budgets. As in many states, persistent economic weakness will continue to present financial threats for the state. The Governor has already taken steps to reduce out-year gaps such as negotiating labor contracts for the next two years which will reduce wages by 3%. The governor has also asked state agencies to reduce general fund requests by 8% for fiscal 2011. The state has also increased the frequency of its revenue forecasting, which traditionally was performed on a semi-annual basis. Since January 2008 the state has published quarterly economic and revenue forecasting which has enabled them to identify and provide solutions for any sudden revenue declines. Moody's expects that, like other Aaa-rated states, Vermont will continue its trend of conservative financial management and aggressive approach to dealing with budget shortfalls to manage its current fiscal challenges.

BUDGET RESERVE LEVELS MAINTAINED AT STATUTORY FUNDING LEVELS OF 5%

Vermont has so far avoided using any of its fully funded budget stabilization reserve funds (BSR). At the end of fiscal 2009, Vermont's General Fund BSR was $60.1 million which reflects the statutorily required funding level of 5% of prior year budgetary appropriations, a level that has been maintained since 2004. Vermont also maintains a fully funded Transportation Fund BSR, also at 5% of prior year appropriations, and one in its Education Fund at the statutory required level of 3.5% to 5% of prior year expenditures, excluding General Fund transfers. Vermont expects to maintain its budget stabilization reserves at the statutory level through the end of fiscal 2010. Additionally the state has set aside $14.8 million in a General Fund Revenue Shortfall Reserve account. The state also maintains a Human Services Caseload Reserve, which is available for unexpected caseload growth. As of June 30, 2009 the reserve held $17.8

million. The governor's fiscal 2010 budget adjustment utilized $16.2 million of the reserve to cover the human services caseload increase experienced by the state. There remains a residual balance of just $70,000 in this reserve. Even with the use of the caseload reserve the state has substantial cushion by keeping the additional budget reserve funds fully funded.

UNEMPLOYMENT RATE HAS DECLINED

Continuous job growth in education and health services, Vermont's largest employment sector, has helped offset persistent weakness in other areas of the economy, primarily manufacturing and construction. Vermont never fully recovered manufacturing job losses from the prior economic recession in 2001-2002. For 2009, Vermont's average annual year-over-year job growth is projected to decline by 3.72%, lower than the projected national employment decline of 4.2%. The state's unemployment level, which has historically been low, rose rapidly during 2009 but has stabilized at 6.4% (November 2009) versus 10.2% for the nation. The states largest private employer IBM has recently announced plans for hiring which is also positive for the state's economy.

DEBT RATIOS CONTINUE TO DECLINE

Vermont's debt levels have declined considerably over the past decade and are now below average relative to Moody's 50-state median, on both a per capita and personal income basis. Debt per capita of $692, compared to the state median of $865, ranked Vermont 34th among the fifty states in Moody's 2009 state debt medians. Debt to total personal income of 1.8%, compared to the 2.5% state median, ranked Vermont 35th. Both ratios represent steady improvement in Vermont's debt profile, reflecting efforts by the state's Capital Debt Affordability Advisory Committee which oversees long-term capital planning for the state.

Vermont's overall pension funding levels have historically been strong relative to other states. Due to the broad based market losses experienced in 2008 the state's two pension systems have seen a decline in funding ratios. As of June 30, 2009 the state employees' system had a 78.9% funding ratio, down from the 94.1% funded ratio reported June 30, 2008. The teachers' system has a funded ratio of 65.4% on June 30, 2009, down from 89% reported June 30, 2008. The state continues to be committed to the full annual funding requirements. Vermont's assessment of its other post employment benefit (OPEB) liability reflects $813 million for state employees and $872 million for teachers. The state has not decided on a funding mechanism for the OPEB liabilities, however they have set up an

irrevocable trust fund to initially be funded with excess revenues from Medicaid part D reimbursements. As of June 30, 2009 this trust fund held $3.7 million of assets.

MOST RECENT RATING ACTION

The last rating action with respect to the State of Vermont was on February 24, 2009 when the rating of Aaa was assigned to the state's $50.5 million General Obligation Bonds 2009 Series A.

The principal methodology used in rating the current issue was Moody's State Rating Methodology published in October 2004 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

**Outlook**

The outlook for Vermont's general obligation debt is stable. The state faces significant pressure to achieve structural budget balance in the coming fiscal years. Moody's expects that the state will continue its trend of proactive and conservative fiscal management in light of declining revenues and increasing expenditures. We believe that Vermont will continue to demonstrate the willingness and ability to respond with budget adjustments as needed to maintain budget balance.

What could make the rating go - DOWN

*A break from the states history of conservative fiscal management.

*Emergence of ongoing structurally imbalanced budgets.

*Depletion of budget reserves without swift replenishment.

*Liquidity strain resulting in multiyear cash flow borrowing.

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January 22, 2010

# Vermont; General Obligation

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# Vermont; General Obligation

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|---|---|---|
| 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

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# NEW ENGLAND ECONOMIC PARTNERSHIP
**(NEEP)**

# Vermont Economic Outlook

**May 2010**

**Vermont Media Sponsor:**

## VERMONT ECONOMIC OUTLOOK

### The Forecast in Brief

- The May 2010 Vermont forecast update for NEEP[1] represents a small, but measurable upgrade from the last NEEP forecast completed in November of 2009.
  - The forecast calls for a historically restrained and uneven paced recovery for most major macro-variables.
  - Much of the reason for the restrained pace of recovery is tied to the still struggling housing and labor markets. Each continues to contend with the lingering effects of the "Great Recession" and represent key forecast risks going forward.
- Similar to last Fall's NEEP forecast which called for a turnaround by early calendar year 2011, rates of recovery-growth for most key macro-variables will not even begin to move closer to historical norms until calendar year 2011. Some will remain at subpar levels until as late as calendar year 2012.
  - More normal rates of recovery-growth will return in the Vermont economy only when the residual effects of the housing market downturn and the painful process of financial sector and household de-leveraging have fully run their course.
- Among the major macro-variables for the Vermont economy over the next 4+ calendar years, it is expected that:
  - After reaching "bottom" during the third quarter calendar year 2009 payroll jobs are expected to continue to follow a modest pace of recovery, finally reaching more typical rates of recovery and beginning in the second half of calendar year 2011 and eventually crossing the line to expansion by Q1: 2013.
  - Gross State Product, will start to bounce back in 2010, and pick up pace in calendar years 2011 and 2012, with rates of growth moving closer to historical averages by 2013.
  - Real[2] Personal Income in Vermont is expected to remain relatively flat in 2010, and resume an upward track in 2011 and beyond, with the pace of recovery in this variable lagging behind that of both the regional and national recoveries.

[1] NEEP means the "New England Economic Partnership".
[2] Or inflation-adjusted.

- Most of the forward recovery progress will be driven by the services-producing job categories, but an expected turnaround in goods-producing job sectors will also contribute positively to Vermont's long-awaited economic/labor market recovery.

    - Among the state's 11 major NAICS sectors, a total of 9 are expected to see positive job changes over the forecast time horizon with the two exceptions being the Construction and Government sectors.

    - The sectors showing the strongest potential for job increases are the Education & Health Services (at 2.7% per year over the 2009-2014 period), Professional & Business Services (at 2.6% per year over the 2009-2014 period), and Leisure and Hospitality sectors (at 2.2% per year over the 2009-2014 period), the three categories with annual rates of job change that exceed 2.0% per year.

    - The weakest sectors include the Construction and Government sectors which are expected to post an average annual rate of payroll job change of 0.6% and 0.2% per year, respectively.

    - Of particular note is the fact that the Manufacturing sector is expected to climb into the positive category over the 2009-2014 period—albeit at an annual average rate of increase that is still less than 1.0% per year.

- The updated May 2010 NEEP forecast estimates the total "peak to trough" decline in payroll jobs will be 13,800, below the 17,900 payroll job decline forecasted last November, and well below the job losses experienced for the nation as a whole in percent terms.

    - If this performance survives revision, Vermont will have reached its labor market "bottom" and begun its recovery before the U.S. economy overall—meaning the state went into recession earlier and emerged from downturn earlier than the U.S. economy in contrast to past recessions.

    - Although the Vermont recessionary job loss "peak-to-bottom" was less severe, this forecast expects that the state's job recovery will trail the New England and U.S. averages through the initial years of the forecast period—or during calendar years 2010-2011.

    - For the out-years of the forecast (or for calendar years 2012-2014), the pace of job recovery, and then growth, is expected to be slightly stronger than the New England average, but slower relative to the U.S. average overall.

- The Vermont unemployment rate appears to have peaked in the second quarter of calendar year 2009 at 7.2%, at a level last experienced in May of 1991.

    - Although lower than the 8.2% forecasted peak unemployment rate from the November 2009 NEEP Outlook, that 7.2% peak rate of unemployment still remains 3.5 percentage points higher than the cyclical low experienced before the Vermont labor market began to deteriorate.

    - Despite the relatively slower pace of the jobs recovery expected in Vermont, the state's unemployment rate overall is expected to remain among the lowest in the New England region throughout the calendar year 2010-2014 forecast period.

- Although the housing market nationally, regionally, and in Vermont appears to have stabilized, a full recovery in housing markets remain a long way out into the future and represents one of the forecast's most significant risks.

    - Price declines in Vermont and in most regions are expected to continue, and the withdrawal of federal support for the housing market during 2010 represents a critical period for markets and it remains unclear if housing has the private sector impetus to continue its recovery on its own.

    - In the near-term, it is expected that additional foreclosures and a substantial inventory of unsold units will continue to put downward pressure on house prices through calendar year 2012.

- Despite the improving tone to this May 2010 NEEP forecast update, the unfolding recovery still faces formidable obstacles and headwinds—as the recent events unfolding around the fiscal austerity measures for Greece, mounting debt problems in the European Union, and the BP oil spill in the Gulf of Mexico attest.

    - Weakness in both residential and commercial construction, the poor fiscal condition of the state and local governments, and energy prices all pose continuing and serious recovery drags or obstacles.

    - In addition, no one is sure—especially since there is no modern historical precedent for—how smoothly the private sector will step up to take the economic recovery baton forward as the unprecedented level of monetary and fiscal support for the economy is progressively withdrawn.

**The Current U.S. Situation—Climbing out of the Hole…But It Will Be a Long Hard Slog to Expansion**

**a. Summary:** Most key macroeconomic measures indicate the U.S. economy reached a bottom during the August/September of calendar year 2009. Gross Domestic Product, the broadest measure of economic activity, has returned three quarters of positive change since the second quarter of calendar 2009. Despite persistently high unemployment, job losses abated during the fall of calendar 2009, and appear to have reached a turning point in the spring of calendar 2010. Housing markets have stabilized, even if only due to significant federal government support, and prices, housing starts and sales have flattened out and even shown some positive movement.

Despite the encouraging signs that the economy has indeed turned a corner, it is likely to be a relatively slow and insecure recovery with several potential obstacles still standing in the way of a broad-based recovery. These include:

**(1) Confidence:** The decline in economic activity during the "Great Recession" was severe, making for a deep "hole" from which to emerge. While a technical recovery is underway, significant improvements will be needed for households and businesses to regain the confidence necessary for recovery and expansion to become self-sustaining.

**(2) Labor Market Conditions:** The U.S. unemployment remains persistently high and is expected to peak at 10.3% in the first quarter of calendar 2011. Job gains should be aided by temporary census hiring in the summer of calendar 2010, but will be hampered by a number of households where workers will exhaust their unemployment benefits. Also, many discouraged workers will

need to return to the labor force and will be in for a challenging job search and contribute to a rising unemployment rate.

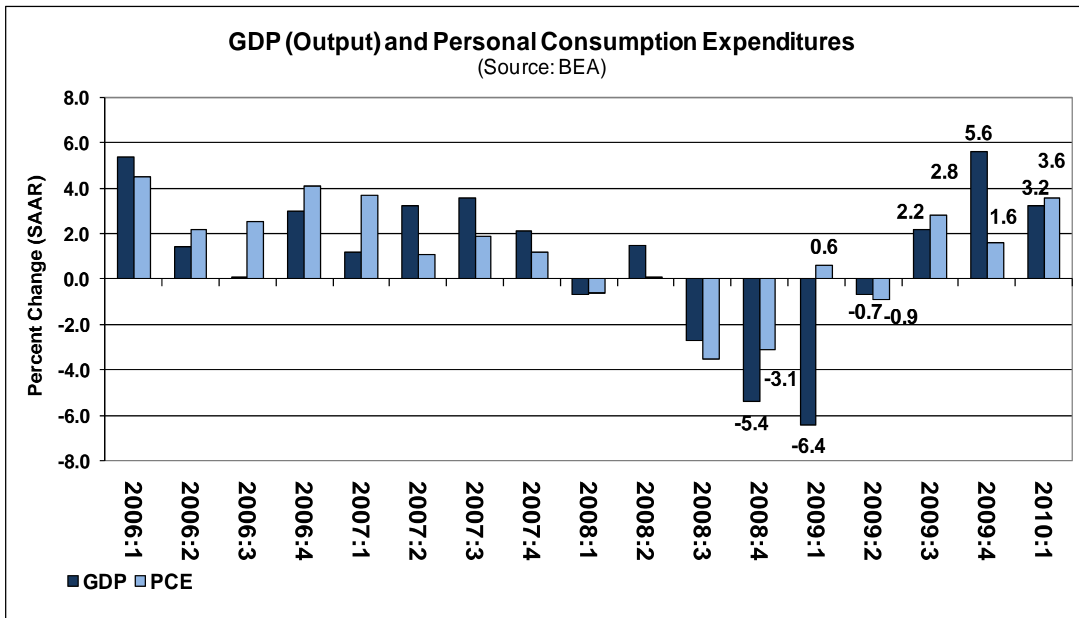
**(3) The Poor Fiscal Condition of Many State and Local Governments:** Many state and local budgets are currently contending with large, structural imbalances between expenditures and revenues. Pressures to balance state and local budgets are causing reductions in jobs and construction spending despite being tempered somewhat by federal support. These budget balancing measures have been and will continue to exert a drag on the still fragile economic turnaround. Although another round of fiscal relief from the federal level may in fact be forthcoming, the need for additional expenditure reductions and/or significant tax and fee increases over the next several years will act to restrain the economy's recovery-expansion process throughout the forecast period.

**(4) On-Going Foreclosure Pressures:** Additional foreclosures are likely in the pipeline as Option ARMs originated in 2006 to 2008 undergo rate resets over calendar years 2010 and 2011. Foreclosures could be reduced by successful federal government efforts to encourage lenders to alter loan terms of troubled borrowers, but effective policy in this area is in no way assured.

**(5) A Struggling Commercial Real Estate Sector:** The value of commercial real estate assets has declined significantly during the downturn and vacancies remain at a problematic and elevated level. If business conditions do not improve soon, defaults on commercial real estate loans could put additional pressure on smaller, regional banks that serve as the primary source of financing for small businesses.

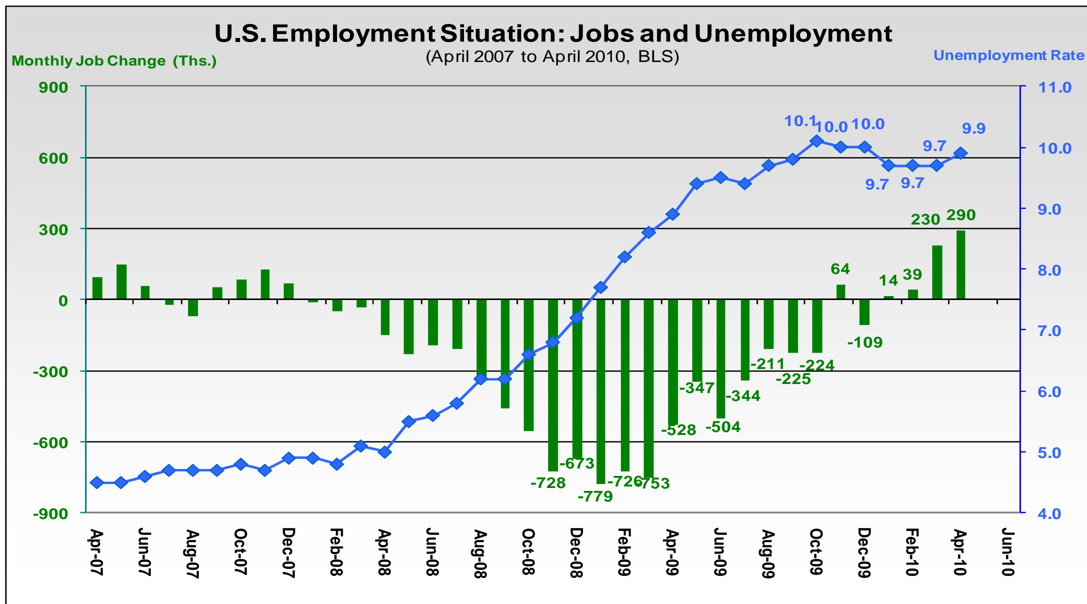
**(6) Persistently High Oil Prices:** Now stubbornly north of $75 per barrel, oil prices threaten to siphon off spending power from other areas of the economy. Persistently high oil prices would exert a large drag on what is expected to develop into a self-sustaining recovery by calendar year 2012.

**b. Gross Domestic Product Has Turned the Corner:** Gross Domestic Product, the broadest measure of economic output, has shown three consecutive quarters of positive change, certainly a welcomed development and a clear sign that a recovery is underway. While the strong overall reading for the fourth quarter of calendar 2009 was primarily a result of businesses replenishing inventories that had been severely drawn down during the recession, the estimate for the first quarter of calendar 2010 was a more broad based indication of economic activity picking up. The rebuilding of inventories continued in the first quarter, but Personal Consumption expenditures expanded substantially and made the largest contribution to the overall change. Other private investment, in addition to inventories, has begun to solidify. While residential investment (which means housing in the GDP report) continued to show weakness in the first quarter of calendar 2010, business investment in software and equipment increased for the third consecutive month and reflects businesses beginning to perceive an improved economic climate. The chart below shows changes in overall GDP and the key component Personal Consumption Expenditures, which accounts for roughly 70% of all economic activity.

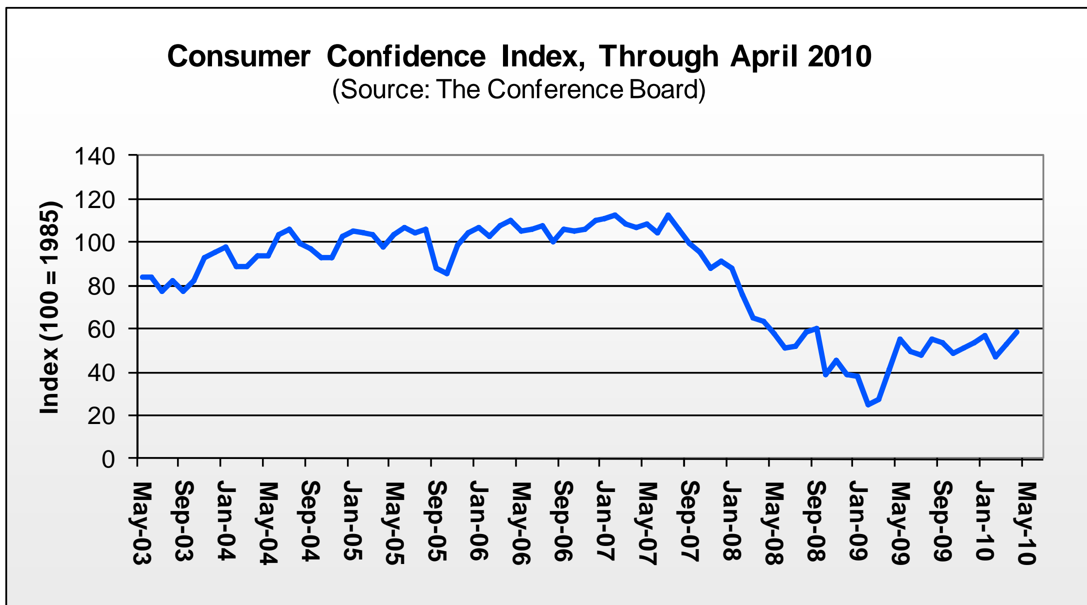



**c. An Especially Troubled Labor Market:** The Employment Situation report covering the month of April showed a second month of a meaningful net increase in payroll jobs in the U.S., with 290,000 jobs added. The March net increase was also revised up from 162,000 to 230,000 jobs. The April increase was again helped by federal government hiring of temporary Census workers, accounting for more than 60,000 of the net increase. The private sector added the most number of jobs in one month since March of 2006 at 231,000 jobs in April. Despite the payroll job increases (measured by an establishment-based survey), there was an increase in the national unemployment rate (measured by a household-based survey), from 9.7% in March to 9.9% in April. The increase in the unemployment rate was driven by a large increase in labor force as discouraged workers are likely returning to look for work. So far, this is consistent with the expectation that, even with the addition of payroll jobs in the near term, the U.S. unemployment rate should move higher before peaking at the end of calendar 2010 or the beginning of calendar 2011.

Still, the economy seems poised to add jobs over the second half of the calendar year 2010 as virtually all forward looking labor market indicators continue on a positive trend, including total weekly hours, manufacturing overtime hours, help wanted advertisements, temporary workers, and a key production index maintained by the Federal Reserve. As demand for goods and services increases, employers need to boost production and tend to increase hours and bring on temp workers before adding permanent employees. This translates into productivity gains (more output per worker), but eventually employers need to expand payrolls to keep up with demand.



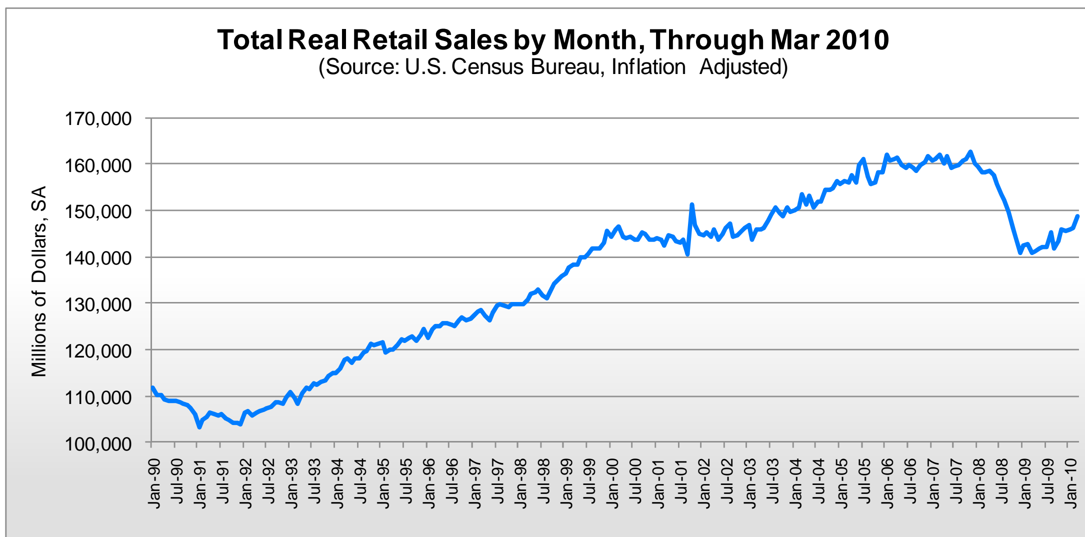

**d. Confidence and Consumption are headed in the right direction, but are still "fragile."** Consumer sentiment, as seen in the chart below, is an important factor in consumption decisions. So far in this recovery, confidence has been fragile and has been unable to break out of the plateau around which it has fluctuated for the past year. While Confidence is up from the record lows experienced back in March 2009, American consumers still appear unconvinced that the economy has turned the corner towards a genuine and sustainable recovery.[3]




Turing to retail spending however, American consumers appear to be moving forward and loosening up their wallets and purses despite some concerns about the future. The second chart below shows retail sales (adjusted for inflation) have picked up significantly climbing by 5.7%

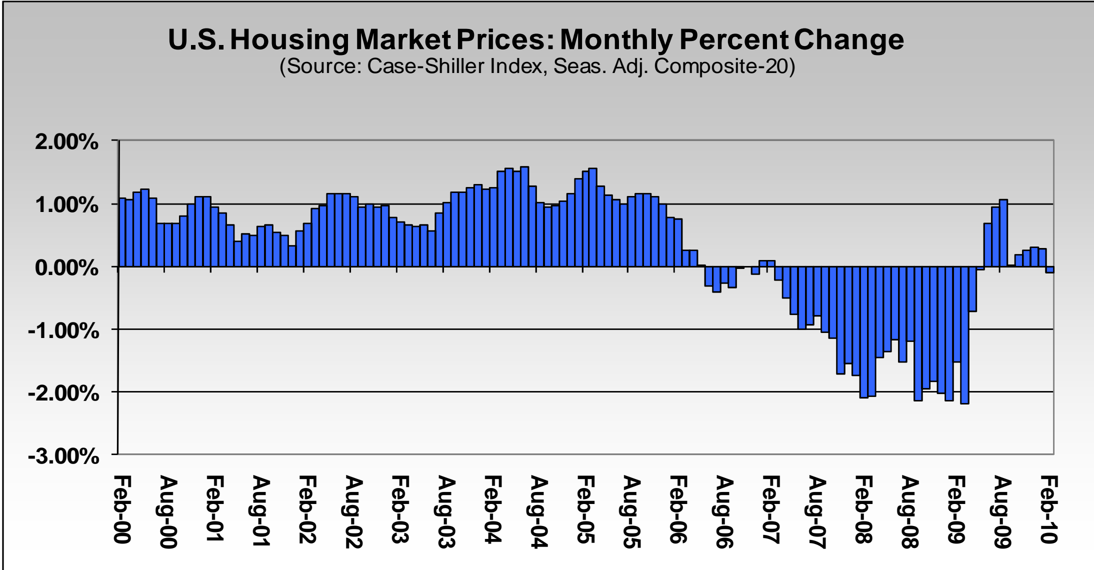
[3] The stock market hiccups in early May represent an all too vivid reminder of the fact that the economic recovery is in no way "out of the woods."

since bottoming out in December 2008. Even with that recovery, consumption spending remains more than 5% below its pre-"Great Recession" level. Sustained improvement in consumption spending will be needed if the current still fragile recovery is to evolve into a sustained recovery-expansion.

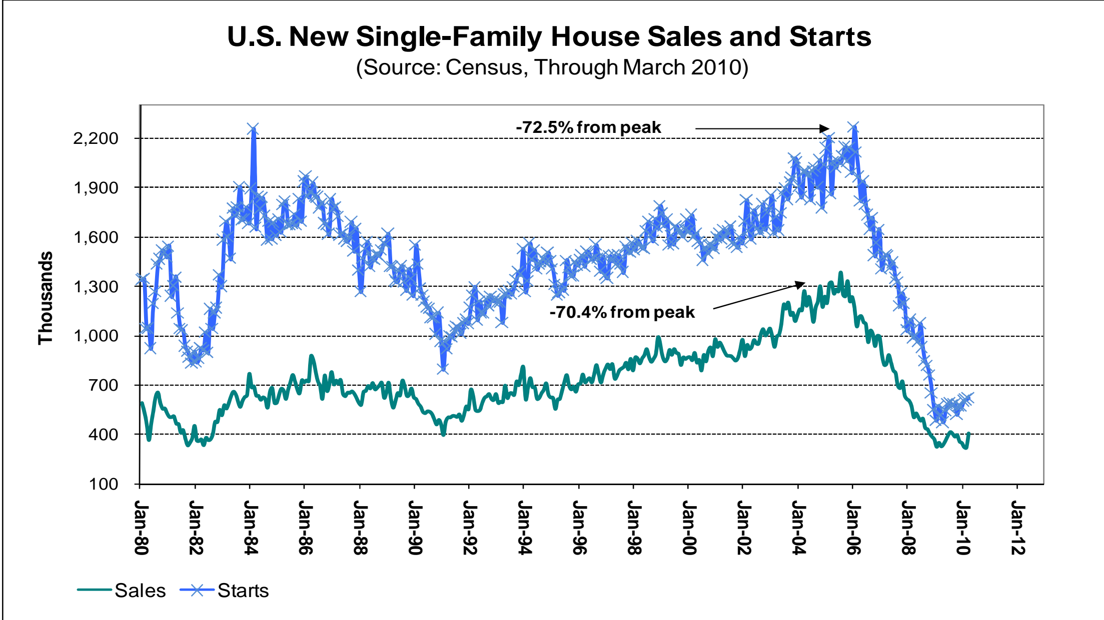



**e. Housing Markets:** The seasonally-adjusted Case-Shiller Housing Price Index has shown some positive movement on the home price front in eight of the last nine months. February's 0.7% decline over the month was the first break in the index's consecutive month increase trend, riding the coattails of the home buyer's tax credit and the massive $1.25 trillion mortgage-backed security purchase program executed by the Federal Reserve. These two initiatives had the effect of keeping mortgage rates low, which has been a key to encouraging buyers to get into the market.

With the expiration of the homebuyer's credit, the housing sector is approaching a critical period in its recovery. Conditions in the market appear to be set for a weak second half of calendar year 2010. These conditions include: (1) only a slowly improving labor market, (2) the continuation of tight credit conditions, (3) a still significant amount of excess housing units in the unsold inventory, (4) and the potential for even more foreclosures (which push prices down further and add even more to unsold house inventory) now that these programs have been wound down. Many analysts believe that some form of federal support to "prop up" the market will continue to be necessary. This could come in some form through Freddie Mac, Fannie Mae, and the Federal Housing Administration, which together already account for more than 90% of securitized mortgage loans. Without this strong federal government support additional price declines in the second half of the calendar year seem almost a certainty, and remain as a significant risk to the still fledgling and atypical U.S. economic recovery.




The continued fragility of the housing market is also evident in the chart below, which highlights a leveling out of sales and starts of new houses since the second half of calendar 2009. Market activity remains at a stunningly low level versus pre-recession levels with starts at 72.5% below their early-2006 peak, and sales 70.4% below the late-2005 peak. These measures of market activity, particularly housing starts, have direct implications for employment in the construction sector, which before the current downturn provided well-paid employment opportunities for many workers (and many without advanced education). Before these job opportunities begin to reappear, more activity in housing starts and sales will be needed. In April, Construction sector added jobs for the second straight month with a gain of 14,000 jobs. While this was a welcomed development, it pales in comparison to the 2.1 million Construction jobs lost since the "Great Recession" began. Clearly, with such steep declines in housing activity, even dramatic improvements in the near term would not correspond to sales and starts levels close to those of the 2006 peaks.



**f. Near-Term Recovery Prospects:** Most analysts are in agreement that the U.S. economy reached a bottom in late summer of calendar 2009. Despite significant political criticism of Federal fiscal and monetary policy efforts to stimulate the economy, the negative impacts of the recession likely would have been deeper and lasted longer than without those actions. As the recovery takes holds, virtually all indicators are pointing to increased production, which should eventually lead to expanding payrolls, increased income for workers, and a return to the labor force of many discouraged workers. As the question now turns to when and how the federal government will begin to withdraw from the economy, there is likely to be little pressure to do so anytime soon. The obstacles outlined above represent downside risks to the U.S. recovery and due to these risks continued federal government support to the economy in some form may be needed to ensure that another dip into recession is averted. Significant existing slack in the economy and weak price pressures will enable, and perhaps require, the federal government to maintain a stimulatory stance, such as low interest rates, for at least the rest of calendar 2010 and perhaps into the next calendar year of the forecast.

**The Vermont Situation**

**a. Current Conditions:** The Vermont economy, like other states in the New England region, appears to have reached a bottom during the second half of calendar year 2009. Labor markets bottomed, and output data suggest gross state product took a turn for the better as well. If true and the data survive revisions, a turning point during the second half of last calendar year would mean that the Vermont economy—which entered the recession earlier than the U.S. average and many of her New England state counterparts—will have done no worse than emerging from the Great recession in sync or perhaps even somewhat earlier than the U.S or the New England region.

Looking more closely at major indicators for the state, the impact of the recession in Vermont has been most evident in the labor market. The bottom in nonfarm employment was reached in September 2009 with a job loss from peak of 4.8%. So far during this recession, Vermont's job losses have been high, but have not yet reached the just-over-6% decline in non-farm payroll jobs that occurred during the 1990-1991 recession. Barring a significant double-dip in jobs, losses will not be as severe as in the 1990-1992 recession. Currently, nonfarm payroll jobs are 3.9% below the peak, on a quarterly average basis using updated actual data for the first quarter of calendar 2010. Job losses in Vermont slowed in the summer and month-to-month changes turned positive in the fall. Job losses in the Construction and Manufacturing sectors have been particularly severe, as second home construction all but ground to a halt in the state, and already difficult challenges faced by Vermont manufacturers were exacerbated by the "Great Recession."

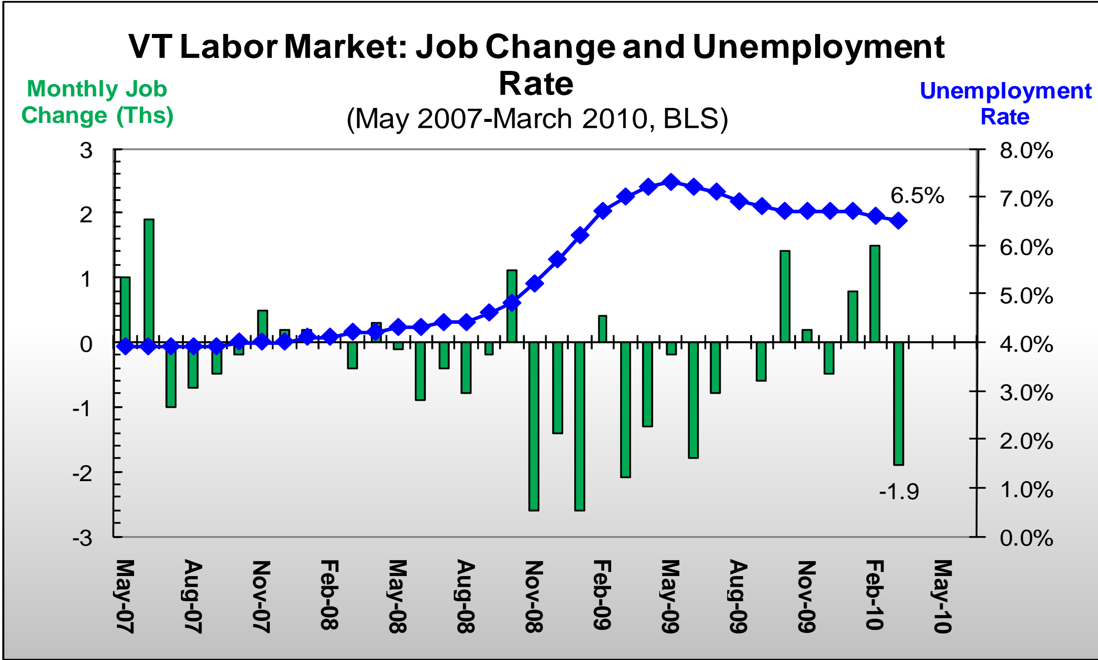
In terms of the year-over-year change in payroll jobs through the month of March 2010, the state ranks near the top of the U.S. and the New England states. In total payroll jobs, Vermont is down 0.9% from one year ago, and ranks second out of the six New England states. The state ranks second in the region in Private Sector year-over-year job change, with a decline of 1.2%. Both New Hampshire and Vermont are ranked in the top ten for both Total Nonfarm jobs and Total Private Jobs, and Maine rounds out the top three performers in year-over-year terms. The relative position of Vermont reflects the fact that the state started to lose jobs earlier than many other states and likely reached a bottom earlier. Therefore, in year-over-year terms, the comparison is versus a time period in which Vermont was further along in the cycle, resulting in a "less negative" year-over-year change through March.

| Table 2: Year-Over-Year Job Change by State<br>*Total Payroll Jobs (Mar 2009-Mar 2010)* | | |
|---|---|---|
| Rank | State | |
| 1 | Alaska | 1.4% |
| 2 | North Dakota | 0.6% |
| 3 | New Hampshire | 0.0% |
| 4 | Montana | -0.5% |
| 5 | South Carolina | -0.8% |
| **6** | **Vermont** | **-0.9%** |
| 12 | Maine | -1.2% |
| 14 | New York | -1.3% |
| 17 | Pennsylvania | -1.4% |
| 22 | Massachusetts | -1.6% |
| 25 | New Jersey | -1.6% |
| 28 | Connecticut | -1.9% |
| 38 | Michigan | -2.5% |
| 39 | Rhode Island | -2.6% |
| 46 | Colorado | -3.1% |
| 47 | California | -3.1% |
| 48 | Arizona | -3.2% |
| 49 | Wyoming | -3.6% |
| 50 | Nevada | -4.3% |
| Source: U.S. Department of Labor, BLS | | |

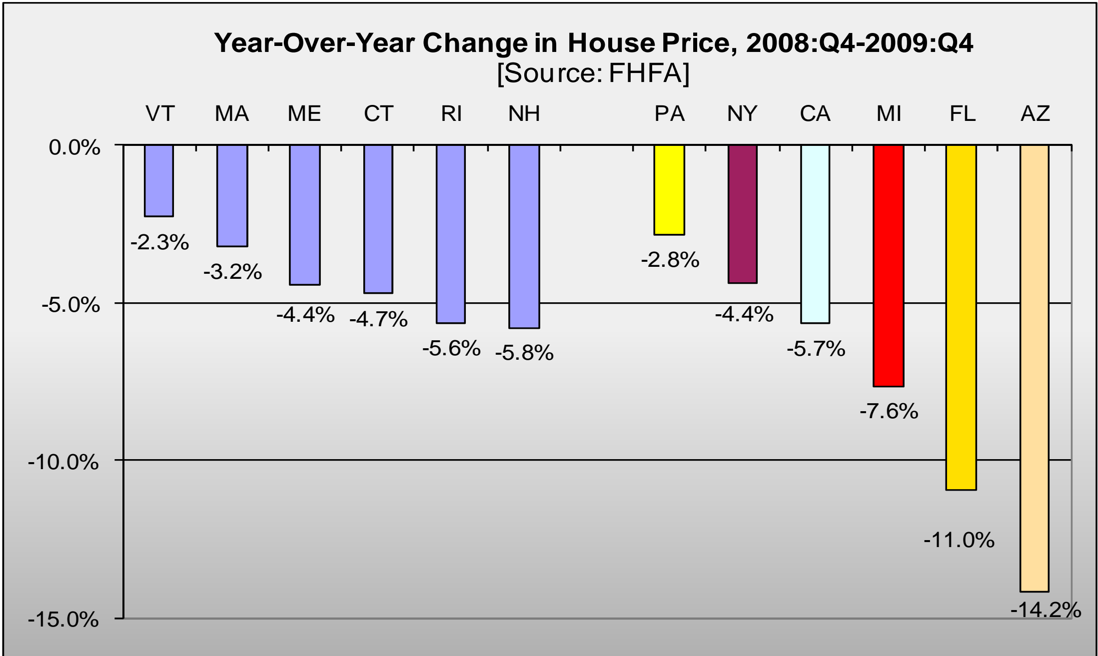
| Table 3: Year-Over-Year Job Change by State<br>*Private Sector Payroll Jobs (Mar 2009-Mar 2010)* | | |
|---|---|---|
| Rank | State | % Change |
| 1 | Alaska | 0.7% |
| 2 | North Dakota | 0.1% |
| 3 | New Hampshire | -0.4% |
| **4** | **Vermont** | **-1.2%** |
| 5 | Maryland | -1.2% |
| 7 | New York | -1.2% |
| 13 | Maine | -1.6% |
| 15 | Pennsylvania | -1.7% |
| 16 | Connecticut | -1.8% |
| 19 | Massachusetts | -1.9% |
| 23 | New Jersey | -2.0% |
| 32 | Michigan | -2.7% |
| 36 | Florida | -2.8% |
| 37 | Rhode Island | -2.8% |
| 46 | Wisconsin | -3.5% |
| 47 | Kansas | -3.5% |
| 48 | Colorado | -4.0% |
| 49 | Nevada | -4.5% |
| 50 | Wyoming | -5.3% |
| Source: U.S. Department of Labor, BLS | | |

The unemployment rate in Vermont, adjusted for seasonality, increased from 4.5% in May of 2008 to 7.3% in May of 2009, and has declined since then. The official rate sits at 6.5% as of March. This is currently the lowest unemployment rate in New England and one of the lowest in the country. Vermont's unemployment rate has historically maintained a level below that of the U.S. overall and most of the other New England states, and this held true throughout the recession.

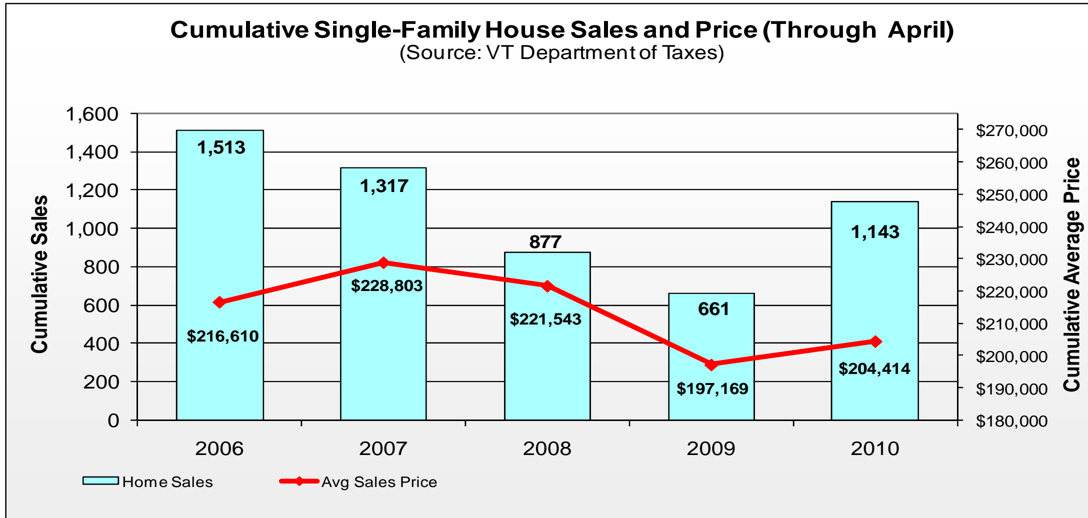
Over the course of the recession, Vermont's unemployment rate has been impacted by changes in employment levels, but also by labor force dynamics, as some job seekers likely became discouraged and left the work force. As overall conditions in the labor market have improved, relatively large increases in labor force have been observed since January of calendar 2010, signaling some "discouraged Vermont workers" appear to be returning to the work force. This labor force growth has been accompanied by employment growth as well over this time period, and this has resulted in the unemployment rate trending down. However, as discouraged workers return to the labor force they are likely to find a challenging job search environment, as job growth is expected to be relatively slow. These labor force dynamics are expected to move the state's unemployment rate slightly higher before a resumption of the current downward trend. It should be noted that Vermont data have been affected by small sample size and significant revisions have occurred in the past. Therefore, while these officially published unemployment data are taken at face value, we recognize that this analysis may be changed by data revisions that could be material.



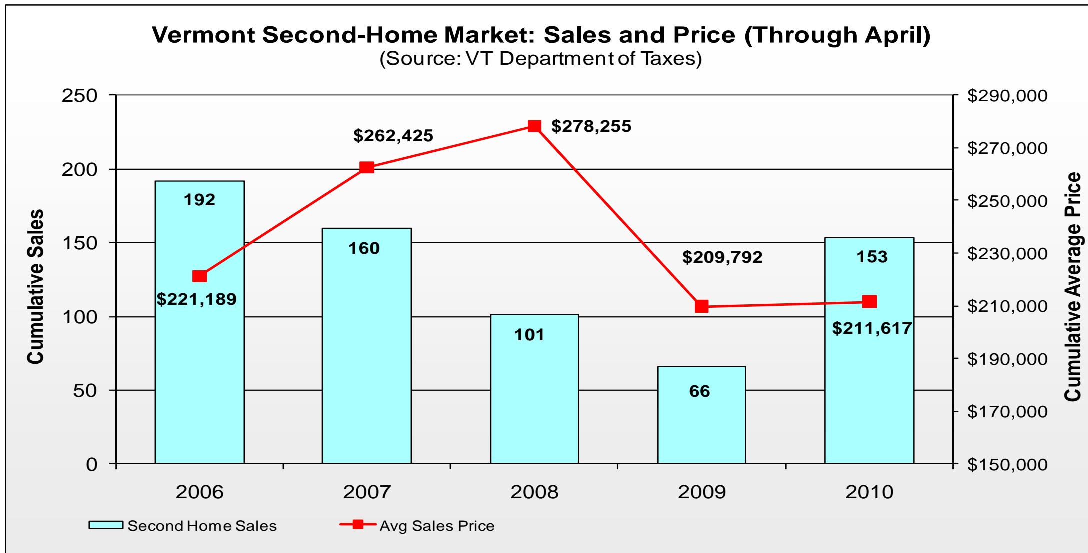

**b. Vermont's Housing Market:** Housing prices in Vermont have held up relatively well compared to many other states in the country. Using FHFA data on a year-over-year basis, California, Florida, Michigan and Arizona have experienced house price declines in excess of 5%, with Arizona having the largest decline at 14.2%. Vermont has the smallest decline at 2.3%, while New Hampshire has seen declines of 5.8%. New England as a whole has been somewhat insulated from the large price declines seen elsewhere, particularly in the southwest region state of California, Arizona, Nevada, as well as Florida.



Looking at housing price data from the Vermont Department of Taxes' Property Transfer Tax statistics,[4] the year–to-date through April data show that cumulative average house prices have declined 10.7% from 2007's cumulative average (as the peak year in this data series), but has increased 3.7% over last year's cumulative average sales price. Sales volume also has increased significantly, and is currently are at a level nearing 2007's sales volume levels. The increase in volume represents a significant turnaround in market activity—even if it was the result of the temporary federal incentives.




The vacation home market, an important component to Vermont's economy, has similarly seen large declines in sales and prices, but has also recently rebounded from the previous year's lows. The April 2010 sales level for second homes was equal to sales levels last reached in July 2009. The second home market has been negatively impacted by the financial market meltdown—and particularly in the Boston and New York financial sectors. From a Vermont perspective, high income households in those metro areas represent a key market for second homes in the state.




[4] This data source is analogous to the National Association of Realtors house sales-price tracking concept.

**c. The Bottom Line on the U.S. and Vermont Economies:** The U.S. and Vermont economies likely reached a bottom in the fall of calendar year 2009, and have begun the transition to recovery as of the spring of calendar year 2010. Most key indicators show measurable and positive changes—including initial gains in output, housing prices and sales, and construction activity. Labor market improvements have been slow to materialize both in Vermont and at the U.S. level. However, it does appear that the jobs recovery began in the Vermont economy at least one to two quarters before the U.S—even if only about 1,000 Payroll jobs have been added in Vermont since the state's labor market turning point. The Vermont unemployment rate remains the lowest in New England and one of the lowest in the nation. More substantial labor market improvements in Vermont, as usual, are expected to lag the other macroeconomic variables in the state, with unemployment rates remaining at elevated levels until calendar 2012.

Despite the encouraging signs that the economy has indeed turned a corner and the process of recovery has begun, the recovery is likely to be a relatively slow and insecure one. This is because the recovery faces an unusually long list of headwinds, if not outright obstacles, to its slow and still fragile progression. Among the more prominent risks-obstacles are: the still uncertain housing market, the fragile but improvements in labor markets, and the daunting fiscal challenges on the state and local government levels. There also has been little evidence of increased lending to small businesses, a critical ingredient for the current turnaround to develop into a sustainable upturn (see the Conference Theme section below). In addition, the recent, sustained rise in energy prices also poses a serious risk to the recovery, and no one is really quite sure how the withdrawal of the unprecedented level of fiscal and monetary stimulus will work out. Add to that, concern about high levels of public debt and the mounting fiscal problems in Greece and other vulnerable countries in the European Union, and the U.S., N.E., and Vermont recoveries still clearly remain "at risk." This formidable list of headwinds and obstacles to the recovery indicates that emerging economic recovery is in no way "out-of-the-woods." A "double-dip recession" or a return to a second significant period of economic decline cannot be entirely ruled out.

**Overview of the Moody's Economy.com National Economic Outlook: A Slight Upgrade**

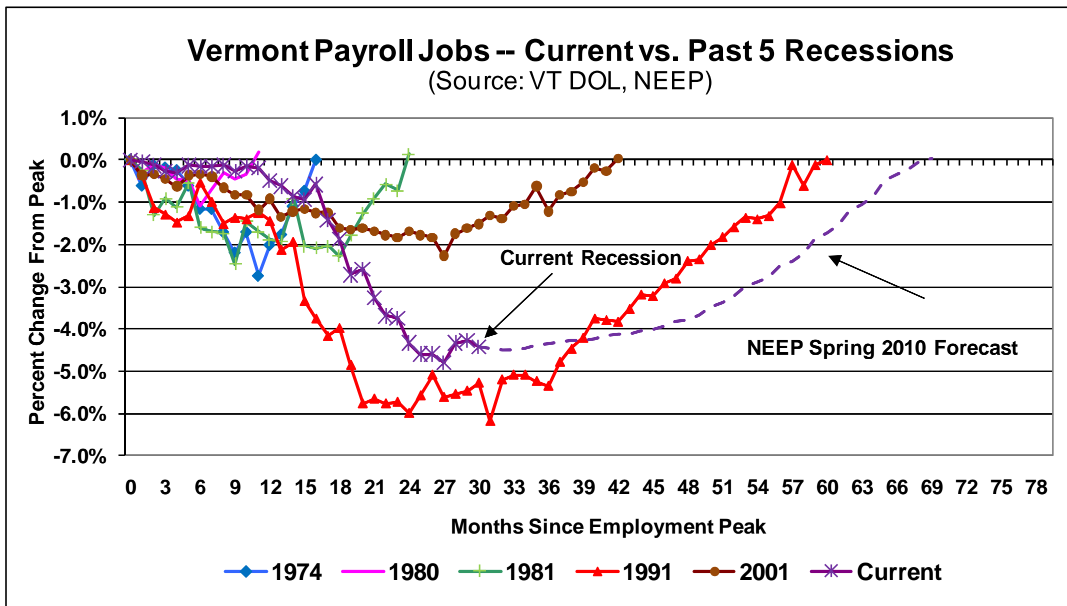
The May 2010 Vermont NEEP forecast update is based on the Moody's Economy.com U.S. control forecast and represents a slight upgrade from the fall 2009 for many key macro variables. The Moody's Economy.com U.S. control forecast includes an uneven path for U.S. GDP recovery-expansion, including a positive 2.8% change in calendar 2010, followed by a 3.5% or more annual rate of increase per year from 2011 to 2013. For 2014, the Moody's Economy.com GDP forecast is for a 2.6% gain. The nonfarm payroll job employment forecast expects some additional job losses for 2010 overall, with recovery to pre-recession jobs levels by the beginning of 2013. The U.S. unemployment rate is expected to move higher before lower, peaking at 10.1% for 2010 overall, and slowly decreasing to 5.8% by 2014, a figure closer to the long term natural rate of unemployment – meaning unemployment is expected to remain elevated for the next three calendar years. Overall, comparing 2009 actuals versus the fall 2009 NEEP forecast, the labor market appears to have fared slightly worse than expected, with higher unemployment and more jobs lost. However, Real Personal Income and Gross Domestic Product did not decline to the extent expected in the fall 2009 NEEP forecast.

**The Vermont Forecast Detail**

**a. Overview:** Because the U.S. economy is perhaps the largest factor driving the Vermont economy, this Vermont forecast update generally tracks the pace and profile of the U.S. economic forecast. Payroll jobs in Vermont appear to have bottomed in the fall of calendar 2009 and have slowly increased since then. The total peak-to-trough decline in jobs, if there is no "double dip

recession" in labor markets, amounts to more than 13,000 lost payroll jobs over 8 quarters. That level of job decline was not as long or severe of a decline as was expected in the fall 2009 NEEP forecast, which called for 17,900 jobs lost over 11 consecutive quarters. With a turning point in the job market likely reached, the jobs recovery is expected to take roughly 14 quarters from the trough (second quarter of calendar 2009), until pre-recession employment levels will be reached (see the chart below). Vermont also appears to have reached a bottom in real output, or Gross State Product (GSP), during the first half of calendar 2009, and is estimated to have seen positive changes in GSP since then. On an annual basis, the Vermont forecast expects a 3.5% increase in output in calendar 2010, and an increasing rate of expansion to 4.0% in 2011, 5.1% in 2012, 3.2% in calendar 2013, before returning to 2.4% in 2014, a rate of growth closer to historical averages. Real Personal Income in Vermont appears to have bottomed in the first half of calendar 2009, but has remained relatively flat, with both positive and negative changes since then. Negative changes in Real Personal Income are expected to continue until the second quarter of calendar 2010, before returning to consistent positive changes.

The chart below compares the decline from the peak in non-farm payroll jobs during the "Great Recession" versus the job loss-recovery record of the previous 5 recessions in percentage terms. Note the downturns of 1991 and 2001, which have been characterized as "Jobless Recoveries." It took 60 months in 1991 and 42 months in 2001 for the labor market recovery from those recessions to reach their respective pre-recession employment levels (e.g. the point of full recovery). Recessions prior to 1991 were followed by much shorter periods of recovery. While this downturn has not resulted in job declines as harsh as the 1990-1992 downturn, the updated May 2010 NEEP forecast calls for previous employment levels to be reached in the first quarter of calendar year 2013, a full 23 quarters or 69 months after peak levels of the second quarter of calendar 2007.




If this forecast holds, Vermont's overall performance will track consistently with the U.S. and the New England region as a whole, with some variables experiencing stronger rates of change in some years and others lagging behind the nation and regional averages. Output in Vermont will increase at a rate consistent with the New England region over the forecast period, but faster than the U.S. overall in 2010 and 2011, on par with U.S. growth in calendar 2012, and slightly below the nation in 2013 and 2014. Real Personal Income in Vermont is expected to increase at a rate slower than

that of the New England region and the nation throughout the forecast period. Improvements in the labor market are expected to come similarly to that of the region overall in terms of job growth, with the Vermont unemployment rate remaining well below the regional rate. However, job growth in Vermont and the region are both expected to lag behind the U.S. overall over the entire forecast period, even though Vermont's unemployment rate will remain below the national unemployment rate throughout the forecast.

On the sector-by-sector front, among the sectors contributing to Vermont's economic and labor market turnaround include: the Education & Health Services sector (at 2.7% per year over the 2009-14 period), Professional & Business Services sector (at 2.6% per year over the 2009-2014 period) and the Leisure and Hospitality Sector (at 2.2% per year over the 2009-14 period). These sectors are the categories that are expected to increase at a rate greater than 2.0% per annum. Also among the job gainers over the 2009-2014 period is the Manufacturing sector at 0.9% per year—thanks in part to stronger export growth in response to a strongly growing global economy and the decline in the value of the U.S. dollar. Overall, 9 of the 11 of the state's major NAICS categories are expected to recover and add jobs over the 2009-2014 forecast period with only the Construction and government sectors losing jobs on an average annual basis over the calendar year 2009-2014 period. Although the Construction sector is expected to lose jobs over the 2009-2014 period on an average annual basis, the 0.6% per year decline is about 1/8$^{th}$ of the 4.1% per year decline this category experienced over the 2004-2009 time frame. If realized, that performance would represent a significant improvement from the four-year nose dive in jobs in this category as the housing market imploded.

Key among services-producing employers in the state is the website developer Dealer.com. Dealer-com recently released a plan to double its work force and expand the company's operations, which should mean roughly another 100 jobs in the greater Burlington area. The company has planned the growth over a three year period and had considered moving the bulk of the operations to California, but was convinced to stay in Vermont by an authorization of $3.5 million in incentives by the Vermont Economic Progress Council.

Within manufacturing, several notable businesses are reportedly doing well and some even expanding. Green Mountain Coffee Roasters, Inc. currently employs more than 1,000 people and its growth should probably mean that it is now a former small business. The company, needing more space, plans to expand operations from its central Vermont location in Waterbury to Williston, closer to the only major metro area of Burlington. Elsewhere in the factory sector, Resolution Inc, an eyewear manufacturer located in Williston, has won recent military contracts ensuring continued operations and job retention in the northwest region of the state.

Another major player in Vermont's manufacturing sector is IBM. IBM is the largest employer in the state with roughly 5,000 employees, and any changes at the Essex Junction facility can have significant economic impacts. IBM, after having several rounds of layoffs during the winter of 2009, has begun to hire again and is looking to fill 100 positions, 75 production-operator positions and 25 manufacturing-technician positions, in the immediate future. The company reported an increase of 13% in earnings for the first three months of 2010 when compared to the same level of earnings during the first three months of 2009. This is certainly a welcomed development given the manufacturing sector's on-going difficulties, which also has been exacerbated by the downturn. Indeed, the fact that there is any forward momentum in the state's factory sector at all is one of the more encouraging developments in this spring 2010 NEEP forecast update.

Turning to housing, recovery in the Vermont housing market is expected to be gradual, but should begin by the first quarter of calendar 2011, two quarters before New England region and a full year

before the U.S. overall, when house prices will start to show consistent positive changes. The forecasts also calls for Vermont to experience significantly less severe housing price declines relative to the other five New England states and relative to many other parts of the nation. This is primarily due to more prudent lending practices overall (which have led to much lower foreclosure rates and forced liquidation house sales—including their 25%-30% price discounts) and the comparatively lower level of speculative activity in the state during the housing market boom of the early- to mid-2000s.

**b. The Second Worst Recession for Vermont since World War II:** This May 2010 forecast upgrade means that the "Great Recession" will likely go down in history as the longest (tied), but only second most difficult downturn for the Vermont economy dating back to the 1930s. Table 4 below compares the peak-to-trough change in selected indicators between the recession of the early 1990s—or the most difficult recession in Vermont since the 1930s—and the current recession. The record for the "Great Recession" was equal to or worse in 5 of 10 macro indicators listed in the table relative to the early 1990s downturn—including the duration from Peak-to-Trough job losses, the decline in Single Family House Permits, job losses in Retail and Manufacturing sectors, and the decline in house prices. On the other side, the declines in Output, Real Personal Income, Total Jobs, Construction Jobs and the change in the Unemployment Rate all are expected to have fared somewhat better during the last downturn relative to the early 1990s recession. However, it should be noted that even the "better" performing variables experienced significant declines, including one in five factory jobs lost and one in four Construction jobs lost during the last recession.

**Table 5: "Peak to Trough" Change in Selected Indictors: This Versus the Early 1990s Recession**

| Variable (Seasonally-Adjusted/Quarter-to-Quarter Basis) | Early 1990s Recession | This Recession | Better/ Worse |
|---|---|---|---|
| Length in Quarters--Peak to Trough Nonfarm Jobs | 8 | 8 | ***Same*** |
| Change in Gross State Product ($2005 Bil.) | -$0.81 | -$0.35 | ***Better*** |
| Percent Change | -5.9% | -1.6% | |
| Change in Real Personal Income ($Bil.) | -$499.0 | -$232.3 | ***Better*** |
| Percent Change | -5.4% | -4.3% | |
| Change in Nonfarm Payroll Jobs (Ths.) | -14.200 | -13.365 | ***Better*** |
| Percent Change | -5.4% | -4.3% | |
| Change in Construction Jobs (Ths.) | -8.420 | -5.370 | ***Better*** |
| Percent Change | -43.2% | -30.7% | |
| Change in Single Family Housing Permits | -2,710 | -2,357 | ***Worse*** |
| Percent Change | -65.5% | -80.3% | |
| Change in Retail Jobs (Ths.) | -2.730 | -3.908 | ***Worse*** |
| Percent Change | -7.8% | -9.6% | |
| Change in Manufacturing Jobs (Ths.) | -4.770 | -6.640 | ***Worse*** |
| Percent Change | -10.7% | -17.9% | |
| Change in FHFA Index [1980=100] Index Points | -4.09 | -18.98 | ***Worse*** |
| Percent Change | -1.9% | -4.1% | |
| "Cyclical High" in Statewide Unemployment Rate | 6.6% | 7.2% | ***Better*** |
| Change in Percentage Points | 4.0 | 3.9 | ***[Higher Rate]*** |

**Source: May 2010 New England Economic Partnership Forecast**

**Conference Theme: The Role of Small Business in the Vermont Economy**

**a. Overview:** Small businesses in Vermont, similar to the situation for the U.S. and New England region as a whole, are a key source of economic activity and growth. Small businesses provide many Vermonters and their families with their source of employment and income. Small businesses provide the many of the job opportunities in the state for several key industries such as agriculture, construction, wholesale and retail trade, real estate, professional and business services, and tourism related sectors. The importance of small business in Vermont is not particularly surprising considering Vermont is rural in nature and home to relatively few large companies. Indeed, Vermont is well known for its "mom and pop" type businesses that cater to visitors, a class of young entrepreneurs that make major contributions in the information and technology sector, and a number of small businesses in the professional and business services category.

Table 6 below shows employment by state by firm size category. The table shows that firms with less than 20 employees represents more than one third of all Vermont employment—a larger share than any other New England state. Note the table also shows that the more rural states of Vermont, Maine and New Hampshire in northern New England rank 1, 2, and 3 in the overall New England region in terms of the percentage of total state jobs found at businesses with less than 20 employees.

**Table 6: Small Firm Employment as a Percent of Private Jobs**

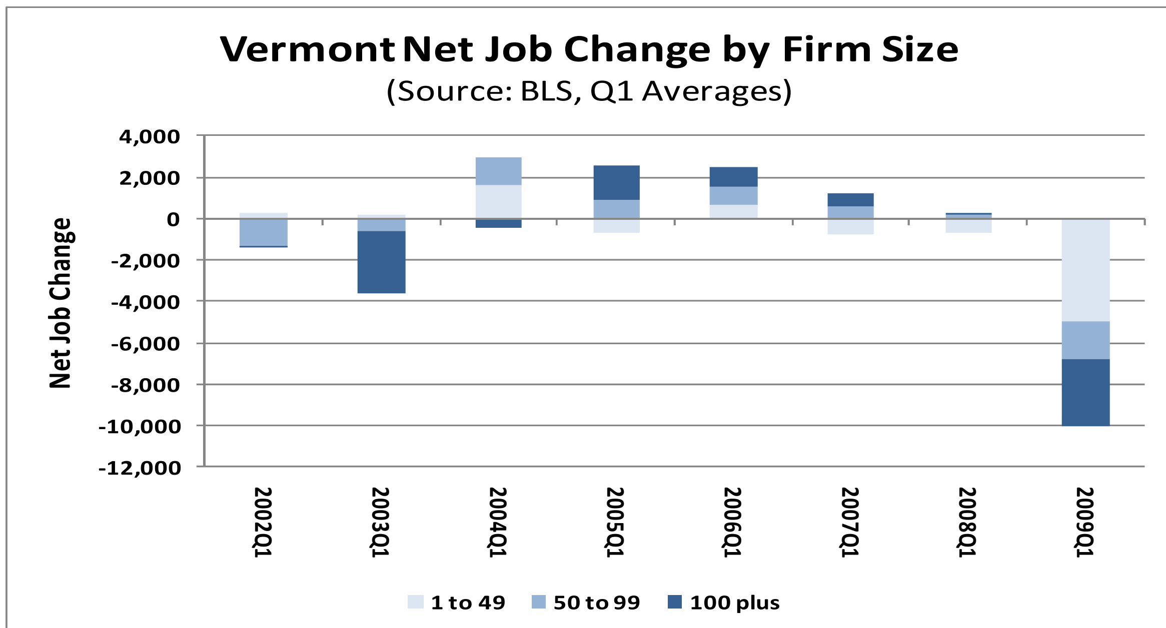
| | Jobs in Firms < 20 | Total Jobs | Percent of Total |
|---|---|---|---|
| VT | 85,078 | 239,711 | 35.5% |
| ME | 156,633 | 465,188 | 33.7% |
| NH | 164,682 | 513,176 | 32.1% |
| RI | 112,997 | 381,059 | 29.7% |
| CT | 380,879 | 1,367,865 | 27.8% |
| MA | 697,153 | 2,687,672 | 25.9% |

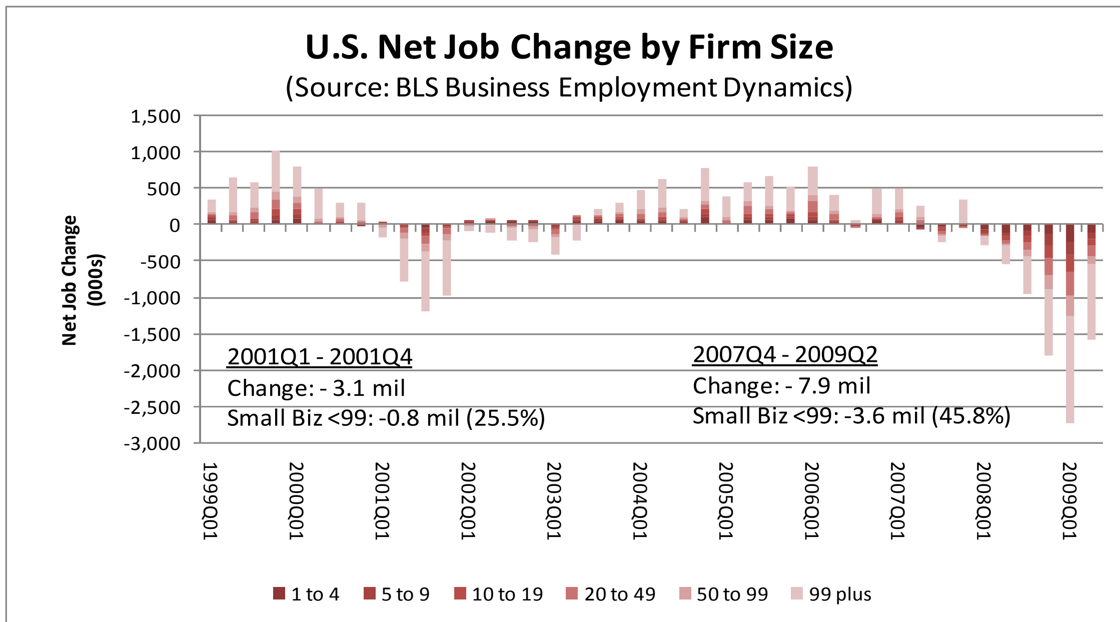
Source: U.S. BLS, 2009 First Quarter Average

As small firms in Vermont have navigated their way through the "Great Recession" some industries have fared better than others. The tourism and hospitality-related businesses appear to have fared relatively well as the industry was bolstered by increased regional tourism (e.g. the "Stay-cation" phenomenon?) and by significant numbers of Canadian visitors to Vermont. In the context of the "Great Recession" and volatile energy prices, some regional visitors (in the Boston, Montreal, and New York metro areas) likely chose to stay closer to home and visit a less expensive destination like Vermont, as opposed to other farther away and more expensive destinations. Canadians in particular continue to recreate and shop in Vermont, as they have enjoyed relatively low prices, lower sales taxes, and greater purchasing power with a relatively weak U.S. dollar. On the other hand, small firms and independent contractors in the construction industry have been severely negatively impacted as residential construction activity, particularly second home construction, has decreased significantly. Second home construction provided many Vermonters with employment during the construction boom of the early 2000s, and this source of employment all but dried up during the economic downturn except for some energy efficiency-conservation

activity. Although some early signs of improvement have been noted in the construction sector (e.g. building permits), construction activity remains at very low levels around the state.

Overall, small firms in Vermont have been faced with challenges similar to those at the national and New England regional levels: rising costs, difficulty obtaining credit (despite the best efforts of regulators and lenders), and most importantly, reduced demand for their goods and services. With these challenges, many small firms have been unable to maintain payroll levels and they have contributed to a significant degree in terms of the state's job losses. The chart below shows the net job change in Vermont by firm size from 2002 to 2009. From 2007 to 2009, using first quarter averages, Vermont saw a 10,454 total job decline, of which 7,289 jobs or a 69.7% share of total job losses came in firms with less than 100 employees. While this share mirrors the U.S. in that the small business category was the category with the largest job declines, the small business share of Vermont's job loss was significantly higher than the U.S. average (at 45.8% of the total). These results appear to indicate that the small business recession in Vermont was harsher than that on the U.S. level. This is intuitively logical given the leading and harsh role played by the small business-dominated Construction sector which was hit especially hard during the last downturn.






As the recovery takes shape, the business climate in the state appears to be improving and demand is starting to return—even if only slowly. Many small firms are still struggling to maintain adequate sales levels, and others who want to expand report they are having difficulty doing so because they have been unable to access affordable credit in an environment of increasingly tightening credit standards. Since much of the job recovery and subsequent expansion is likely to come from small businesses, the shape and pace of the recovery in Vermont will depend to a significant degree on how well these small businesses are able to get back on their feet and re-establish themselves as job generators.

Efforts in the state have been made to ensure credit is flowing to small firms, including an initiative by Vermont's Senator Leahy that could be described as "credit fair." The event was held in April and brought together more than 20 local lenders in the state and more than 100 businesses potentially seeking credit. The Vermont Economic Development Authority (VEDA), a source for low interest business loans, is also active and recently approved $6.1 million for projects across the state, including: (1) the expansions of industrial parks in Brattleboro and St. Albans, (2) the expansion of the Vermont Wood Pellet Company in Clarendon, VT, (3) the retention and continued operation of a bed and breakfast in Cavendish, VT, (4) an expansion and land improvement project at the Sugarbush Resort, (5) $1.7 million in financing directed toward Vermont farmers, and (6) more than $0.5 million in loans directed specifically for small business activities. All of this comes on the heels of the significant expansion recently completed at the Jay Peak Resort in the state's Northeast Kingdom made in conjunction with its effective utilization of the EB-5 Immigrant Investor Program.

One important part of the state's small business infrastructure that continues to struggle is the state's dairy farmers. For the past several years, the state's dairy operations have been facing serious challenges brought on by low milk prices, relatively high feed prices, persistently high energy prices, and difficulty accessing credit. Last year in particular, many operations consumed significant portions of their balance sheets to make ends meet. This year, many operations are struggling find the resources to plant their crops. The number of dairy farms in the state has declined from more than 11,000 in 1950 and 2,000 in 1995, to roughly 1,100 commercial operations at present. The State's Agriculture Secretary recently estimated that as many as 200

more dairy farms could go out of business by the end of 2010 if the significant problems faced by many operations are not addressed. The issue of Vermont's declining dairy farms, nearly all of which are small operations, is not a new one. However, their plight has been severely exacerbated by the impacts and residual effects of "Great Recession."

Among the state's small businesses, several notable businesses are reportedly doing well and some even expanding. Green Mountain Coffee Roasters, Inc. currently employs more than 1,000 people and the company, needing more space, plans to expand operations from its central Vermont location in Waterbury to Williston, closer to the only major metro area of Burlington. The website developer Dealer.com has released its plan to double the work force and expand the company's operations, which should mean roughly another 100 jobs in the Burlington area. The company has planned the growth over a three year period and had considered moving the bulk of the operations to California, but was convinced to stay in Vermont by an authorization of $3.5 million in incentives by the Vermont Economic Progress Council. Resolution Inc, an eyewear manufacturer located in Williston, has won recent military contracts ensuring continued operations and job retention in the region.

**b. Conclusions on Vermont Small Businesses:** As in the New England region overall, but especially for the more rural states, small businesses play a critical role in Vermont's economy. Without significant numbers of large companies and major metropolitan areas, small businesses provide employment and income for many residents. However, small businesses usually do not have much product diversification which limits their ability to offset losses in one area of the business with gains in other areas. As demand dried up over the course of the recent economic downturn, small businesses in Vermont have been especially challenged to maintain sales levels and cover costs, let alone earn a sustaining level of return.

As labor costs represent a significant portion of total costs, reducing payroll levels can be the most effective option for employers to cut costs in the short term. Clearly, in Vermont job losses in small firms accounted for a substantial portion of total job losses. As the recovery takes shape, even if only at a snail's pace, demand for the goods and services of small businesses should pick up and encourage employers to add to payrolls. Expansion usually requires access to credit, which is still tight in Vermont—as it is elsewhere. Under the pressure of regulators in the aftermath of the financial system meltdown, lenders are reportedly requiring more documentation and more equity in the business. This has not always been the case for small business lending, and can be especially difficult for small enterprises to develop on their own. If small businesses are to play an important role adding back Vermont jobs, these obstacles will need to be addressed so that small businesses will take a more supportive, if not leading role, as factor facilitating the state's economic and labor market recovery, which is already expected to be restrained by historical standards.

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