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CAPITAL DEBT AFFORDABILITY ADVISORY COMMITTEE

State of

Vermont

RECOMMENDED ANNUAL GENERAL OBLIGATION DEBT AUTHORIZATION

September 2006

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INTRODUCTION

We are pleased to present this report to the Capital Debt Affordability Advisory Committee of the State of Vermont (the "Committee" or "CDAAC"). As in prior years, this analysis is intended to assist the Committee in determining the maximum amount of long-term, general obligation debt ("G.O. debt") that the State should authorize for the upcoming fiscal year (ending June 30, 2008).

The Committee's enabling legislation requires the Committee to present to the Governor and the General Assembly each year, no later than September 30, a recommendation as to the maximum amount of G.O. debt the State should authorize for the forthcoming fiscal year, consistent with certain guidelines enumerated in the statute. This report provides the supporting analysis and documentation necessary for the Committee to comply with the legislative requirements. As required by the enabling legislation, this analysis extends through fiscal year 2017.

In fiscal year 2006, $45 million of G.O. debt was issued (representing the full amount of that year's authorization) while $45.3 million of G.O. debt was retired. During fiscal 2004, the State sold $48 million General Obligation Revenue Anticipation Notes ("RANs"), which were repaid on March 5, 2004. However, there were no RANs sold by the State during fiscal years 2005 and 2006. As the RANs are considered self-supporting debt (and are excluded from "net tax-supported debt" by the rating agencies), they would not, as a general matter, be included in this report. It is expected that during FY 2007, a total of $45 million of general obligation bonds will also be issued, representing the full amount of the year's authorization. This year's report presents an analysis of the recommended level of G.O. debt issuance for FY 2008 of $49.2 million. The reasons for CDAAC's recommendation of $49.2 million are set forth below under "Reasons for Fiscal 2008 Recommended Authorization."

According to Moody's Investors Service's most recent information, the State's relative position, among states, improved with respect to both net tax-supported debt as a percent of personal income (i.e., from 27th in 2005 to 28th in 2006) and net tax-supported debt per capita (i.e., from 25th in 2005 to 29th in 2006).

In September 2004, the Committee adopted new 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. The new set of guidelines reflected (i) the significant improvement that the State had achieved in its debt load position and (ii) the commitment of the State to work toward the achievement of a triple-A investment grade rating.

Moody's Credit Scorecard

In August, 2006, Moody's Investors Service issued a new report entitled, "U.S. States Credit Scorecard." This report has been included as an appendix to this document. It is being included for the reason that Moody's has identified the scorecard "as an additional analytic tool to enhance the consistency of our state general obligation (G.O.) credit analysis." As part of the Moody's report, the rating agency places each of the 50 states within one of five tiers for the four major rating categories germane to a Moody's rating: finance, economy, debt, and governance. It should be emphasized that, according to this Moody's report, Vermont ranks in the top tier (top ten states) for three of the four major rating categories: finance, economy and debt. Vermont and Delaware are the only two states ranked in the top tier for three or more categories. As indicated elsewhere in this affordability study, the State is attempting to achieve a triple-A rating. The results of the scorecard illustrate that Vermont is well on its way toward achieving this goal - at least with respect to Moody's. It should be noted, however, that in the governance category, Vermont is ranked in the third tier, largely as a result, according to the rating agency, of the State's past financial reporting problems, which have now been corrected; Moody's has indicated that there is a lag effect with respect to the scorecard incorporating the correction. In addition, Moody's has indicated that it expects Vermont's position in the governance category to improve in the near future.

Reasons For Fiscal 2008 Recommended Authorization

As stated above, CDAAC is proposing that the maximum amount of long-term GO debt authorized for the State in fiscal 2008 be $49.2 million. The rationale for this recommendation is presented below:

1. The fiscal 2005 recommended authorization rose by over 5% from $39 million to $41 million, and the fiscal 2006 recommended authorization increased the 2005 authorization by nearly 10% to $45 million for an increase of over 15% in two years. The FY 2007 recommended authorization remained at the 2006 level. In percentage terms, the 15% growth from 2004-2007 is relatively large, and an additional $4.2 million increase for fiscal 2008 reflects a 26% increase over the period 2004-2008.

2. Nonetheless, CDAAC believes that the fiscal 2008 recommended authorization is consistent with its policy of trying to provide important capital contributions to the State’s physical infrastructure requirements within a framework of acceptable debt affordability. Over the last four years, including fiscal 2008, CDAAC has recommended a sizeable amount of new capital funding for Vermont – that is, an additional $24.2 million of proceeds in aggregate from the sale of general obligation debt toward the State’s capital improvement program.

3. At present, the State is in compliance with all of its guidelines with the exception of the 5-year median debt per capita for triple A-rated states. However, based on current projections, the $49.2 million debt authorization amount is expected to allow the State to be in line with all debt guidelines within the near future, possibly as early as 2007. Higher amounts would delay this occurrence.

4. CDAAC also has some concerns about the economic and financial uncertainties affecting the country near-term. With volatile oil prices, Federal deficits and uneven economic trends, the economic and financial outlook of the State and the country is now somewhat more unsure; as a result, CDAAC believes it is a more prudent course of action for the State at present to continue to be modest with respect to new authorizations of future State indebtedness.

This year's report is organized into seven sections. **Section 1** presents the State's key existing debt statistics. **Section 2** consists of economic and financial forecasts. **Section 3** discusses the State's recent authorization history and sets forth the effect of the issuance of $45 million in fiscal year 2007 and $49.2 million annually thereafter on future outstanding debt and debt service requirements. **Section 4** includes a history of the State's debt ratios and shows the projected effect of the Section 2 and 3 forecasts on the State's future debt ratios. **Section 5** summarizes the findings of the previous sections and offers considerations for the Committee in its determination of whether to revise the planned future fiscal year debt authorizations. **Section 6** documents relevant provisions of the enabling legislation and explains the methodology and assumptions behind certain projections included in this report. **Section 7** is composed of appendices, including rating agency reports and the "Vermont Economic Outlook" dated May 2006 published by the New England Economic Partnership ("NEEP").

We would like to express our gratitude to the State Treasurer's Office, the Department of Finance and Management, Economic and Policy Resources, Inc. ("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.

1. DEBT STATISTICS

Net Tax-Supported Debt Outstanding

The State's aggregate net tax-supported principal amount of debt decreased from $440.3 million as of June 30, 2005 to $440.0 million as of June 30, 2006, a decrease of 0.07%. Except for the fiscal year 2002, when a carry-forward amount of authorization was included in the debt issue, for each of the years during the period 1999-2006, the State retired more general obligation bonds than it sold, including the issuance of refunding debt.

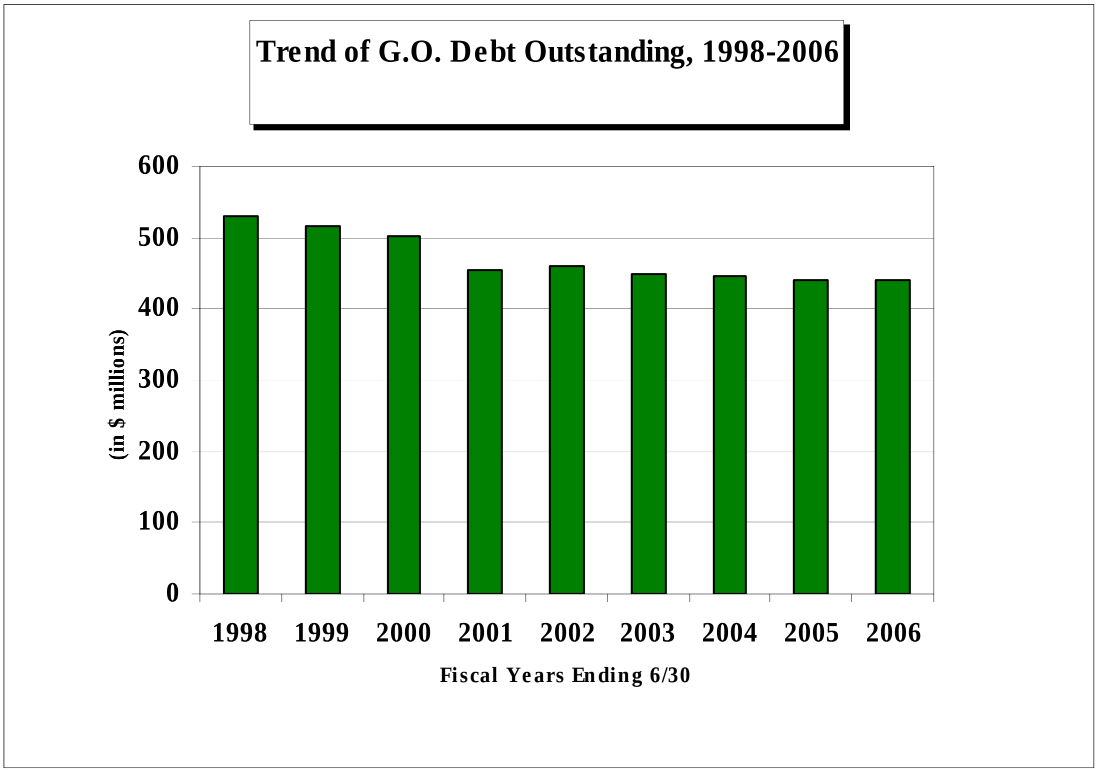
The table below sets forth the sources of the change in net tax-supported debt outstanding from 2005 to 2006 (in thousands):

Net Tax-Supported Debt as of 6/30/05	$440,266
G.O. New Money Bonds Issued	45,000
Less: Retired G.O. Bonds	(45,272)
Net Tax-Supported Debt as of 6/30/06	$439,994

Debt Statement
As of June 30, 2006 ($ Thousands)

General Obligation Bonds*:	
General Fund	415,861
Transportation Fund	12,128
Special Fund	12,005
Contingent Liabilities:	
VEDA Mortgage Insurance Program	9,049
VEDA Financial Access Program	917
Reserve Fund Commitments:	
Vermont Municipal Bond Bank	471,485
Vermont Housing Finance Agency	95,205
VEDA Indebtedness	70,000
Gross Direct and Contingent Debt	1,086,650
Less:	
Contingent Liabilities	(9,966)
Reserve Fund Commitments	(636,690)
Net Tax-Supported Debt	**439,994**

* Includes original principal amounts of Capital Appreciation Bonds.



G.O. DEBT OUTSTANDING, 1998-2006
(As of June 30, in $ millions)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
TOTAL	528.6	517.3	503.9	454.9	460.5	448.2	444.7	440.3	440.0

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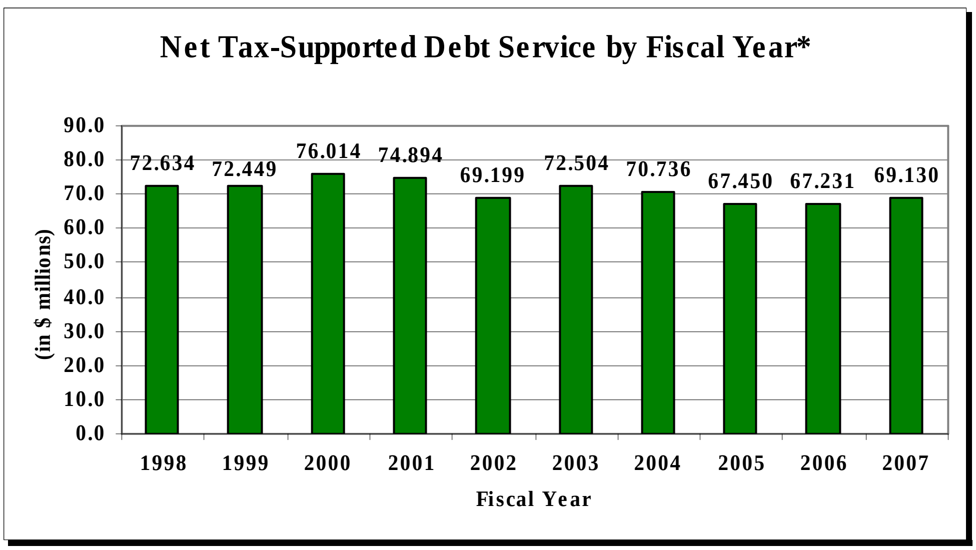
Net Tax-Supported Debt Service by Fiscal Year

- The State's net tax-supported fiscal year debt service requirement for fiscal year 2007 will be $69.13 million, 2.83% more than the $67.23 million paid in fiscal year 2006. This increase comes after a 0.3% decrease in 2006, a 4.6% decrease in 2005, a 2.4% decrease in 2004, a 4.8% increase in 2003, a 7.6% decrease in 2002, a 1.5% decrease in fiscal year 2001 and a 4.9% increase in fiscal 2000.

Net Tax-Supported Debt Service Paid in FY 2006	$67,231
Decrease in Annual D/S Requirement FY 2006-2007	(2,422)
D/S Increase Due to G.O. Debt Issued in FY 2006	4,321
Net Tax-Supported Debt Service Due in FY 2007	$69,130



**Consists of General Obligation Bonds.*

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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, 2006 without the issuance of any additional G.O. debt. Please refer to the table on page 12 for the State's projected principal amounts outstanding and annual debt service requirements assuming the issuance of $45 million G.O. debt during FY 2007 and $49.2 million annually thereafter through and including FY 2017.

FUTURE GENERAL OBLIGATION NET TAX-SUPPORTED DEBT
As of June 30, 2006
(in $ thousands)

	GENERAL OBLIGATION BONDS							
	GENERAL FUND		TRANSP. FUND		SPECIAL FUND		STATE DIRECT DEBT	
Fiscal Year	Beginning Principal Outstanding	Debt Service	Beginning Principal Outstanding	Debt Service	Beginning Principal Outstanding	Debt Service	Beginning Principal Outstanding	Debt Service
2007	415,861	64,547	12,128	2,088	12,005	2,495	439,994	69,130
2008	373,198	61,207	10,594	1,995	10,105	2,496	393,897	65,698
2009	332,274	58,980	9,088	1,912	8,120	2,496	349,482	63,388
2010	292,149	54,375	7,594	1,795	6,030	2,500	305,773	58,670
2011	255,025	50,383	6,146	1,728	3,825	1,026	264,996	53,138
2012	220,538	44,475	4,695	1,642	2,985	626	228,218	46,743
2013	187,501	38,377	3,259	790	2,505	628	193,265	39,795
2014	158,310	37,230	2,605	760	2,000	629	162,915	38,619
2015	129,252	27,231	1,953	472	1,470	633	132,675	28,336
2016	107,542	23,173	1,563	356	910	636	110,015	24,165
2017	88,938	19,515	1,272	343	320	336	90,530	20,195

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2. ECONOMIC AND FINANCIAL FORECASTS

This section of the report is based on the economic analysis provided by NEEP for the State of Vermont. NEEP's report, "Vermont Economic Outlook," dated May 2006 (a copy of which is included in the Appendices), states that "the current up-cycle for the Vermont economy will endure through calendar year 2010, traversing through an expected modest sub-cycle in calendar 2007 and into early 2008," reflecting lower levels of output, growth in jobs, and income than the projected U.S. average growth rates – but generally higher than the projected New England regional averages.

According to the May 2006 NEEP Report:

1) During the economic forecast period through 2010, the State's rate of payroll job growth is projected to be 1.0% per year, inflation-adjusted personal income growth is projected at 1.9%, and inflation-adjusted output growth is projected to be 3.1% per year. These categories "are expected to remain historically restrained and uneven for this point in the business cycle."

2) On a sector-by-sector basis, six of eight major categories have moved from recovery to expansion. Only the manufacturing sector is expected to lose some jobs at -0.3% per year over the forecast period. Absent among the major job growth sectors is the construction sector with an expected gain rate of under 1.0% per year.

3) The highest rates of job growth are expected in the Professional and Business Services sector (at 2.1% per year), the Education and Health Services sector (at 2.0% par year), and the Leisure and Hospitality sector (at 1.8% per year) over the 2006-2010 forecast period.

4) Relatively high energy prices will continue to have a dragging effect on State's economy, adding costs in such energy-intensive sectors as resource-processing, chip fabrication, and food processing which are already in sharp global-wide cost competition.

5) The rate of housing price appreciation has slowed, but is still in the low double-digit rate range. The "inevitable correction [in housing prices] that is likely to occur within the next year to 18 months" remains a threat to the State's economic outlook – "if this correction is not orderly and manageable."

One of the most important factors restraining the growth of the economy, according to the NEEP report, is the recent increase in energy prices. "The challenge to Vermont's energy future is to find a way to meet its energy needs that is affordable, efficient, reliable, and minimizes environmental impacts."

As shown below, the EPR forecasts for Vermont indicate growth in revenues, population, personal income and estimated full valuation.

As shown in the table below, EPR's population estimate for 2006 is about 0.42% greater than its forecast for 2005, and its estimates of future population growth average about 0.57% annually from 2007 through 2017. Personal income increased 4.4% from 2005 to 2006 and is projected to achieve an average annual growth rate of 4.1% from 2007 through 2017. Estimated full valuation increased 4.6% from 2005 to 2006 and is projected to achieve an average annual growth rate of 3.2% from 2007 through 2017. 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)
2004	621.2	19.72	50,827
2005	623.1	20.65	53,034
2006	625.7	21.55	55,452
2007	629.9	22.58	57,287
2008	634.1	23.62	58,803
2009	638.3	24.65	60,595
2010	641.8	25.68	62,636
2011	645.3	26.50	64,954
2012	648.9	27.63	67,104
2013	652.4	28.76	69,590
2014	655.6	29.91	71,702
2015	658.9	31.11	73,798
2016	662.3	32.34	75,934
2017	665.7	33.60	78,087

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

As shown in the table on the following page, total revenue for fiscal year 2006 is $72.50 million more than in 2005, an increase of 5.8%. Fiscal year 2007 revenue growth is forecast at 2.2%, and the average annual revenue growth rate during the period 2007 through 2017 is expected to be approximately 3.8%.

Current and Projected Revenues (2)

Fiscal Year	General Fund (in $ millions)	Transportation Fund (in $ millions)	Total Revenue (in $ millions)
2005	1,035.3	209.1	1,244.4
2006	1,107.1	209.8	1,316.9
2007	1,122.7	223.4	1,346.1
2008	1,135.3	232.4	1,367.7
2009	1,181.6	237.2	1,418.8
2010	1,234.2	245.3	1,479.5
2011	1,298.2	251.3	1,549.5
2012	1,364.4	260.0	1,624.4
2013	1,432.6	265.9	1,698.5
2014	1,496.7	275.5	1,772.2
2015	1,558.6	283.2	1,841.8
2016	1,620.2	293.4	1,913.6
2017	1,684.4	300.8	1,985.2

(2) Amounts for FY 2007-2017 are "current law" revenue forecasts based on a consensus between the State's administration and legislature.

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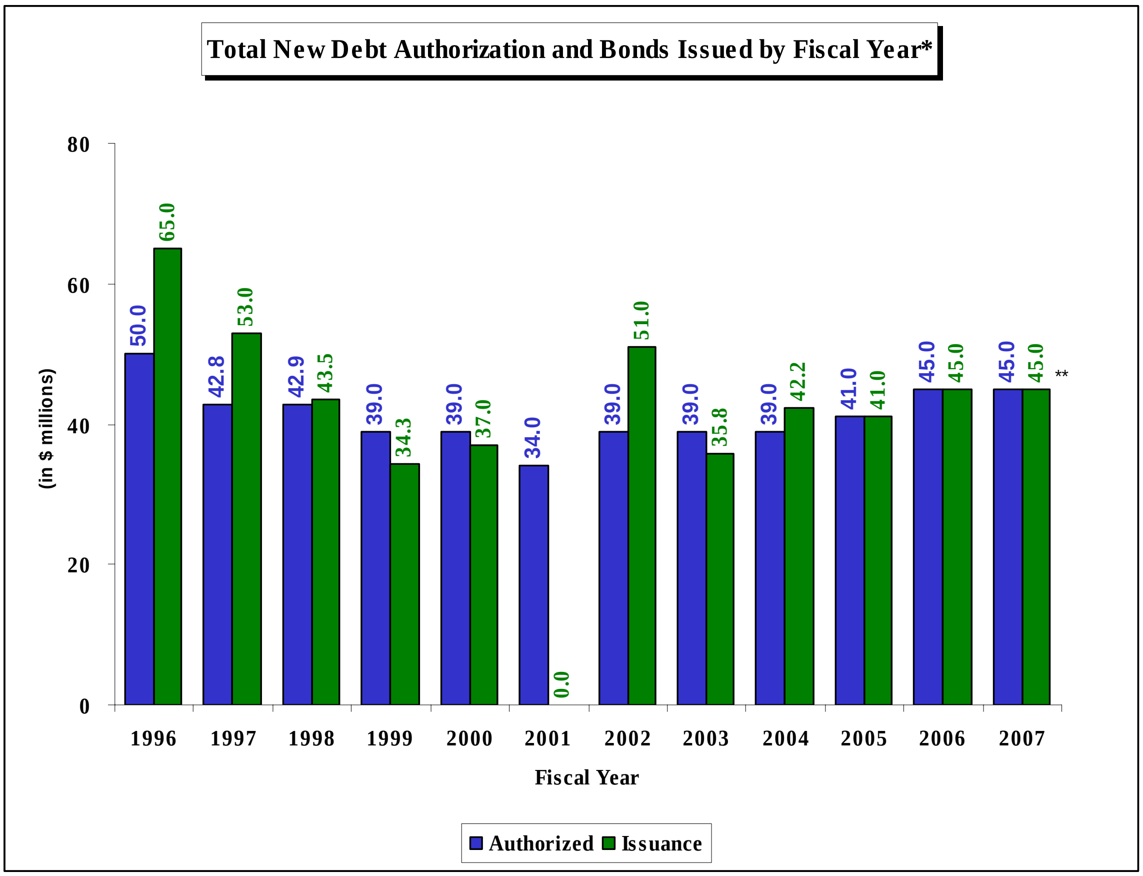
3. DEBT AUTHORIZATIONS AND PROJECTION SCENARIOS

Recent Debt Authorizations

During fiscal year 2004, $42.2 million of debt was sold, representing the full amount of that year's authorization ($39 million) plus the carry forward of the authorized but unissued amount from fiscal year 2003 ($3.2 million). During fiscal years 2005 and 2006, $41 million and $45 million of debt, respectively, were sold, representing the full amount of those years' authorizations. During fiscal year 2007, $45 million of debt is expected to be sold, the total amount of the 2007 authorization. We believe this trend in which the State has annually extinguished all or nearly all 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 of Vermont since 1996.



** Authorized but unissued debt has been carried forward and employed in subsequent years' bond issuances. Note: It should be emphasized that a sizeable amount of the $34 million authorization in 2001 was paid down through pay-as-you-go funding and the use of surplus funds.*
*** Anticipated to be issued.*

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 page and summarized below. The projected debt service (at 6% interest rate) assumes the issuance of $45 million in G.O. debt during fiscal year 2007 and $49.2 million annually thereafter through fiscal year 2017.

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

Fiscal Year	G.O. Debt Service
2006	67,231
2007	69,130
2008	70,768
2009	73,858
2010	74,384
2011	73,941
2012	72,480
2013	70,310
2014	73,757
2015	67,942
2016	68,082
2017	68,268

Fiscal Year Ending	G.O. Bonds Outstanding
6/30/2006	439,994
6/30/2007	438,897
6/30/2008	441,312
6/30/2009	441,843
6/30/2010	442,716
6/30/2011	444,998
6/30/2012	446,515
6/30/2013	450,045
6/30/2014	451,095
6/30/2015	457,135
6/30/2016	463,760
6/30/2017	470,945

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EXISTING AND PROJECTED NET TAX-SUPPORTED G.O. DEBT SERVICE ($000)													
		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
	Current	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Est.
FY	D/S	$45MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	D/S
2007	69,130												69,130
2008	65,698	5,070											70,768
2009	63,388	4,928	5,542										73,858
2010	58,670	4,786	5,387	5,542									74,384
2011	53,138	4,643	5,231	5,387	5,542								73,941
2012	46,743	4,501	5,076	5,231	5,387	5,542							72,480
2013	39,795	4,359	4,920	5,076	5,231	5,387	5,542						70,310
2014	38,619	4,217	4,765	4,920	5,076	5,231	5,387	5,542					73,757
2015	28,336	4,075	4,610	4,765	4,920	5,076	5,231	5,387	5,542				67,942
2016	24,165	3,932	4,454	4,610	4,765	4,920	5,076	5,231	5,387	5,542			68,082
2017	20,195	3,790	4,299	4,454	4,610	4,765	4,920	5,076	5,231	5,387	5,542		68,268

EXISTING AND PROJECTED NET TAX-SUPPORTED G.O. BOND PRINCIPAL PAYMENTS ($000)													
		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
	Current	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Est.
FY	Principal	$45MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	Principal
2007	46,097												46,097
2008	44,415	2,370											46,785
2009	43,709	2,370	2,590										48,669
2010	40,777	2,370	2,590	2,590									48,327
2011	36,778	2,370	2,590	2,590	2,590								46,918
2012	34,953	2,370	2,590	2,590	2,590	2,590							47,683
2013	30,350	2,370	2,590	2,590	2,590	2,590	2,590						45,670
2014	30,240	2,370	2,590	2,590	2,590	2,590	2,590	2,590					48,150
2015	22,660	2,370	2,590	2,590	2,590	2,590	2,590	2,590	2,590				43,160
2016	19,485	2,370	2,590	2,590	2,590	2,590	2,590	2,590	2,590	2,590			42,575
2017	16,335	2,370	2,590	2,590	2,590	2,590	2,590	2,590	2,590	2,590	2,590		42,015

EXISTING AND PROJECTED NET TAX-SUPPORTED G.O. BONDS OUTSTANDING ($000)													
		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
	Current	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Issue	Est.
FY	Debt	$45MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	49.2MM	Debt
2006	439,994												439,994
2007	393,897	45,000											438,897
2008	349,482	42,630	49,200										441,312
2009	305,773	40,260	46,610	49,200									441,843
2010	264,996	37,890	44,020	46,610	49,200								442,716
2011	228,218	35,520	41,430	44,020	46,610	49,200							444,998
2012	193,265	33,150	38,840	41,430	44,020	46,610	49,200						446,515
2013	162,915	30,780	36,250	38,840	41,430	44,020	46,610	49,200					450,045
2014	132,675	28,410	33,660	36,250	38,840	41,430	44,020	46,610	49,200				451,095
2015	110,015	26,040	31,070	33,660	36,250	38,840	41,430	44,020	46,610	49,200			457,135
2016	90,530	23,670	28,480	31,070	33,660	36,250	38,840	41,430	44,020	46,610	49,200		463,760
2017	74,195	21,300	25,890	28,480	31,070	33,660	36,250	38,840	41,430	44,020	46,610	49,200	470,945

4. DEBT RATIOS

G.O. Debt Guidelines

In the last several years, the State's investment grade ratings have significantly improved; at present, the State is, on a composite basis, the highest rated state in New England with high double-A ratings from all three nationally recognized credit rating agencies. The State is currently pursuing a strategy to achieve a triple-A rating in the near future and has employed its debt load guidelines to assist the State achieve this goal.

It is important to recognize that there are numerous advantages to the State in being assigned to a triple-A rating. First, it will reduce the State's own borrowing costs. Second, those entities that rely on the State's moral obligation, contingent liability pledge, such as the Vermont Municipal Bond Bank, the Vermont Housing Finance Agency, and the Vermont Economic Development Authority, should see their own relative cost of capital improve with a triple-A rating for Vermont. Third, CDAAC believes that the State's economic development efforts will be enhanced as a result of a triple-A rating; companies are more favorably inclined to locate or expand in a state that has managed its debt and financial affairs well enough to acquire the coveted triple-A rating, and such companies anticipate greater stability from a triple-A rated state than one which is rated below that level.

Therefore, CDAAC has adopted guidelines that are consistent with a triple-A rated state. As such, there are four guidelines that are followed by CDAAC in the development of the proposed general obligation bond authorization. First, the State will be guided annually by its ability to meet the 5-year average for the mean in per capita debt load for triple-A states. Second, the State should be able annually to meet the 5-year median of triple-A states in per capita debt load. Third, the State should be able to meet annually the 5-year average for the mean of debt as a percent of personal income for triple-A states. Fourth, the state will be guided annually by its ability to meet the 5-year median for triple-A states of debt as a percent of personal income At present and assuming implementation of the 2008 proposed general obligation authorization amount, the State is able to meet three of the four standards for both debt per capita and debt as a percent of personal income. Vermont, at present, is not able to meet the 5-year median debt per capita for triple-A rated states. It is our expectation that the spread between the triple-A 5-year median and Vermont's performance with respect to debt per capita should close over time; until such time as that happens, the median related to debt per capita will remain a goal. It should be noted that at the time of the establishment of the previous guidelines in the early 1990s, the State was not able to meet those guidelines, and it took several years before the State was in compliance with them. In addition, CDAAC has adopted the guideline of limiting annual general obligation debt service to no more than 6% of operating revenues, consisting of the annual aggregate of General and Transportation Funds. At present and based on the 2008 proposed general obligation authorization amount, the State will be in compliance with the 6% guideline for the foreseeable future. Please see the accompanying charts to evaluate the State's current and anticipated position with respect to the CDAAC guidelines.

This section discusses the impact of the proposed issuance of $45 million of G.O. debt during FY 2007 and $49.2 million of G.O. debt annually during FY 2008-2017 on the State's key debt ratios. Please refer to the "Historical and Projected Debt Ratios" on page 20 for the statistical detail described below.

Debt Per Capita

The Committee has adopted a guideline for the State to equal or perform better than the 5-year average for the mean and 5-year median of triple-A rated states on the basis of debt per capita. At present, the targets are $796 for the mean and $682 for the median. Based on data from Moody's Investors Service, Vermont's 2006 debt per capita figure of $707 is better than the 5-year average mean for triple-A rated states but is above the median. However, looking at 2006 figures alone for triple-A rated states, Vermont's relative comparison improves, although the State is still not able to match the median. Using the 5-year Moody's median for triple-A rated states ($682) and increasing it by 2.70% annually, combined with an assumption that the State will issue $49.2 million through 2017, it appears that Vermont will match the 5-year Moody's median for triple-A rated states in the near future, possibly as early as 2007 (see "Historical and Projected Debt Ratios"). It should be emphasized that the debt numbers for Vermont have been falling and stabilizing while those of the triple-A rated states, on a composite basis, have been rising – that explains the reason that the State should incrementally improve its relative position regarding debt per capita over time.

Debt as a Percent of Personal Income

The Committee has adopted a guideline for the State to equal or perform better than the 5-year average for the 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 2.6% for the mean and 2.5% for the median. Based on data from Moody's Investors Service, Vermont's 2006 debt as a percent of personal income figure of 2.2% is better than the 5-year average mean and 5-year median for triple-A rated states. Moreover, considering the 2006 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 $49.2 million through 2017, Vermont should continue to improve relative to the 5-year average of mean and 5-year median for triple-A rated states (see "Historical and Projected Debt Ratios").

Debt Service as a Percentage of Revenues[1]

This ratio, reflecting annual general obligation debt service as a percent of the annual aggregate General and Transportation Funds, is currently 5.2%. With the projected issuance of G.O. debt, this ratio is expected to decrease to 5.1% for the fiscal year ending June 30, 2007, increase to 5.2% for the next two fiscal years, and drop 0.01%-0.05% annually thereafter until 2017, at which time it is estimated to be 3.4%. As noted elsewhere herein, the State's newly adopted standard for this category is 6% of annual general obligation debt service as a percent of the annual aggregate General and Transportation Funds. At present and for the foreseeable future, it is anticipated that the State will continue to satisfy this standard by a considerable margin.

It should be noted that Moody's eliminated the state ranking system for debt burden calculated on the basis of net tax-supported debt service as a percentage of revenues. The last Moody's median was computed in 1996 at 3.5%. Nevertheless, the rating agencies compute this ratio for each state issuer annually to determine debt levels on an absolute basis and to evaluate the trend over time.

Debt to Full Valuation

We calculate the State's net tax-supported debt as a percent of its estimated full valuation to be 0.7% at the present time and will remain at this level for the fiscal year ending June 30, 2010. Thereafter, we project this ratio to decline to 0.6% in 2011 and remain at that level through 2017.

Moody's has also eliminated the state ranking system for net tax-supported debt calculated as a percentage of estimated full value.

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[1] *In this discussion, "Revenues" does not include any revenues associated with Act 60.*

STATE OF VERMONT
APPROACH TOWARD ESTABLISHING DEBT RATIO GOALS
Comparative Mean Debt Ratios*

Per Capita	2002	2003	2004	2005	2006
All States	$ 810	$ 838	$ 944	$ 999	$1,060
Triple-A**	724	735	823	831	868
VERMONT	**813**	**861**	**724**	**716**	**707**

% of Pers. Inc.	2002	2003	2004	2005	2006
All States	2.7%	2.7%	3.1%	3.2%	3.2%
Triple-A**	2.5	2.5	2.7	2.7	2.7
VERMONT	**3.0**	**3.0**	**2.5**	**2.3**	**2.2**

* Based on data provided by Moody's Investors Service and excluding Florida.
** Ten states currently rated triple-A by one or more of the nationally recognized rating agencies: Delaware, Florida (since 2005), Georgia, Maryland, Minnesota, Missouri, North Carolina, South Carolina, Utah and Virginia.

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STATE OF VERMONT
MOODY'S INVESTORS SERVICE
DEBT PER CAPITA

Triple-A Rated States	July, 2006 Ratings Moody's	S&P	Fitch	2002	2003	2004	2005	2006
Delaware	Aaa/Stable	AAA/Stable	AAA/Stable	$1,650	$1,599	$1,800	$1,865	$1,845
Florida	Aa1/Stable	AAA/Stable	AA+/Stable	______	______	______	______	976
Georgia	Aaa/Stable	AAA/Stable	AAA/Stable	804	802	827	803	784
Maryland	Aaa/Stable	AAA/Stable	AAA/Stable	879	977	1,077	1,064	1,169
Minnesota	Aa1/Stable	AAA/Stable	AAA/Stable	576	625	691	679	746
Missouri	Aaa/Stable	AAA/Stable	AAA/Stable	347	368	461	449	496
North Carolina	Aa1/Positive	AAA/Stable	AAA/Stable	375	429	556	682	804
South Carolina	Aaa/Negative	AA+/Stable	AAA/Stable	615	587	599	558	661
Utah	Aaa/Stable	AAA/Stable	AAA/Stable	708	682	846	792	707
Virginia	Aaa/Stable	AAA/Stable	AAA/Stable	566	546	546	589	601
MEAN	___________	___________	__________	**724**	**735**	**823**	**831**	**868[1]/879[2]**
MEDIAN	___________	___________	__________	**615**	**625**	**691**	**682**	**746[3]/765[4]**
Vermont	Aa1/Positive	AA+/Stable	AA+/Stable	813	861	724	716	707

Triple-A Rated States
5-Year Mean and Median Excluding Florida[5]:
MEAN: 796 Vermont: 764
MEDIAN: 682 Vermont: 724

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[1] Excluding Florida.
[2] Including Florida.
[3] Excluding Florida.
[4] Including Florida.
[5] Florida has not had a triple-A rating over the five-year period; it first received a triple-A rating from S&P in 2005.

STATE OF VERMONT
MOODY'S INVESTORS SERVICE
DEBT AS % OF PERSONAL INCOME

Triple-A Rated States	2002	2003	2004	2005	2006
Delaware	5.3%	5.0%	5.6%	5.5%	5.3%
Florida	______	______	______	______	3.2
Georgia	2.9	2.9	2.9	2.8	2.7
Maryland	2.6	2.8	3.0	2.9	3.0
Minnesota	1.8	1.9	2.0	2.0	2.1
Missouri	1.3	1.3	1.6	1.5	1.6
North Carolina	1.4	1.6	2.0	2.5	2.8
South Carolina	2.5	2.4	2.4	2.2	2.5
Utah	3.0	2.9	3.5	3.2	2.7
Virginia	1.8	1.7	1.7	1.8	1.7
MEAN	**2.5**	**2.5**	**2.7**	**2.7**	**2.7[1]/2.8[2]**
MEDIAN	**2.5**	**2.4**	**2.4**	**2.5**	**2.7[3]/2.7[4]**
Vermont	3.0	3.0	2.5	2.3	2.2

Triple-A Rated States

5-Year Mean and Median Excluding Florida[5]:
MEAN: 2.6% Vermont: 2.6%
MEDIAN: 2.5% Vermont: 2.5%

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[1] Excluding Florida.
[2] Including Florida.
[3] Excluding Florida.
[4] Including Florida.
[5] Florida has not had a triple-A rating over the five-year period; it first received a triple-A rating from S&P in 2005.

Government Finance Associates, Inc.

Historical and Projected Debt Ratios

Fiscal Year (ending 6/30)	Net Tax-Supported Debt Per Capita (in $): State of Vermont	Moody's Median	State's Rank [4]	Net Tax-Supported Debt as Percent of Personal Income: State of Vermont	Moody's Median	State's Rank [4]	Net Tax-Supported Debt as Percent of Estimated Full Valuation: State of Vermont [2]	Moody's Median	State's Rank [4]	Net Tax-Supported Debt Service as Percent of Revenues [5]: State of Vermont [2]	Moody's Median	State's Rank [4]
Actual [1]												
1995	914	409	9	4.7	2.1	9	1.5	1.1	17	6.6	3.4	8
1996	984	431	9	4.9	2.1	8	1.6	1.5	n.a.	7.2	3.5	8
1997	992	422	9	4.7	2.1	8	1.2	n.a.	n.a.	6.9	n.a.	n.a
1998	946	446	9	4.2	1.9	9	1.2	n.a.	n.a.	7.6	n.a.	n.a
1999	953	505	10	4.2	2.0	10	1.1	n.a.	n.a.	7.2	n.a.	n.a
2000	925	540	9	3.8	2.2	10	1.1	n.a.	n.a.	7.0	n.a.	n.a
2001	828	541	15	3.3	2.1	14	0.9	n.a.	n.a.	6.8	n.a.	n.a.
2002	813	573	18	3.0	2.3	14	0.9	n.a.	n.a.	6.5	n.a.	n.a.
2003	861	606	16	3.0	2.2	17	0.8	n.a.	n.a.	6.7	n.a.	n.a.
2004	724	701	24	2.5	2.4	25	0.8	n.a.	n.a.	6.0	n.a.	n.a.
2005	716	703	25	2.3	2.4	27	0.8	n.a.	n.a.	5.4	n.a.	n.a.
2006	707	754	29	2.2	2.5	28	0.7	n.a.	n.a.	5.1	n.a.	n.a.
Current [2] [3]	703	n.a.	n.a.	2.0	n.a.	n.a.	0.7	n.a.	n.a.	5.2	n.a.	n.a.
Projected (FYE 6/30) [3]		State Guideline			State Guideline						State Guideline	
2007	697	700		1.9	2.5		0.7			5.1	6.0	
2008	696	719		1.9	2.5		0.7			5.2	6.0	
2009	692	739		1.8	2.5		0.7			5.2	6.0	
2010	690	759		1.7	2.5		0.7			5.0	6.0	
2011	690	779		1.7	2.5		0.6			4.8	6.0	
2012	688	800		1.6	2.5		0.6			4.5	6.0	
2013	690	822		1.6	2.5		0.6			4.1	6.0	
2014	688	844		1.5	2.5		0.6			4.2	6.0	
2015	694	867		1.5	2.5		0.6			3.7	6.0	
2016	700	890		1.4	2.5		0.6			3.6	6.0	
2017	707	914		1.4	2.5		0.6			3.4	6.0	
5-Year Moody's Mean for Triple-A States		796			2.6			n.a.			n.a.	
5-Year Moody's Median for Triple-A States		682			2.5			n.a.			n.a.	

(1) Actual data for 1995 to 2006 were compiled by Moody's Investors Service.
(2) For years 1997-2006, calculated by Government Finance Associates, Inc.; for years 1995 and 1996, calculated by Moody's Investors Service.
(3) Projections assume the issuance of $45 million of G.O. debt during FY 2007 and $49.2 million annually thereafter through 2017.
(4) Rankings are in numerically descending order (i.e., from high to low debt).
(5) Revenues are adjusted beginning in fiscal year 1998 to exclude the effect of Act 60.

5. SUMMARY

The State's positive debt trends are highlighted as follows:

- The Committee adopted new debt authorization guidelines in order to compare Vermont's debt load performance against triple-A states. As a general matter, while the State's five year performance doesn't quite compare as well, the State's current debt position is more positive than the composite results for triple-A states, except for one standard. It is expected that the State will be able to comply with every one of its standards in the near future, possibly as early as 2007.

- The State's revenue surpluses in many previous years, resulting in the funding (often at full funding) of the State's budgetary stabilization funds for the General, Transportation, and Education Funds, contributed to significant pay-as-you-go and budgetary surplus amounts being employed for funding capital improvements.

- The State's practice of issuing debt with level annual principal installments has resulted in a favorable amortization rate. At roughly 81% within ten years, the State's bond payout ratio (rapidity of debt repayment) has been favorably received by the rating agencies and represents a debt management characteristic to be continued.

These developments have helped Vermont attain a series of incremental upgrades from Moody's Investors Service, Fitch Ratings, and Standard & Poor's, which currently rate the State Aa1, AA+ and AA+, respectively. Vermont is the highest rated state, on a composite basis, in New England. The State must continue to stabilize its debt position in order to preserve and, hopefully, further enhance its current ratings into the coveted triple-A category.

The State of Vermont experienced a slight decrease (i.e., improvement) in its relative debt position among all states for 2006, as determined by Moody's Investors Service, on the basis of net tax-supported debt as a percent of personal income (i.e., from 27th in 2005 to 28th in 2006). Vermont's position also improved, as determined by Moody's Investors Service, with respect to net tax-supported debt per capita (i.e., from 25th in 2005 to 29th in 2006).

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6. 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, general obligation debt that the State may prudently issue for the ensuing fiscal year. At the discretion of the Committee, such recommendation may include guidelines and other matters that may be relevant to the additional debt to be authorized. The deadline for the Committee's annual recommendation is September 30th. In making its recommendation, it is the Committee's responsibility to consider the following provisions of the enabling legislation:

SUBPARAGRAPH (1):

The amount of state general obligation bonds 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 general obligation 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 general obligation 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 general obligation 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 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 real (through a payment or a replenishment obligation being made), then such debt or guarantee is not included in the State's debt statement. Similarly, to the extent that the State has not been called upon to pay for the debt components, as envisioned in Subparagraph (5), then those items should not become quantifiable factors included in the affordability analysis.

- Contingent or Limited Liability Obligations (all figures as of June 30, 2006):

1. VEDA Mortgage Insurance Program: The State had a contingent liability of $9.05 million with respect to this Program.

2. VEDA Financial Access Program: The State had a contingent liability of $0.9 million with respect to this Program.

- Reserve Fund Commitments (all figures as of June 30, 2006):

1. Vermont Municipal Bond Bank: The Bank had $471.5 million of debt outstanding secured by reserve fund commitments from the State. 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, the State has not been required to appropriate money to the reserve fund for this program.

2. Vermont Housing Finance Agency ("HFA"): The State HFA had $95.2 million of debt outstanding secured by reserve fund commitments from the State. It has not been necessary for the State to appropriate money to maintain the reserve fund.

3. It should also be noted that the State has authorized the VEDA to incur indebtedness in an amount of $70 million secured by the State's reserve fund commitment and an additional amount of "full faith and credit" guarantees for other VEDA program purposes. However, based upon VEDA's historical performance and the quality of the loans it has provided and expects to provide, it is not anticipated that these State commitments will produce any direct liability on the State's debt burden.

- 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 of 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 economic conditions and outlook for the state.

SUBPARAGRAPH (7):

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 also used by the rating agencies for determining the amount of debt 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 predictability of these indices would become less certain. Similarly, if the State were to incur serious deficits or face a significantly 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 should be emphasized that the rating agencies, in the development of the various comparative debt ratios that are applied and reviewed in the rating of State debt obligations, also do not predict the impact of unexpected financial fortunes that can befall governmental borrowers. 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 continue 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, we have made realistic and conservative assumptions, consistent with the past. For example, for anticipated debt issuances, we have assumed that future interest rates on State G.O. indebtedness will average approximately 6.00%; this rate is more than 150 basis points above current rates and well above recently experienced interest rates on State issues.

At the same time, we have assumed that the State will maintain its current ratings: "Aa1" from Moody's, "AA+" from S&P, and "AA+" from Fitch. Of course, a negative change in the State's ratings in the future would 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, general obligation debt that the State can annually afford to issue.

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7. APPENDICES

A. 2006 State Debt Medians (Moody's Investors Service)

B. Fitch Ratings Credit Report

C. Moody's Investors Service Credit Report

D. Moody's U.S. States Credit Scorecard

E. Standard & Poor's Credit Report

F. Vermont Economic Outlook (New England Economic Partnership)

Special Comment

April 2006

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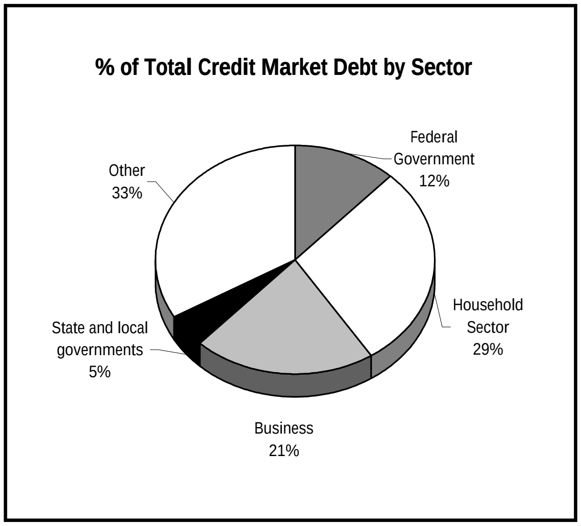
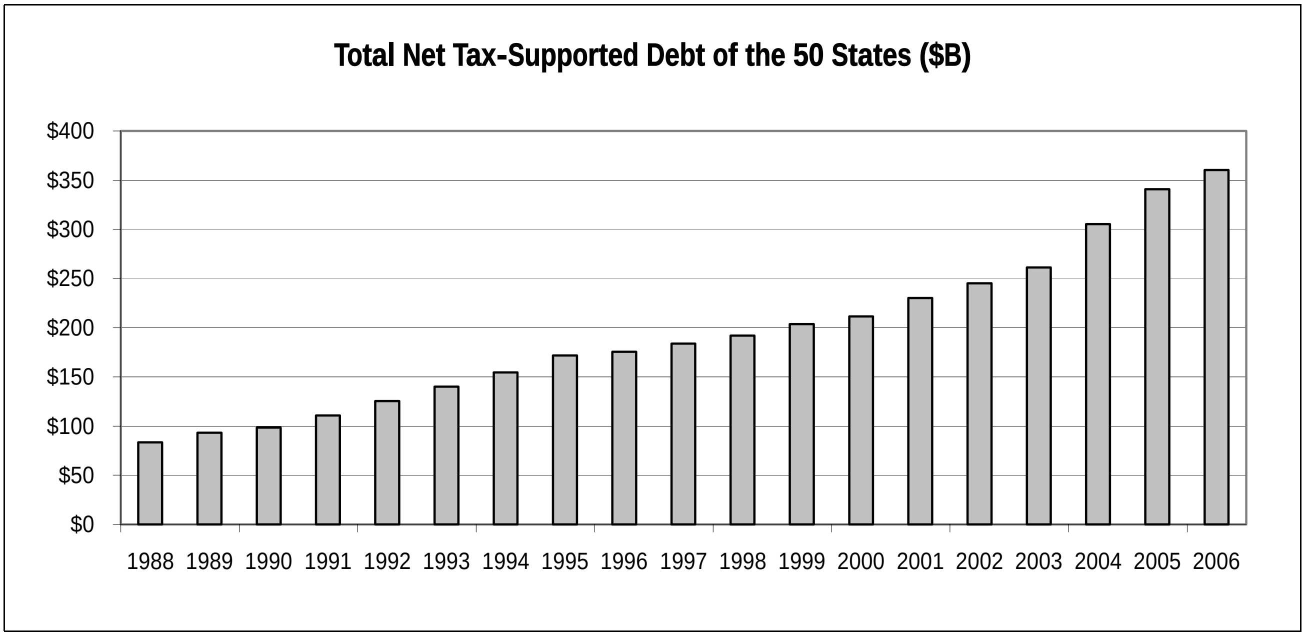
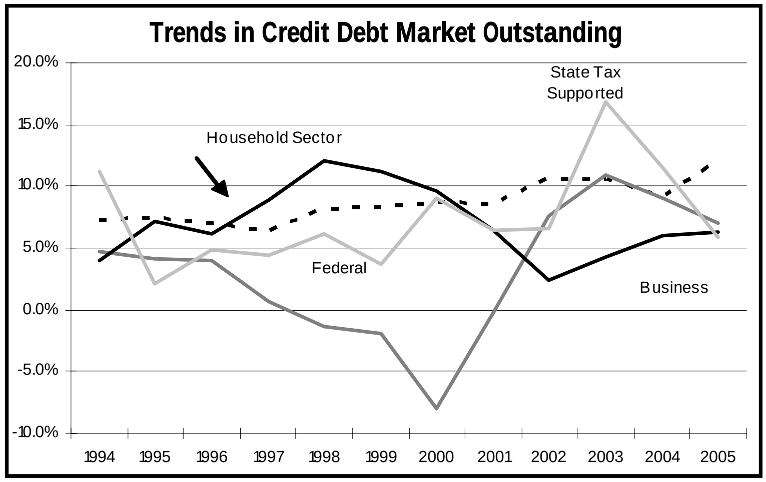
2006 State Debt Medians

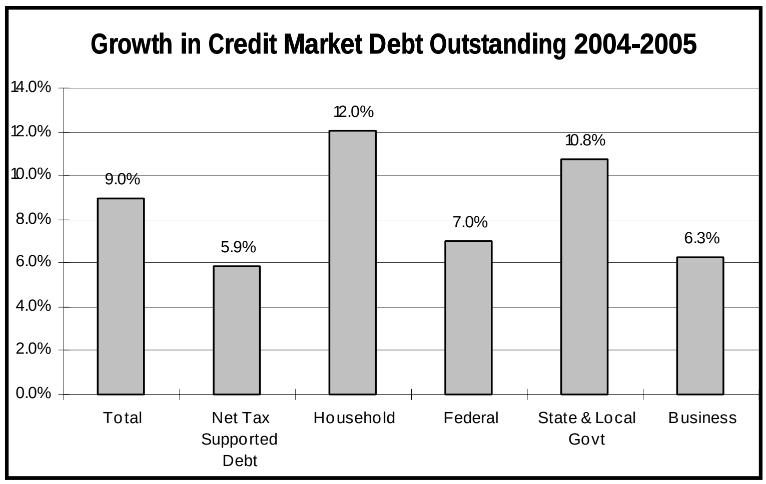
Moody's annually presents an analysis of state debt medians. This special comment examines the condition of net state tax-supported debt as of the end of calendar year 2005. The medians are based on two measures of state debt burden: debt per capita and debt as a percentage of personal income. These two measures reflect an examination of long-term obligations issued by the states and supported by their tax bases, and are the debt burden measures used most commonly by municipal analysts. While debt burden is among many factors that Moody's uses to determine credit ratings, it plays an important role in our determination of credit quality. We also consider gross debt, which is a measure that includes contingent debt liabilities that may not have a direct tax cost but that are included in state audited financial statements. (For a detailed discussion of the measure of gross debt, see Moody's 2001 State Debt Medians report.)





Net-Tax Supported Debt Grows More Slowly in 2005





State net-tax supported debt increased by 5.7% in 2005, to a total of $360.3 billion. While significantly slower than the previous two years, the growth is relative to a larger base: in 2003 and 2004 net-tax supported debt increased by 16.8% and 11.7%, respectively. Since 1988, the long-term average annual growth rate is 8.5%.

Low interest rates have allowed states to continue to finance capital projects at comparatively low cost. During the recent past period of fiscal stress, many states could not afford a pay-as-you-go approach and increased debt issuance to fund projects and to balance their budgets. States faced a different environment in 2005. Revenues recovered notably in most states during the last year, easing the fiscal strain and allowing states to begin rebuilding budget reserves and to improve fiscal year-end GAAP balances. Although the revenue picture is brighter, states still face significant future spending challenges. Under-funded pensions and the need to fund other post-employment benefits, public infrastructure requirements, Medicaid and state-employee healthcare costs, and pent-up demand to restore previously cut state spending all compete for the same state funds.

Among noteworthy bond transactions in 2005 was the Massachusetts School Building Authority's issuance of $2 billion in bonds backed by a 1-cent pledge of state sales tax revenue; $2.7 billion of highway and bridge trust fund bonds issued by the New York State Thruway Authority and supported by state taxes; and $960 million of transportation system bonds issued by the New Jersey Transportation Trust Fund Authority. The State of California also issued $6 billion of general obligation bonds in several new money and refunding sales during the year, and the Golden State Tobacco Securitization Corporation issued $3.2 billion of tobacco settlement bonds with a state appropriation backup pledge.

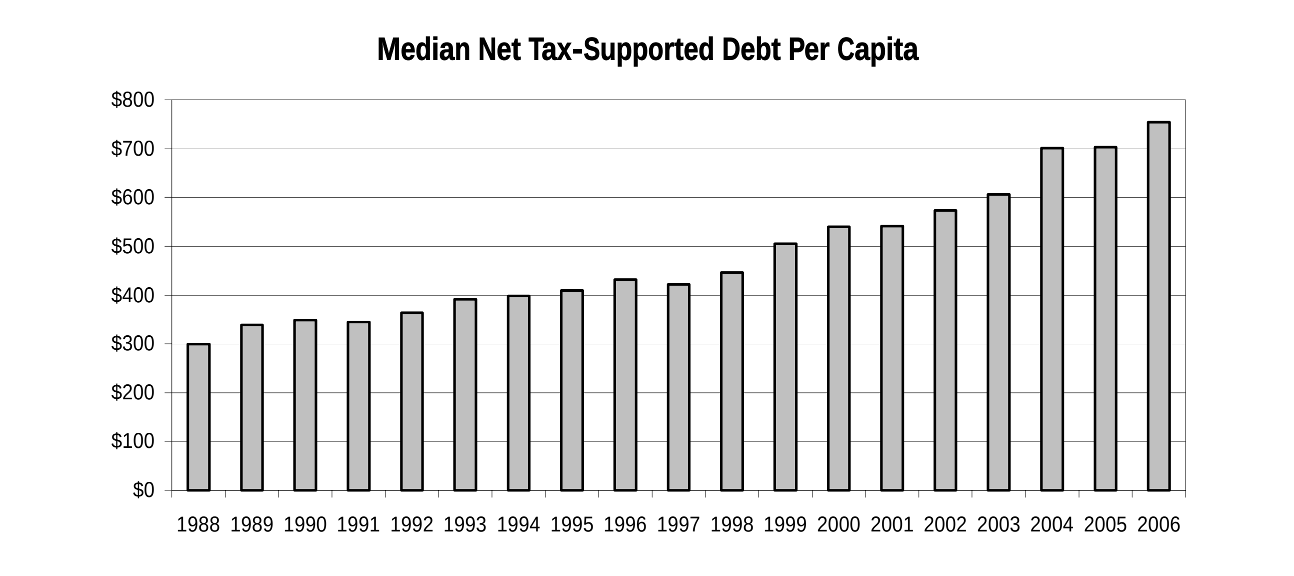
Overall US Credit Markets: Household, Federal Debt Expand Rapidly in 2005

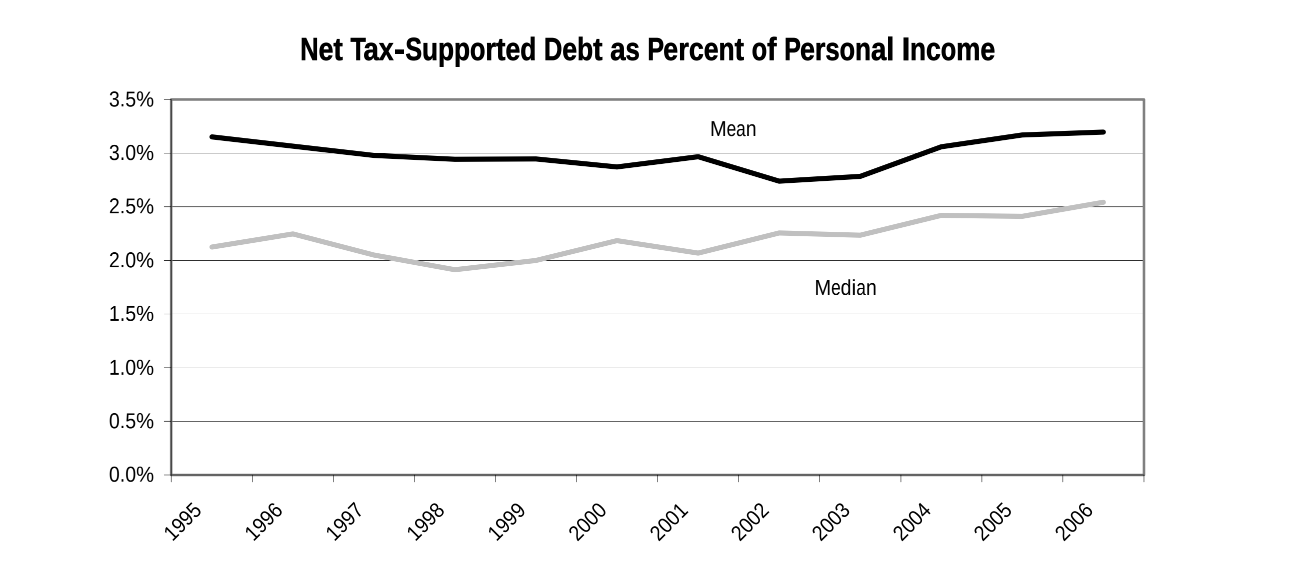
In 2005, the total amount of debt outstanding in the US credit markets increased by 9%. The household sector expanded the most, growing by 12% compared to the previous year and accounting for 29% of all credit market debt. Pushed upwards by continued double-digit growth in home mortgages, and by moderate growth in consumer credit, household debt has increased by 10.2% on average over the past five years.

Federal government borrowing accounted for 12% of total debt outstanding in 2005, an increase of 7% over 2004 (when it grew by 9%). As with the previous year, the increase reflects additional spending for national security and healthcare. Following the recent expansion of the federal debt limit to $9 trillion, federal borrowing will likely continue to grow substantially next year. Business sector debt increased by 6.3% and was 21% of total debt outstanding in 2005.

State Debt Burdens Increase

Reflecting their continued use of debt to finance capital projects, median net-tax supported debt per capita in 2005 increased by 7.2% to $754 and the median ratio of debt to personal income grew to 2.5%, the highest level since 1987. At the same time, mean debt per capita grew by 6.0% while the mean ratio of debt to personal income was unchanged from the previous year at 3.2%. The latter reflects debt growth among the historically largest state issuers at a pace close to the growth of personal income.





Outlook: State Debt Issuance Expected to Slow in 2006

Amid rising interest rates, improving state revenues, and strengthening balance sheets, state debt issuance is beginning to slow. States no longer are issuing deficit bonds to finance revenue shortfalls and are increasing the pay-as-you-go components of their capital plans, and as a result are reducing their reliance on debt. Nonetheless, infrastructure needs such as roads, schools, prisons and environmental protection continue to grow, bolstering demands on states to increase debt issuance. Moody's expects state debt growth to continue in 2006, but at a slower rate than in recent years.

Related Research

Special Comments:

2005 State Debt Medians, May 2005 (92494)

Municipal Rating Trends Remain Positive In First Quarter Of 2006: Economic Recovery Persists, April 2006 (97210)

Rating Methodology:

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

Outlook:

Stable Outlook in States in 2006, January 2006 (96540)

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.

Net Tax-Supported Debt Per Capita

			Rating
1	Massachusetts	$4,128	Aa2
2	Hawaii	$3,905	Aa2
3	Connecticut	$3,624	Aa3
4	New Jersey	$3,276	Aa3
5	New York	$2,569	Aa3
6	Illinois	$2,026	Aa3
7	Delaware	$1,845	Aaa
8	Washington	$1,684	Aa1
9	California	$1,597	A2
10	Wisconsin	$1,437	Aa3
11	Rhode Island	$1,402	Aa3
12	Oregon	$1,350	Aa3
13	Kentucky	$1,225	Aa2*
14	New Mexico	$1,222	Aa1
15	Mississippi	$1,171	Aa3
16	Maryland	$1,169	Aaa
17	Kansas	$1,169	Aa1*
18	West Virginia	$1,119	Aa3
19	Florida	$976	Aa1
20	Ohio	$915	Aa1
21	Alaska	$880	Aa2
22	Louisiana	$855	A2
23	North Carolina	$804	Aa1
24	Georgia	$784	Aaa
25	Pennsylvania	$762	Aa2
26	Minnesota	$746	Aa1
27	Nevada	$717	Aa1
28	Utah	$707	Aaa
29	Vermont	$707	Aa1
30	Michigan	$683	Aa2
31	South Carolina	$661	Aaa
32	Arizona	$607	Aa3*
33	Maine	$606	Aa3
34	Alabama	$603	Aa2
35	Virginia	$601	Aaa
36	Missouri	$496	Aaa
37	Indiana	$474	Aa1*
38	New Hampshire	$514	Aa2
39	North Dakota	$342	Aa2*
40	Arkansas	$409	Aa2
41	Oklahoma	$395	Aa3
42	Montana	$377	Aa3
43	Colorado	$314	NGO**
44	Texas	$307	Aa1
45	Tennessee	$234	Aa2
46	South Dakota	$225	NGO**
47	Idaho	$152	Aa2*
48	Iowa	$110	Aa1*
49	Wyoming	$103	NGO**
50	Nebraska	$27	NGO**
	MEAN:	***$1,060***	
	MEDIAN:	***$754***	
	Puerto Rico	$7,312 ***	Baa2

** Issuer Rating (No G.O. Debt)*
*** No General Obligation Debt*
**** This figure is not included in any totals, averages, or median calculations but is provided for comparison purposes only.*

Net Tax-Supported Debt as a % of 2004 Personal Income

1	Hawaii	12.1%
2	Massachusetts	9.8%
3	Connecticut	8.0%
4	New Jersey	7.9%
5	New York	6.7%
6	Illinois	5.9%
7	Delaware	5.3%
8	Washington	4.9%
9	Mississippi	4.8%
10	New Mexico	4.7%
11	California	4.6%
12	Kentucky	4.5%
13	Wisconsin	4.5%
14	Oregon	4.5%
15	West Virginia	4.4%
16	Rhode Island	4.1%
17	Kansas	3.8%
18	Florida	3.2%
19	Louisiana	3.1%
20	Maryland	3.0%
21	Ohio	2.9%
22	North Carolina	2.8%
23	Utah	2.7%
24	Georgia	2.7%
25	Alaska	2.6%
26	South Carolina	2.5%
27	Pennsylvania	2.3%
28	Vermont	2.2%
29	Arizona	2.2%
30	Alabama	2.2%
31	Nevada	2.2%
32	Michigan	2.1%
33	Minnesota	2.1%
34	Maine	2.0%
35	Virginia	1.7%
36	Missouri	1.6%
37	Arkansas	1.6%
38	Indiana	1.4%
39	Oklahoma	1.4%
40	New Hampshire	1.4%
41	Montana	1.4%
42	North Dakota	1.2%
43	Texas	1.0%
44	Colorado	0.9%
45	Tennessee	0.8%
46	South Dakota	0.7%
47	Idaho	0.6%
48	Iowa	0.4%
49	Wyoming	0.3%
50	Nebraska	0.1%
	MEAN:	***3.2%***
	MEDIAN:	***2.5%***
	Puerto Rico	61.2%

*** This figure is based on 2004 Personal Income. It is not included in any totals, averages, or median calculations but is provided for comparison purposes only.*

Total Net Tax Supported Debt (000's)

				Rating
1	California	$57,697,000		A2
2	New York	$49,466,000		Aa3
3	New Jersey	$28,562,000		Aa3
4	Massachusetts	$26,410,909		Aa2
5	Illinois	$25,863,606		Aa3
6	Florida	$17,357,380		Aa1
7	Connecticut	$12,720,691		Aa3
8	Washington	$10,589,432		Aa1
9	Ohio	$10,490,319		Aa1
10	Pennsylvania	$9,476,910		Aa2
11	Wisconsin	$7,954,654		Aa3
12	Georgia	$7,110,040		Aaa
13	Texas	$7,017,682		Aa1
14	North Carolina	$6,985,135		Aa1
15	Michigan	$6,909,000		Aa2
16	Maryland	$6,549,390		Aaa
17	Kentucky	$5,113,931		Aa2*
18	Hawaii	$4,979,128		Aa2
19	Oregon	$4,915,623		Aa3
20	Virginia	$4,547,205		Aaa
21	Louisiana	$3,868,815		A2
22	Minnesota	$3,827,281		Aa1
23	Arizona	$3,607,261		Aa3*
24	Mississippi	$3,419,281		Aa3
25	Kansas	$3,207,330		Aa1*
26	Indiana	$2,972,793		Aa1*
27	Missouri	$2,878,014		Aaa
28	South Carolina	$2,812,021		Aaa
29	Alabama	$2,747,602		Aa2
30	New Mexico	$2,357,020		Aa1
31	West Virginia	$2,032,278		Aa3
32	Utah	$1,746,281		Aaa
33	Nevada	$1,730,784		Aa1
34	Delaware	$1,556,057		Aaa
35	Rhode Island	$1,509,048		Aa3
36	Colorado	$1,466,678		NGO**
37	Oklahoma	$1,399,891		Aa3
38	Tennessee	$1,394,319		Aa2
39	Arkansas	$1,137,192		Aa2
40	Maine	$800,874		Aa3
41	New Hampshire	$673,631		Aa2
42	Alaska	$584,200		Aa2
43	Vermont	$440,266		Aa1
44	Montana	$352,385		Aa3
45	Iowa	$325,300		Aa1*
46	North Dakota	$217,430		Aa2*
47	Idaho	$216,835		Aa2*
48	South Dakota	$174,391		NGO**
49	Wyoming	$52,665		NGO**
50	Nebraska	$48,357		NGO**
	Totals	**360,272,315**		
	Puerto Rico	*$28,606,130*	*****	*Baa2*

** Issuer Rating (No G.O. Debt)*
*** No General Obligation Debt*
**** This figure is not included in any totals, averages, or median calculations but is provided for comparison purposes only.*

Gross Tax Supported Debt (000's)

				Gross to Net Ratio
1	California	$64,428,000		1.12
2	New York	$49,567,000		1.00
3	New Jersey	$33,066,000		1.16
4	Massachusetts	$31,682,180		1.20
5	Illinois	$26,191,406		1.01
6	Connecticut	$20,345,891		1.60
7	Michigan	$19,909,000		2.88
8	Florida	$17,506,580		1.01
9	Washington	$15,189,432		1.43
10	Texas	$13,217,682		1.88
11	Pennsylvania	$12,762,910		1.35
12	Oregon	$11,691,861		2.38
13	Minnesota	$10,784,431		2.82
14	Ohio	$10,619,397		1.01
15	Wisconsin	$10,170,555		1.28
16	Virginia	$9,090,592		2.00
17	Colorado	$8,156,678		5.56
18	Georgia	$7,110,040		1.00
19	Kentucky	$7,008,590		1.37
20	North Carolina	$6,985,135		1.00
21	Hawaii	$6,575,256		1.32
22	Maryland	$6,550,290		1.00
23	Alabama	$5,818,721		2.12
24	Utah	$5,574,581		3.19
25	South Carolina	$5,517,601		1.96
26	Indiana	$4,688,231		1.58
27	Louisiana	$4,596,807		1.19
28	Arkansas	$4,227,985		3.72
29	Maine	$4,199,769		5.24
30	Arizona	$3,854,261		1.07
31	Tennessee	$3,845,032		2.76
32	Kansas	$3,430,343		1.07
33	Mississippi	$3,419,281		1.00
34	Alaska	$3,110,155		5.32
35	West Virginia	$3,086,771		1.52
36	Nevada	$3,004,879		1.74
37	Missouri	$2,928,989		1.02
38	New Mexico	$2,860,020		1.21
39	Delaware	$2,230,401		1.43
40	New Hampshire	$1,995,663		2.96
41	Rhode Island	$1,876,369		1.24
42	Iowa	$1,792,897		5.51
43	Oklahoma	$1,450,523		1.04
44	Vermont	$1,092,449		2.48
45	North Dakota	$961,660		4.42
46	Idaho	$710,050		3.27
47	Montana	$491,014		1.39
48	South Dakota	$431,767		2.48
49	Nebraska	$59,787		1.24
50	Wyoming	$52,665		1.00
	Totals	**475,917,577**		**1.40**
	Puerto Rico	*$31,828,030*	****	*1.11*

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

Net Tax-Supported Debt as a Percentage of Personal Income	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Alabama	2.4	2.2	2.0	2.0	1.8	1.9	1.7	1.5	2.3	2.2	2.2	2.2	2.0	2.0	2.2
Alaska	2.5	2.6	2.4	1.2	0.9	0.9	0.5	0.0	1.0	0.4	0.4	0.3	3.0	2.8	2.6
Arizona	1.6	1.8	1.6	2.7	2.4	2.1	1.9	1.9	1.6	1.6	1.9	2.1	2.3	2.6	2.2
Arkansas	0.7	0.7	0.7	0.6	0.7	0.6	0.8	0.6	0.9	1.2	1.2	1.4	1.8	1.6	1.6
California	2.0	2.5	3.0	3.5	2.8	2.6	2.6	2.6	2.4	2.5	2.5	2.5	3.2	4.7	4.6
Colorado	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.03	0.4	0.7	0.9	0.9	1.0	0.9
Connecticut	8.7	8.9	9.1	9.6	9.7	9.4	8.7	8.7	8.1	8.0	8.0	8.2	8.4	8.5	8.0
Delaware	8.1	7.5	8.0	8.0	7.6	6.4	5.9	5.7	5.2	5.5	5.3	5.0	5.6	5.5	5.3
Florida	2.2	2.3	2.9	3.0	2.9	3.0	3.4	3.5	3.4	3.3	3.4	3.5	3.5	3.4	3.2
Georgia	2.5	2.9	3.0	3.1	3.3	3.1	2.9	2.9	2.8	2.6	2.9	2.9	2.9	2.8	2.7
Hawaii	10.2	10.4	12.1	10.5	10.3	10.9	10.7	11.2	11.6	11.0	10.4	10.9	10.4	11.1	12.1
Idaho	0.3	0.4	0.3	0.3	0.3	0.3	0.2	0.4	0.4	0.3	0.4	0.3	0.5	0.6	0.6
Illinois	2.7	2.7	3.0	3.2	3.2	2.9	2.7	2.6	2.6	2.7	2.8	3.2	5.8	6.2	5.9
Indiana	0.7	1.0	1.0	1.0	0.9	0.9	0.8	0.9	0.9	1.1	1.1	1.1	1.3	1.4	1.6
Iowa	0.2	0.4	0.4	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.6	0.6	0.5	0.5	0.4
Kansas	0.5	1.3	2.0	2.1	2.0	1.9	1.7	2.0	2.4	3.1	3.0	3.0	3.3	4.0	3.8
Kentucky	4.7	5.1	5.0	4.7	5.1	4.1	3.9	3.7	3.5	4.4	4.3	4.4	4.4	4.0	4.5
Louisiana	6.5	6.3	5.9	5.4	4.9	4.4	2.6	2.6	2.4	2.5	2.4	2.7	2.6	2.4	3.1
Maine	2.2	2.7	2.6	2.7	2.7	2.6	1.9	1.9	2.1	2.0	1.9	1.8	1.8	2.2	2.0
Maryland	3.4	3.3	3.3	3.5	3.4	3.3	3.1	3.3	3.0	2.6	2.6	2.8	3.0	2.9	3.0
Massachusetts	8.0	8.5	8.2	8.4	8.3	8.1	7.8	7.8	8.0	8.5	8.5	8.5	8.5	8.5	9.8
Michigan	1.2	1.6	1.5	1.5	1.5	1.5	1.6	1.7	1.5	1.6	1.5	1.8	2.2	2.2	2.1
Minnesota	2.2	2.2	2.0	1.9	1.9	2.2	1.9	2.0	1.9	1.8	1.8	1.9	2.0	2.0	2.1
Mississippi	1.8	1.8	2.1	2.0	3.0	2.9	3.5	4.4	4.7	4.6	4.7	5.6	5.2	4.8	4.8
Missouri	1.3	1.3	1.2	1.2	1.3	1.3	1.0	1.0	1.0	1.1	1.3	1.3	1.6	1.5	1.6
Montana	2.2	2.1	1.9	3.2	2.4	1.4	1.4	1.7	1.7	1.7	1.6	1.4	1.3	1.1	1.4
Nebraska	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nevada	2.9	2.7	2.2	2.1	2.0	1.8	1.6	1.8	1.8	1.8	1.7	1.4	2.0	2.0	2.2
New Hampshire	2.5	2.7	2.9	2.9	2.9	2.5	2.4	2.3	2.0	1.5	1.5	1.4	1.5	1.3	1.4
New Jersey	2.2	3.0	2.9	3.7	3.6	3.8	5.1	5.2	5.3	5.5	5.6	5.5	5.9	7.4	7.9
New Mexico	1.8	1.7	2.1	2.1	2.1	2.0	1.9	2.6	3.1	4.0	4.0	3.7	4.1	5.3	4.7
New York	5.6	6.1	6.4	6.6	6.9	6.7	6.5	6.6	6.4	6.2	5.9	5.9	6.7	7.2	6.7
North Carolina	0.6	0.6	0.6	0.8	0.7	0.7	1.0	1.2	1.4	1.4	1.4	1.6	2.0	2.5	2.8
North Dakota	1.2	1.2	1.1	1.1	1.1	1.0	0.8	0.6	0.7	0.9	0.9	0.9	0.9	0.6	1.2
Ohio	2.4	2.5	2.5	2.4	2.5	2.5	2.5	2.7	2.7	2.6	2.6	2.6	2.7	2.9	2.9
Oklahoma	0.4	0.4	1.0	1.0	0.8	0.9	0.8	1.2	1.3	1.4	1.3	1.2	1.2	1.2	1.4
Oregon	1.5	1.1	1.2	1.2	1.4	1.9	1.2	1.2	1.3	1.6	1.5	1.6	4.5	4.7	4.5
Pennsylvania	2.7	2.6	2.7	2.6	2.4	2.2	2.0	2.3	2.2	2.2	2.3	2.3	2.2	2.3	2.3
Rhode Island	6.1	8.8	8.9	8.7	8.5	8.7	6.6	6.5	6.2	5.3	5.2	5.0	4.4	4.3	4.1
South Carolina	1.8	1.9	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.8	2.5	2.4	2.4	2.2	2.5
South Dakota	2.2	2.3	2.3	2.1	1.8	1.8	1.5	1.5	1.5	1.2	0.9	0.7	0.9	0.9	0.7
Tennessee	1.0	0.8	0.8	0.9	0.9	0.9	0.9	1.0	1.0	1.2	0.9	0.8	0.8	0.7	0.8
Texas	1.2	1.1	1.2	1.6	1.7	1.5	1.4	1.3	1.2	1.0	0.9	0.9	0.8	1.0	1.0
Utah	1.6	1.7	1.6	1.7	1.8	1.7	3.1	3.6	3.3	2.8	3.0	2.9	3.5	3.2	2.7
Vermont	4.5	4.6	4.5	4.7	4.9	4.7	4.2	4.2	3.8	3.3	3.0	3.0	2.5	2.3	2.2
Virginia	1.2	1.3	1.6	1.7	1.6	1.7	2.1	2.0	2.1	1.9	1.8	1.7	1.7	1.8	1.7
Washington	4.4	5.0	5.0	5.0	4.8	5.0	4.8	4.6	4.6	4.4	4.4	4.8	4.9	4.9	4.9
West Virginia	4.7	3.4	3.1	2.5	2.6	2.7	2.8	3.4	3.3	4.2	4.0	4.1	3.6	4.6	4.4
Wisconsin	2.7	3.1	3.0	3.0	2.9	3.2	2.8	2.8	2.7	3.2	3.0	3.3	4.5	4.7	4.5
Wyoming	0.0	0.0	0.5	0.4	0.4	0.7	0.7	1.0	1.0	1.0	1.4	0.9	0.8	0.7	0.3
Median	**2.2**	**2.2**	**2.1**	**2.1**	**2.1**	**2.1**	**1.9**	**2.0**	**2.2**	**2.1**	**2.3**	**2.2**	**2.4**	**2.4**	**2.5**

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Report Number: 97215

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Tax Supported
New Issue

State of Vermont

Rating
General Obligation Bonds .... AA+

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New Issue Details
$30,000,000 General Obligation Refunding Bonds, 2005 Series D, are scheduled for competitive bids on Nov 15. Bonds will be due July 15, 2006–2025 and are callable on or after July 15, 2015 at par.
Security: The bonds are general obligations of the State of Vermont, with its full faith and credit pledged.

■ Outlook
Vermont's conservative approach to debt and financial operations provides a strong foundation for its high credit quality. During the protracted recession period of the early 1990s, the state assiduously followed an austere recovery program, demonstrating well its willingness to take appropriate action for stability. Following recovery, its reserves were fully funded, expenditure levels remained under control, and substantial surplus was used for capital purposes, allowing debt to decline. The state's economy weakened in 2001–2002, and revenues were below projections. Appropriations were cut, but partial use of the reserve was still necessary. Operations subsequently have been favorable, and reserves fully rebuilt.

■ Rating Considerations
Important to Vermont's long-term credit assessment is the demonstrated willingness to keep debt within manageable parameters and fidelity to the simplicity of debt structure, having used faith and credit obligations almost exclusively. Virtually all direct debt remains general obligation, and amortization is rapid. In line with affordability recommendations, annual borrowing has been reduced, and considerable capital needs have been met from cash, not bonding. Net tax-supported debt has declined 18% since 1997, and debt ratios are moderate.

Financial operations were successful for the six years through 2001. After elimination of the deficit in fiscal 1996, the rebuilding of the budget stabilization reserve commenced, followed by the establishment of further reserves for education and welfare as well as the use of current surplus for capital purposes. Reserves became fully funded at 5% of revenues. Revenues, driven by the personal income tax, consistently exceeded estimates until weakness surfaced in 2001, forcing use of over half of the reserves by fiscal 2002. In fiscal 2003, revenues recovered to meet estimates, and in both fiscal years 2004 and 2005, surging revenues allowed for sizable surpluses and full replenishment of reserves. Through October 2005, fiscal 2006 revenues are on track with estimates.

Vermont lost nearly 5% of employment in the early 1990s recession, but by 1994, employment exceeded the pre-recession level. However, manufacturing employment, higher paying than the services sector, was slower to recover. Manufacturing again suffered from 2000–2003, falling 19% before stabilizing in 2004. This loss was offset by resiliency in other sectors, and total employment was virtually unchanged from 2000–2003 before resuming growth during 2004 with a 1.3% job gain. Through September 2005, employment was up 1.5% over the previous year. Per capita personal income growth climbed from 91% of the U.S. level in 1997 to 97% in 2004.

November 11, 2005

Strengths

- Virtually exclusive use of general obligation debt.
- Moderate and declining debt ratios, with affordability planning.
- Generally conservative financial policies.
- Reserves fully funded.

Risks

- Some vulnerability due to importance of the manufacturing sector.
- Rapidly growing Medicaid and education expenditures constrain future budgets.

Debt Position

Vermont has an increasingly favorable debt position, and debt levels have consistently declined, with reduced issuance recommendations from the debt affordability advisory committee. Net tax-supported debt of $470 million is 18% below that of 1997, which has driven ratios down to $757 per capita and 2.5% of personal income, well below the 1997 levels of $987 per capita and 4.4% of personal income.

There are no constitutional or statutory restrictions on debt in Vermont. All direct debt is now general obligation, as a minor amount of leases and certificates of participation (COPs) was refunded in 1998. The bonds, which refunded the leases and COPs, are treated as special fund bonds for internal cost accounting purposes but are actually general purpose obligations. General purpose bonds are serviced from the general fund and highway debt from the transportation fund. Not included in the general obligation debt is debt issued by the Education and Health Building Finance Agency for the benefit of developmental and mental health services providers, although much support for the programs comes from state appropriations.

There is considerable exposure through credit extension, although it was significantly reduced with the sale of the portfolio of the Vermont Home Mortgage Board, which had liabilities of $117 million in 1998. The state's full faith and credit back up certain programs of the Vermont Economic Development Authority (VEDA), including the authority to insure up to $15 million in mortgages, and the authority is authorized to reimburse lenders participating in the Financial Access Program to a maximum of $2 million. Mortgages amounted to $8.5 million, and the reimbursement liability was about $870,000 million. VEDA has issued commercial paper ($53.7 million outstanding) for financing new loans; the commercial paper program has a reserve deficiency makeup provision with the state, not to exceed $55 million. Calls on the various guarantees have been minor. There are reserve fund deficiency makeup provisions with the state's municipal bond bank and the housing finance agency, with the latter limited to $125 million in bonds; no calls have been made through this provision.

Short-term debt has been employed regularly, both for operating and capital purposes. In 1993–1997, it was entirely in the form of commercial paper. Subsequently, there was then no need for operating borrowing until fiscal 2003 when $75 million was issued. In fiscal 2004, $48 million was issued, but the state's finances have improved since then, with no short-term borrowing needed.

Vermont has a capital debt affordability advisory committee that will recommend prudent debt authorizations, taking into account, among other things, debt in relation to personal income and debt service in relation to revenues. Annual amounts declined from $64 million in fiscal 1994 to $43 million in 1997 and 1998 and to under $40 million in each year from 1999–2004. The recommendation rose to $41 million in fiscal 2005 and $45 million in 2006 and 2007. Authorizations have approximately matched recommendations, although surpluses were used to reduce bonding in fiscal years 2000 and 2001.

The state will follow this issue with $15 million of general obligation Vermont citizen bonds in December. The state now makes annual bond authorizations, eliminating any overhang of authorized but unissued debt.

Financial Operations

The general fund is the basic operating account. Accounting has been done on a cash basis, but the conversion to generally accepted accounting principles (GAAP) was completed for the 1996 fiscal year. Vermont's comprehensive annual financial reports (CAFRs) for fiscal years 2002, 2003, and 2004 were each delayed due to complications of a new financial system, conversion to GAAP Statement No. 34, and a delay in auditing capital assets. The state believes the problems have been remedied, and the fiscal 2005 CAFR is expected to be issued in December.

Vermont has a diverse revenue stream, including a personal income tax, which provided for 20.1% of audited fiscal 2004 total own-source revenues. The income tax was decoupled from the federal income tax in tax year 2001. Vermont's 6% sales tax — which yields 12.5% of revenues — exempts food, medicine, clothing, and supplies and energy for manufacturing and agricultural uses. Vermont also has a corporate income tax, an insurance tax, property transfer tax, an estate tax, liquor and cigarette taxes, and a statewide property tax for education, which was 23.2% of revenues.

After a difficult period, Vermont returned to surplus operations in fiscal 1996, which, when combined with a transfer from the transportation fund, eliminated the general fund deficit from the previous year. During fiscal 1997, revenues well exceeded estimates, and a major reserve fund deposit was made. At June 30, 1997, the budget stabilization fund had a balance of $35.1 million, $7 million was in reserve for education and $2.9 million was reserved for debt reduction. The transportation fund held $7 million in its reserve.

Financial operations in the following years were favorable, with revenues generally ahead of estimates, operating surpluses achieved, and reserves fully funded at 5% of revenues. Additionally, significant appropriations were made for capital and other one-time purposes. In fiscal 2001, growth slowed, but an operating surplus of $36 million was achieved. Cigarette taxes, which totaled $11 million in the previous year, began to flow to the health care access trust fund instead of the general fund.

The fiscal 2002 budget assumed that available revenue would be around the same level as in the previous year, and the operating surplus after transfers of $23 million to the transportation and education funds was set at $9.3 million. In fact, general fund revenues were about 7% lower than in 2001 and 10% below original estimates. The personal income tax was 11% below the previous year and 13% below original estimates. Revenue estimates were lowered twice during the year, and in response, appropriations were reduced; however, the final shortfall dictated the use of $29 million from the reserve, leaving $17 million in that fund. On a GAAP basis, the general fund ran a $23 million operating deficit, to close with a $149.6 million total fund balance.

Fiscal 2003 revenue estimates were lowered, and the gap was to be met from transfers and cuts. However, following late year strength, revenues actually matched the original level, and in essence, the transfers were added to reserves. Taxes for the year rose 3.1%, reflecting strength in insurance and estate taxes, while the personal income tax was up only 0.9% and the sales tax, 1.8%. At the close of the year, the general fund stabilization reserve was about one-half funded at $23.5 million, and the transportation reserve held $9.2 million. A caseload reserve amounted to $17.2 million. The education fund drew on its reserve, bringing it down to $11.2 million. On a GAAP basis, the general fund ran a $49.8 million operating deficit and closed with a $99.8 million fund balance.

General and Special Revenue Funds
($000, GAAP)

	2001–2002	2002–2003	2003–2004
Revenues	2,804,565	2,913,367	3,296,227
Taxes	1,600,725	1,615,244	1,831,298
Federal Aid	964,141	1,036,188	1,195,394
Expenditures	2,894,940	3,055,008	3,213,100
Education	1,035,570	1,090,652	1,132,649
Human Services	1,065,880	1,202,966	1,299,899
Transportation	311,133	284,978	289,728
Debt Service	69,214	73,213	70,833
Operating Result	(17,840)	(88,109)	147,312
General Fund Balance	149,594	99,752	154,725
Undesignated Balance	97,898	47,061	61,974

GAAP – Generally accepted accounting principles.

The fiscal 2004 budget expected moderate revenue growth. Actual growth was 4.5% for the income tax and 17.0% for the sales tax (inclusive of a rate increase). The state also applied $50 million in one-time federal aid plus $32.9 million in enhanced Medicaid support, which allowed it to bolster various reserve accounts and make one-time expenditures. The state closed fiscal 2004 with a $57 million general fund surplus, which was reduced by year-end transfers to the transportation fund, teacher's retirement, the caseload reserve, and other funds. The state also transferred $20.9 million to fully fund the stabilization reserve and carried forward a $15.6 million surplus. The state also realized surpluses in both the transportation and education funds, which allowed full funding of the reserves for those accounts, and a $14.9 million surplus was carried forward in the education fund. On a GAAP basis, the general fund incurred a $54.9 million operating surplus and a total fund balance of $154.7 million.

Fiscal 2005 revenue estimates, originally set at $922.6 million in January 2004, were raised to $950 million in July and $981.3 million in January; the total general fund revenues ultimately amounted to $1.04 billion, or 8.9% over fiscal 2004's, with the overage due largely to personal income tax receipts, which was up 16.4%, and corporate income tax receipts, up 34%. A $54 million operating surplus was used for a $21 million transfer to the health access trust fund and smaller transfers, including the teacher's retirement fund and the transportation fund, leaving a $19.6 million carryover.

The enacted fiscal 2006 general fund budget was based on $1.015 billion general fund revenues, later increased to $1.06 billion. Through October 2005, the general fund was up 10% over last year and ahead of estimates. Revenue growth was led by stronger than expected corporate tax receipts; personal income tax receipts are slightly below estimates.

Education fund spending was up sharply in fiscal 2005 as the result of Act 68, which increased the state's share of K–12 education spending and lowered local property taxes. The sales tax was raised from 5% to 6% on Oct. 1, 2003, and effective July 1, 2004, one-third of all sales tax receipts are allocated to the education fund, with the remainder retained in the general fund. The act also splits the statewide property tax rate, with homestead property taxed at a rate equal to about two-thirds of the nonresidential rate, which takes advantage of the significant and increasing number of out-of-state second home owners in Vermont.

The transportation and education funds are important in state operations. Transportation revenues have been sluggish, with revenues to date down 1.3% from last year. The education fund relies on the allocation of the sales tax, the statewide property tax, lottery proceeds, and motor vehicle purchase and use tax receipts. Operations of the fund have often relied on use of its reserve, now also fully funded.

Vermont's pension systems are strong. The State Employees Retirement System was 97.8% funded at the last actuarial valuation on June 30, 2005. The Vermont State Teacher's Retirement System was 90.7% funded. The state has funded the teacher's system below the actuarially recommended contribution; however, it added a portion of both the fiscal years 2004 and 2005 surplus.

Economic Base

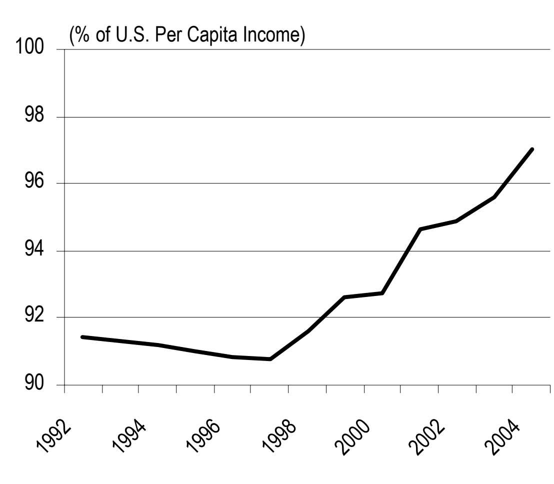
Vermont has a small but increasingly prosperous economy that includes manufacturing, tourism, agriculture, and health and educational services. Health and education services now account for nearly 18% of employment, and leisure and hospitality make up nearly 11%, both well above the national average. Educational services alone are 4.2% of Vermont's jobs, nearly twice the national share. The business and professional services sector is small here, making up just 7.2% of state jobs compared with 12.5% for the nation.

Manufacturing, mostly durables, is still important at 12.1% of jobs, above the national rate of 10.9%. Manufacturing declined in the 1990s recession, with employment dropping from over 50,000 in 1985 to the 43,000 level in the early 1990s. There was recovery, with 2000 manufacturing employment at 46,400, but it slipped by 2003 to 37,600 and has stabilized near that level. The state's largest private employer continues to be IBM, which reduced its work force, primarily in the Burlington area, by some 1,800 employees during the recession, although it has added back some employees. General Electric also has a significant manufacturing facility in Rutland. Tourism is broad based, including several ski areas for winter attraction, while the scenic beauty and countryside encourage summer and fall visitors. Several ski areas have undergone improvement, including a continuation of year-round use. Increasing second home and condominium usage provides some stability and has driven a surge in housing prices. Canadian tourism and shopping are an economic factor.

Employment in Vermont peaked in 1989 after a period of rapid growth. Nearly 5% of employment was lost, only about half as severe as the losses in most New England states. By the end of 1994, the loss had been regained, and 2001 annual employment was more than 15% over the earlier peak.

Vermont's employment growth has outperformed the nation's during each year of the current decade, as it rose 1.1% during 2001 and then lost a combined total of 0.9% in 2002 and 2003. Job growth returned to Vermont in 2004, with a 1.3% increase, which both exceeded the national average and recouped the entire recessionary loss. Through September 2005, Vermont gained 1.5% jobs over the previous September, led by

Vermont Per Capita Income
(Years Ended Dec. 31)



a 5.6% increase in construction and a 3.7% gain in professional and business services. Unemployment is consistently among the lowest in the nation.

Vermont's personal income per capita has lagged the U.S. rate since World War II, falling to as low as 77% of the U.S.'s in 1950, and it hovered at only 83% as recently as 1977. In more recent times, per capita personal income hovered around 90% of the U.S. average until 1998, when it began a string of seven straight years of growth ahead of the nation. Revised 2004 per capita personal income of $32,063 was 97% of the U.S. rate, a modern record high and ranking the state 23rd among the states. However, Vermont remains less wealthy than neighboring New Hampshire, where a faster-growing economy and the influence of the Boston metropolitan region drove per capita personal income to 111% of the U.S. rate in 2004.

Vermont's population grew 8.2% during the 1990s, faster than the New England region, yet slower than the U.S. The census bureau estimates Vermont has grown about 0.5% per year during this decade, about as fast as New England but slower than the U.S. Vermont's population is well-educated, with nearly one-third of adult Vermonters holding college degrees, ranking ninth of the 50 states. Vermont also has the nation's largest share of population — nearly three-quarters — living outside the state's primary metropolitan area.

Economic Trends

Nonfarm Employment
(000, Not Seasonally Adjusted)

Unemployment Rates
(%, Not Seasonally Adjusted Annual Rates)

	Vermont	% Change	U.S.	% Change	Vermont	U.S.	State as % of U.S.
1989	262	—	108,014	—	3.6	5.3	68
1990	258	(1.6)	109,487	1.4	4.9	5.6	88
1991	249	(3.3)	108,374	(1.0)	6.6	6.8	97
1992	251	0.8	108,726	0.3	6.4	7.5	85
1993	257	2.5	110,844	1.9	5.3	6.9	77
1994	264	2.5	114,291	3.1	4.6	6.1	75
1995	270	2.4	117,298	2.6	4.3	5.6	77
1996	275	1.8	119,708	2.1	4.4	5.4	81
1997	279	1.6	122,776	2.6	4.0	4.9	82
1998	285	2.0	125,930	2.6	3.1	4.5	69
1999	292	2.3	128,993	2.4	2.9	4.2	69
2000	299	2.4	131,785	2.2	2.6	4.0	65
2001	302	1.1	131,826	0.0	3.3	4.7	70
2002	299	(0.9)	130,341	(1.1)	4.0	5.8	69
2003	299	0.0	129,999	(0.3	4.5	6.0	75
2004	303	1.3	131,480	1.1	3.7	5.5	67
Sept. 2004	306		132,127	—	3.5	5.4	65
Sept. 2005p	311	1.5	134,325	1.7	3.7	5.1	73

Personal Income
(Change from Prior Year)

Personal Income Per Capita
(Change from Prior Year)

	% Change			% Change		
	Vermont	U.S.	State Growth as % of U.S.	Vermont	U.S.	State Growth as % of U.S.
1990	4.3	6.4	67	2.9	5.2	57
1991	1.3	3.5	37	0.6	2.1	29
1992	6.8	6.3	108	6.0	4.8	124
1993	3.1	3.7	83	2.2	2.4	93
1994	4.9	5.2	95	3.8	3.9	98
1995	4.8	5.3	89	3.8	4.1	94
1996	5.4	6.0	90	4.6	4.8	96
1997	6.9	6.1	114	4.7	4.8	99
1998	6.1	7.4	83	7.1	6.1	116
1999	5.8	5.1	114	5.1	3.9	129
2000	7.9	8.0	98	7.0	6.8	102
2001	5.1	3.5	145	4.6	2.4	187
2002	1.6	1.8	91	1.0	0.8	133
2003	3.4	3.2	107	2.9	2.2	134
2004	5.8	6.0	97	6.5	4.9	132

Components of Personal Income: Earnings
(%)

	Vermont			U.S.		
	2002	2004	% Change	2002	2004	% Change
Construction	7	8	23	6	6	12
Manufacturing	18	16	(1)	14	13	5
Durable Goods Manufacturing	13	12	(2)	9	8	5
Trade, Transportation, and Utilities	17	17	10	16	16	9
Financial Activities	6	6	14	10	10	15
Professional and Business Services	9	9	14	15	15	10
Education and Health Services	15	15	13	10	11	13
Government and Government Enterprises	17	18	16	16	17	12
Total Nonfarm Earnings	—	—	11	—	—	10

State Population: 608,827 (2000 Census); 621,394 (2004 Census Bureau Estimate).
Population Change: 1990–2000 U.S. 13.1%, State 8.2%; 2000–2004 U.S. 4.3%, State 2.1%.
Personal Income Per Capita 2004p: $32,063, 97% of U.S., rank 23rd.
p – Preliminary.

Note: Monthly unemployment rates are seasonally adjusted.

New Issue: Vermont (State of)

MOODY'S ASSIGNS Aa1 RATING TO STATE OF VERMONT GENERAL OBLIGATION BONDS AND REVISES OUTLOOK TO POSITIVE FROM STABLE

Aa1 RATING AND POSITIVE OUTLOOK AFFECT APPROXIMATELY $455 MILLION IN OUTSTANDING GENERAL OBLIGATION BONDS

State
VT

Moody's Rating

ISSUE	RATING
General Obligation Bonds (Vermont Citizen Bonds), 2005 Series E	Aa1

Sale Amount	$15,000,000
Expected Sale Date	12/06/05
Rating Description	General Obligation Bonds

Moody's Outlook Positive

Opinion

NEW YORK, Nov 30, 2005 -- Moody's Investors Service has assigned a rating of Aa1 to the State of Vermont's general obligation bonds. At this time, Moody's has revised the outlook on Vermont's general obligation bond rating to positive from stable. The Aa1 rating and positive outlook affect a total of approximately $455 million in outstanding general obligation bonds, including the current offering.

The state's high quality rating reflects Vermont's sound financial position with increased reserve levels; relatively stable economic performance during the recent recession despite weakness in Vermont's manufacturing sector; and manageable debt levels that have steadily declined over the past decade. Vermont replenished funds used to offset revenue weakness during the recession, primarily in fiscal 2002, and its Budget Stabilization Reserves (BSR) are fully funded at statutory maximum levels. Vermont plans to sell $15 million General Obligation (Vermont Citizen Bonds) 2005 Series E on or about December 6th. Proceeds will be used for a variety of capital projects of the state.

At this time, Moody's has revised the outlook on Vermont's general obligation bond rating to positive from stable. The positive outlook on Vermont's general obligation bond rating incorporates Moody's expectations for continued growth in the state's primary revenue sources and maintenance of strong reserve balances and manageable debt levels. We believe that Vermont will continue to demonstrate the willingness and ability to respond with budget adjustments as needed to maintain budget balance.

Credit strengths are:

*Sound financial management and fiscal policies indicated by conservative budgeting practices.

*Prompt action to reduce spending following revenue weakening during recession.

*Relatively rapid restoration of reserves used during period of revenue weakness.

*Steady progress in reducing previously high debt ratios.

*Low unemployment rates.

Credit Challenges are:

*Medicaid cost pressures.

*Slower job recovery following rebound at the end of 2003.

*Achievement of timely financial audit reports with recently implemented system change.

HEALTHY REVENUE GROWTH IN FISCAL 2005; FISCAL 2006 INCORPORATES IMPROVED REVENUE FORECAST

Vermont's revenue recovered relatively quickly from the recession, aided in part by a 1% increase in the state's general sales and use tax rate from 5% to 6% effective October 1, 2003. The telecommunications sales tax rate was also increased to the same rate of 6%. While sales and use tax revenues were essentially flat during the recession, continued growth in a variety of smaller state tax resources, such as the room and meal tax, helped Vermont offset the substantial 10% falloff in personal income taxes in fiscal 2002. After the drop, income taxes grew slightly in fiscal 2003 and made a healthy increase of almost 5% in fiscal 2004, followed by an extraordinary gain of over 16% in fiscal year 2005. Personal income taxes are the state's largest revenue source, accounting for about 48% of General Fund revenues in fiscal 2005. Sales and use taxes represent Vermont's second largest revenue source at about one-fifth of General Fund revenues.

Vermont's most recent consensus revenue forecast (July 2005) reflects continued improvements in Vermont's economy. General Fund revenues are expected to grow by 2.3% over the prior year. This projection incorporates a $45 million upward adjustment in General Fund revenues since the fiscal 2006 budget was adopted. While the revenue growth is significantly slower than the average annual growth of over 9% in the last two fiscal years, the pace appears more sustainable. Vermont recently changed its corporate tax structure in order to improve the state's competitive business position. Personal income taxes are estimated to rise by 3.3% in fiscal year 2006 while sales and use taxes are projected to increase by 4%. Beginning in fiscal year 2005, one-third of the state's sales and use tax is dedicated to the Education Fund, pursuant to Act 68.

The state expects Budget Stabilization Reserves in the General, Transportation, and Education Funds to remain fully funded at the end of fiscal 2006, as they were at the end of fiscal year 2005.

STRUCTURAL BUDGET BALANCE REFLECTS SOUND FINANCIAL MANAGEMENT

Vermont was well-positioned to weather the recent recession as a result of its conservative budgeting practices, available reserves, and prompt action to control spending. As the economy and state revenues weakened in fiscal 2002, the state's personal income taxes dropped 10%, while sales and use taxes were essentially flat. The state eliminated a General Fund operating deficit by drawing on its General and Education Fund Budget Stabilization Reserve funds. Despite only modest income and sales tax growth, Vermont's revenue collections improved in fiscal 2003 and total tax revenues grew about 3% over the prior year, after dropping 6% between fiscal years 2001 and 2002. Vermont received $50 million in federal relief funds which were prudently applied for one-time uses rather than base-building. The state began to restore its General Fund BSR in fiscal 2003 and brought it to the full statutory maximum of 5% of prior year budgetary appropriations by year-end fiscal 2004. Vermont also maintains budget stabilization funds in its Transportation and Education Funds and these were fully funded by the end of fiscal 2004 as well. A Human Services Caseload Reserve, which is available for unexpected caseload growth due to the economy, was used only slightly during the recession and adds another layer of flexibility in the event of revenue fluctuation.

Vermont's management strength has been somewhat undermined by delays in financial reporting over the past few years, a situation corrected last year following the implementation of a new software system. The state expects a timely publication of its financial audit for fiscal year 2005 which ended June 30, 2005.

CONTINUED ECONOMIC IMPROVEMENT; MANUFACTURING SECTOR SHOWS SOME GAINS

Vermont's economy held up relatively well in the recent recession and recorded modest overall job gains for 2004, slightly higher the national pace. The state's unemployment level has crept upward slightly over the past few months. However, at 4.0% in October 2005 it was a full percentage point below the national unemployment rate of 5.0% the same month and one of the lowest in the New England region. Continuous job growth in education and health services, Vermont's largest employment sector, helped offset persistent weakness in manufacturing and to a lesser extent in the trade, transportation, and utilities sector in calendar year 2004. For 2005, Vermont's average monthly year-over-year job growth has been positive for all employment sectors. Manufacturing, still one of the core industries of Vermont's economy, is finally experiencing job growth although the sector is still down about 9,000 (20%) from peak levels five years ago.

Employment is stable at IBM, the Vermont's largest employer with 6,200 employees in 2005. The company has succeeded in securing several long-term supply contracts with the US Department of Defense and Eastman Kodak, although IBM does not expect additions to its employment base

DEBT RATIOS DECLINE; MODEST ISSUANCE PLANNED

Vermont's debt levels have declined considerably over the past decade and are now about average relative to Moody's 50-state median, on both a per capita and personal income basis. Debt per capita of $716, compared to the state median of $703, ranked Vermont 25th among the fifty states in Moody's 2005 state debt medians. Debt to total personal income of 2.3%, compared to the 2.4% state median, ranked 27th. 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. The state's debt authorization levels have dropped steadily over the past decade. The fiscal 2006 amount recommended by the advisory committee for legislative authorization is about three-fourths of the level authorized in 1995.

Outlook

The positive outlook on Vermont's general obligation bond rating incorporates Moody's expectations for continued growth in the state's primary revenue sources and maintenance of strong reserve balances and manageable debt levels. 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 - UP

*Institutionalization of best financial management practices, including adherence to timely audited financial reporting.

*Continued trend of sound financial operations with maintenance of strong reserve levels

*Sustained job growth.

What could make the rating go - DOWN

*Deterioration in the state's financial performance.

*Weakened reserve levels.

*Increasing debt ratios relative to Moody's 50-state median.

*Muted economic recovery resulting in persistent revenue weakness

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Special Comment

August 2006

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U.S. States Credit Scorecard

New Quantitative Tool Introduced to Enhance Consistency of State Government General Obligation Analysis

Summary

Moody's state ratings team has developed and begun to use internally a quantitative scorecard as an additional analytic tool to enhance the consistency of our state general obligation (G.O.) credit analysis. The fundamental approach to rating state government debt, outlined in Moody's State Rating Methodology (November 2004), remains unchanged. The new scorecard reflects and supports the fundamental methodology, by assembling and comparing select data points and other variables in the areas of economy, debt, finances, and governance framework, which are the four main factors in our state analysis. Use of the scorecard will help preserve discipline and consistency with regard to the statistical part of our analysis, and better identify important statistical trends within the sector.

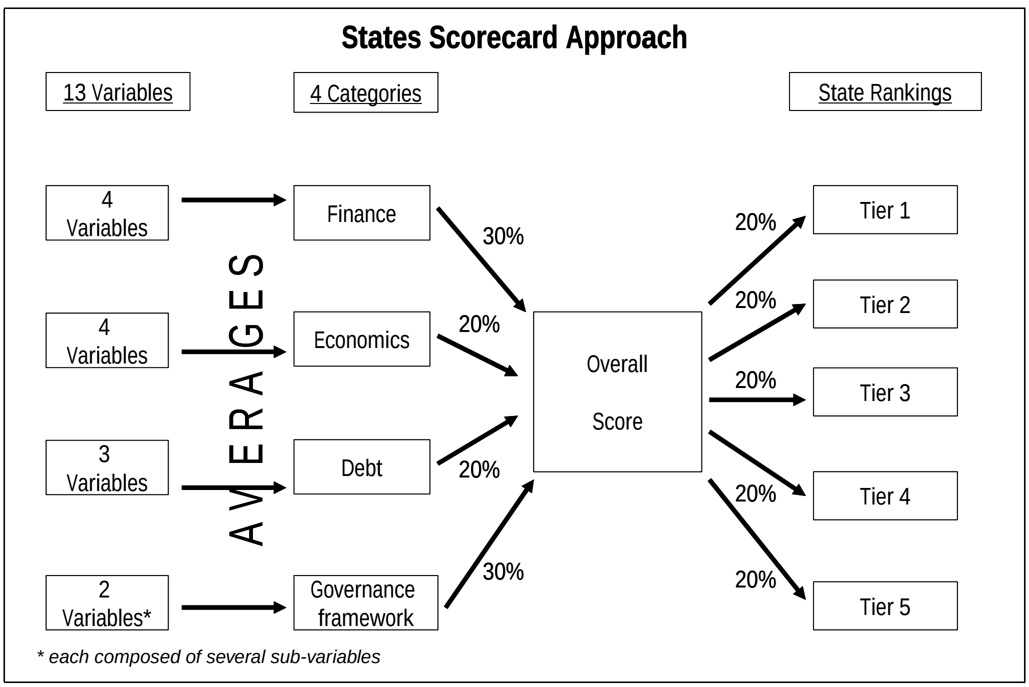
- The scorecard provides clear relative rankings of the 50 states on the most important statistical variables included in Moody's state government credit analysis.
- The quantitative data and rankings will be updated annually, and used in the rating process to enhance state comparative analysis and identify sector trends. The scorecard variables may be modified or added to over time as new data become available and/or refinements are made to our fundamental rating methodology.
- The scorecard includes variables related to the states' implementation of certain financial governance framework best practices, as well as measures of institutional financial flexibility which are also important factors in our ratings analysis.
- The scorecard results have limitations in that they are backward-looking, using only historical data. The results are used to inform the rating process but not to determine Moody's state G.O. rating assignments.

This report provides a description of the scorecard, including the individual variables, scoring and ranking methods employed to produce the rankings for each state, as well as general discussion of the intended purpose, expected analytical benefits, and limitations of the scorecard. We discuss the 2006 scorecard results compared to 2005 results and compared to actual state G.O. rating changes made over the past year. Finally, in the appendices, we present the 2005 and 2006 scorecard ranking results, as well as median and range information for the underlying statistical data in both years.

Importantly, the scorecard is not meant to be a substitute for rating committee judgments regarding ultimate credit quality and G.O. bond ratings for the individual states, nor is it meant to be a matrix for automatically assigning or changing ratings. As discussed in our 2004 methodology report, Moody's state ratings are forward-looking opinions of relative financial strength, with an emphasis on quality of governance framework. Included in the rating is our assessment of the expected willingness of state leadership to preserve a strong financial profile in the future, recognizing that all states face inevitable cyclical economic downturns as well as persistent constituent demands in excess of available fiscal resources. The willingness element is ultimately a matter of judgment, which we believe transcends the measurement ability of any strictly quantitative tool or approach. Moreover, the limited number of variables included in the scorecard cannot fully capture the breadth and depth of our fundamental credit analysis. Nevertheless, the historical performance statistics captured in the scorecard are important, and in general higher ratings can be expected among the states with the highest statistical scores and rankings from the scorecard.

Scorecard Variables and Ranking System Reflect Moody's Fundamental State Rating Methodology

The States scorecard has been developed to reflect and support Moody's fundamental approach to rating state governments, by assembling and comparing select data points and other variables in the areas of economy, debt, finances, and management, which are the four main factors in our state analysis. In total, there are thirteen variables scored for each state, which are described in more detail below and in the Appendix. The approach generates relative rankings of the 50 states on each variable, averages them by factor or category, and then generates an overall ranking by weighting each of the four factors. Consistent with the discussion in our 2004 methodology report, the finances and governance framework categories are weighted heavily relative to the economy and debt categories. The resulting overall rankings are then grouped into quintiles, or relative "tiers" of performance on the scorecard. For example, Delaware and Virginia achieved top quintile rankings in 2005 and 2006, while Hawaii and Pennsylvania achieved middle quintile rankings, and California and Mississippi achieved bottom quintile rankings in both years.



A useful aspect of the relative ranking approach is its ability to separate changes in relative position over time from general changes affecting the entire class of state credits. For example, almost all states have experienced a rebound over the past two years in many of their economic and financial indicators, but fewer have experienced significantly above-average improvement relative to the sector. The ranking information helps Moody's to sharpen its analysis of individual state trends relative to sector trends.

Individual State Rankings and Trends Influence, but Don't Determine Ratings

The scorecard's use of a strict ranking approach is expected to help preserve discipline and consistency with regard to the statistical part of our state credit analysis. At the same time, the presentation of broad quintiles or tiers is intended to minimize the importance assigned to relatively minor changes in statistical rankings from year-to-year. Moreover, even a movement between tiers may not be viewed as particularly significant given the overall credit strengths shared by the 50 states and their relatively narrow range of G.O. ratings (with 44 of our 46 G.O. or equivalent ratings in the Aa and Aaa categories). On the other hand, a strong upward or downward tier movement, especially if sustained over time, could be an indicator of a meaningful change in relative performance, and could warrant re-examination of the G.O. rating.

The scorecard has several important limitations, including the fact that it necessarily provides a backward look at a state's performance. By comparison, Moody's state G.O. ratings are forward-looking opinions of relative financial strength, with an emphasis on the quality of a state's governance framework. Included in the G.O. rating is our assessment of the expected willingness of the state leadership to preserve a strong financial profile in the future, recognizing that all states will face inevitable cyclical economic downturns as well as persistent constituent demands that exceed available fiscal resources. The willingness element is ultimately a matter of judgment, which we believe transcends the measurement ability of any strictly quantitative tool or approach. Nevertheless, the historical performance statistics captured on the scorecard are important, and in general, higher ratings can be expected among the states with the highest statistical scores and rankings from the scorecard. However, there is no rule that a particularly high or low scorecard ranking, even if it persists over time, will necessarily have implications for an issuer's bond rating.

Limitations of the States Scorecard Tool

- The scorecard is retrospective or backward-looking, relying on collection of a consistent set of 50-state data. It necessarily focuses on historical data, some of which (e.g. pension data) may have a significant reporting lag.
- The scorecard may miss important underlying trends. For example, two states may have the same five-year average fund balance ratio, but one is experiencing a declining trend and the other an improving trend.
- The ranking approach may insufficiently weight absolute differences in performance. For example, the difference between the 10th ranked state and the 20th ranked state on any given variable may be very small, while the difference between the 45th and 48th ranked states may be quite large by comparison.
- The scorecard's variables are necessarily limited. The governance framework variables in particular capture only a portion of the governance framework analysis that is included in Moody's G.O. rating opinions (see discussion in text).

States Scorecard's Finance, Economy, and Debt Variables*

Finance Variables

1. Five-Year Average Fund Balance Ratio
2. Five-Year Tax Revenue Growth
3. Five-Year Expenditure Growth
4. Borrowing for Operations
   a. short-term cash-flow borrowing in any of the past two years
   b. long-term borrowing for budget purposes in the most recent fiscal year
   c. long-term borrowing for budget purposes in any of the three prior fiscal years

Debt Variables

1. Ten-Year Growth in Net Tax-Supported Debt as % of State Personal Income
2. Net Tax-Supported Debt to State Tax Revenues
3. State Pension Funding Ratio

Economic Variables

1. Ten-Year Growth in State Per-Capita Income as % of US Average
2. Five-Year State Employment Growth
3. Five-Year Domestic Net Migration as % of US Total
4. State Poverty Rate

(see Appendix A for detailed definitions of each of these variables)*

Scorecard's Governance Framework Variables are Necessarily Limited

The analysis of a state's governance framework factors is an important part of Moody's state G.O. analysis, albeit one that is difficult to measure objectively. In the scorecard, we have focused on two areas that are relevant to a baseline analysis of governance framework strength: (i) the institutional financial flexibility that is inherent in the state constitution, and (ii) the degree to which certain fiscal "best practices" have been implemented by the state. It is important to note, however, that the scores and rankings in these areas may be eclipsed by our assessment of the more intangible and subjective elements of governance framework strength, most importantly the expected willingness to take strong but unpopular fiscal actions when necessary in times of stress. The degree to which a state employs conservative fiscal planning assumptions in order to avoid or at least minimize potential future stress is also very important. Certainly, all of Moody's Aaa rated states carry this strong subjective assessment of governance framework strength, though the ability to capture this information in a quantitative tool, such as the scorecard, is limited.

State Scorecard's Governance Framework*

1. Institutional Financial Flexibility – presence of each of the following either detracts from or enhances the score on this variable:
    a. Inflexible spending mandates or revenue restrictions in state constitution
    b. Voter initiative/ referendum process in state constitution
    c. Super-majority requirement for budget passage or tax increases
    d. Timely budget adoption
2. Fiscal Best Practices – presence of each of the following enhances the score on this variable:
    a. Consensus revenue forecasting process
    b. Multi-year financial planning oriented around structural budget balance
    c. Executive branch legal power to make mid-year spending adjustments w/out legislative approval
    d. Regular and effective debt affordability analysis
    e. Timely GAAP-basis audited financial reporting

** See Appendix A for detailed definitions of each of these variables*

Review of 2006 Scorecard Results: 14 States Change Tiers; Median Data Show Improvement

The 2006 scorecard rankings are based predominantly on underlying data from 2005, and the 2005 scorecard rankings are based predominantly on data from 2004. Appendix B shows a comparison of the overall tier rankings in both years, and highlights 14 states that had tier movements up and down in the recent year. Appendix C further breaks down the tier changes by category — i.e. Finances, Economy, Debt, and Governance Framework.

By its nature, the tier system exaggerates the number of movements, as every state moving up a tier necessarily causes another state to move down, and vice-versa. Given this feature, the amount of tier movement activity in the past year is slightly less than the amount of Moody's state G.O. rating changes that occurred in 2005, when six states were upgraded and three states downgraded, for a total of nine changes. While most of the states with rating changes during 2005 did not have corresponding tier movements, there is still generally good consistency between the current ratings and tiers for these states.

State G.O. Rating Changes and Scorecard Changes

State	Jan'05 to Jan'06 Rating Change	2005 to 2006 Scorecard Tier Change
Alabama	Aa3 to Aa2	3 to 4 (declined)
California	A3 to A2*	5 (unchanged)
Florida	Aa2 to Aa1	2 to 1 (improved)
Hawaii	Aa3 to Aa2	3 (unchanged)
Louisiana	A1 to A2	4 (unchanged)
Maine	Aa2 to Aa3	5 (unchanged)
Michigan	Aa1 to Aa2	4 (unchanged)
Nevada	Aa2 to Aa1	3 (unchanged)
New York	A1 to Aa3	5 (unchanged)

** subsequently raised to A1 in May 2006*

Moody's analysis of the economic, financial, and debt data underlying the scorecard rankings indicates that most states saw economic, revenue, and financial improvement during the past year. Some of the recent improvement is not captured in the scorecard variables that employ five-year averages. For example, while most states saw fund balance improvements in the past year, the 50-state median for the five-year fund balance ratio fell to 3.8% in 2005 from 5.0% in 2004. On the other hand, the recent financial improvement is more clearly indicated by the decline in the number of states employing long-term deficit borrowing to two in 2005 from ten in 2004. Appendix D provides median data for each of the Finance, Economy, and Debt variables as reported in the 2005 and 2006 scorecards (primarily reflecting 2004 and 2005 data).

In addition to highlighting tier changes, the scorecard allows Moody's analysts to identify and focus on those states which have demonstrated the greatest relative improvements and declines. For example, the state with the greatest total score increase in the past year was Montana, which led to its upward tier movement on the scorecard. Montana has demonstrated strong economic performance in recent years, as particularly evidenced by its rising per-capita income as a percent of the U.S. State financial performance has also been strong, and debt levels have remained low. These trends have been recognized by Moody's via the recent assignment of a positive outlook on the state's Aa3 G.O. bond rating.

In the case of Louisiana, the state recorded a moderate improvement in its financial category score over the past year and a significant decline in its economic category score. The latter is not surprising, in light of the economic disruption caused by Hurricane Katrina. However, the hurricane had no effect on the state's financial statistics, which were reported as of June 30, prior to the hurricane. The state's G.O. rating was downgraded late in the year to A2 with a negative outlook. The outlook was subsequently revised to stable in June of this year.

Scorecard Variables May be Refined Over Time

The scorecard framework represents an "open architecture" that Moody's expects to refine in the future if appropriate. For example, as new and consistent data become available on OPEB liabilities, this could be added as another scorecard variable. Changes or refinements could also be made if warranted by future changes in Moody's State Rating Methodology. We view the basic approach of scoring by relative rankings for each variable, weighting by factor or category, and "tiering" the results as a disciplined yet flexible and appropriate framework for the state sector.

Finally, we do not expect there to be any change in the nature of the interactions between state issuer clients, their agents and Moody's state rating analysts as a result of introducing the scorecard tool. Our comprehensive approach to rating state governments has not changed. The scorecard focuses on a limited set of variables that are meant to inform rather than determine our ultimate analysis of individual state credit strengths and G.O. ratings.

Appendix A

Detailed Description of Finance, Debt, Economy, and Governance Framework Variables

FINANCE VARIABLES

1. Five-Year Average Fund Balance Ratio

The most recent five-year average of the ratio of Unrestricted Fund Balance plus Available Reserves to Operating Revenues. The data are for the state's primary operating funds, on a GAAP basis, as reported in Moody's MFRA.

2. Five-Year Tax Revenue Growth

The most recent five-year total growth in state tax revenues. The data are for the state's primary operating funds, on a GAAP basis, as reported in Moody's MFRA.

3. Five Year Expenditure Growth

The most recent five year total growth in state operating expenditures. The data are for all governmental funds (including federal special revenue funds), on a GAAP basis.

4. Borrowing for Operations

This variable is an amalgamation of three yes/no questions: (i) has the state incurred short-term cash-flow borrowing in any of the past two years? (ii) has the state incurred long-term borrowing for operating budget purposes in the most recent fiscal year? (iii) has the state incurred long-term borrowing for operating budget purposes in any of the three prior fiscal years? The scoring for this variable is relatively more sensitive to question (ii), as this is an indicator of current structural budget imbalance pressure in addition to the recent incurrence of long-term deficit-related debt. States rankings for this variable are generated in a manner that is proportionally consistent with the 1 to 50 rankings used for other variables.

DEBT VARIABLES

1. Ten-Year Growth in Net Tax-Supported Debt as % of State Personal Income

A measure of the growth of the state's debt over the past ten years relative to the state's economic base, as measured by total state personal income. Each state's net tax-supported debt data is compiled annually by Moody's and published in our annual State Debt Medians Report. The last five years' of debt data and debt as a percent of personal income are also reported in Moody's MFRA.

2. Net Tax Supported Debt to State Tax Revenues

A current measure of state tax-supported indebtedness, relative to the current tax revenue base of the state's operating funds. Both data points are reported in Moody's MFRA.

3. State Pension Funding Ratio

The most recently reported ratio of state defined benefit pension system assets (on an actuarial valuation basis) to the present value of actuarial accrued liabilities. If the state is involved in the funding of multiple defined benefit systems, a combined funding ratio is used. The data is collected by Moody's from publicly-available sources. The scorecard rankings are based on the most recent year for which a great majority of states have reported data – for example, the 2006 scorecard ranks pension funding data predominantly reported as of 2004. Despite the effort to ensure reporting period comparability, the use of differing actuarial methods and assumptions by the states may still limit the true comparability of the data.

ECONOMIC VARIABLES

1. Ten-Year Growth in State Per-Capita Income as % of US Average

The most recent ten-year growth in the ratio of state per-capita income to U.S. per-capita income. The data are on a calendar year basis, as reported by the U.S. Bureau of Economic Analysis.

2. Five Year State Employment Growth

The most recent five-year total growth in the state's total payroll employment (both private sector and government sector), as reported by the U.S. Bureau of Labor Statistics. The data is on a calendar-year average basis, and is not seasonally adjusted.

3. Five-Year Domestic Net Migration as % of US Total

The state's most recent five-year total net domestic migration, as reported by the U.S. Census Bureau, as a percentage of total U.S. domestic migration over the same period. It is an indicator of the relative attractiveness of the state's economy, and is naturally skewed by absolute size of the economies in question. The largest states will typically be at either the top end (e.g. Florida) or the bottom end (e.g. NY) of this ranking. Foreign migration, which can also be a positive state economic indicator, is not included in this measure.

4. State Poverty Rate

The current percentage of the state's population living in households with income below the national poverty level, as defined and reported by the U.S. Census Bureau. The data are for the most recent year reported by the Census Bureau (i.e. 2004 data in the 2006 scorecard), and is currently reported in MFRA.

GOVERNANCE FRAMEWORK VARIABLES

1. Institutional Financial Flexibility

This variable is an amalgam of four yes/no questions:

a. Inflexible spending mandates and/or revenue limits – does the state constitution contain (i) one or more significant and inflexible minimum spending mandates, or (ii) an inflexible limitation on overall revenue collection and/or requirement to refund "excess" revenues?

b. Initiatives and referenda – does the state constitution authorize a process of voter initiative and/or referenda which has in the past led to significant fiscal policy uncertainties?

c. Super-majority requirements - does the state constitution require greater than majority approval of legislators for adoption of the budget and/or for raising new revenues?

d. Timely budget adoption – has the state, on more than one occasion over the past five years, passed its budget later than one month after the start of the fiscal year or had a budget delay of any length that resulted in a partial or full state government shutdown?

2. Fiscal Best Practices

This variable is an amalgam of five yes/no questions:

a. Consensus revenue forecasting - does the state adhere to an institutionalized consensus revenue estimating process, supported by nonpartisan and objective economic analysis?

b. Multi-year financial planning - does the state regularly publish multi-year financial plans, including out-year analysis of revenue and spending forecasts?

c. Executive branch mid-year spending reduction powers – does the executive branch have the legal power to make mid-year spending reductions, without need for legislative approval, and is this supported by strong budget monitoring and control processes?

d. Debt affordability analysis - does the state regularly publish a debt affordability analysis that effectively informs capital budgets and legislative debt authorization decisions?

e. Timely audited financial reporting – for each of the past two fiscal years, has the state published its audited, GAAP basis financial statements within nine months of the fiscal year-end?

Appendix B
2005 Scorecard and 2006 Scorecard State Rankings
(states listed alphabetically by quintile)

	2005	Rating as of Jan. 05	2006	Rating as of Jan. 06
Tier 1	Delaware	Aaa	Delaware	Aaa
	Indiana	Aa1	Florida↑	Aa1
	Maryland	Aaa	Maryland	Aaa
	Minnesota	Aa1	Minnesota	Aa1
	New Hampshire	Aa2	Nebraska↑	-
	North Dakota	Aa2	North Dakota	Aa2
	Utah	Aaa	Utah	Aaa
	Vermont	Aa1	Vermont	Aa1
	Virginia	Aaa	Virginia	Aaa
	Wyoming	-	Wyoming	-
Tier 2	Arkansas	Aa2	Arkansas	Aa2
	Florida	Aa2	Georgia	Aaa
	Georgia	Aaa	Idaho	Aa2
	Idaho	Aa2	Indiana↓	Aa1
	Iowa	Aa1	Iowa	Aa1
	Nebraska	-	Montana↑	Aa3
	Rhode Island	Aa3	New Hampshire↓	Aa2
	South Dakota	-	South Carolina↑	Aaa
	Tennessee	Aa2	Tennessee	Aa2
	Texas	Aa1	West Virginia↑	Aa3
Tier 3	Alabama	Aa3	Hawaii	Aa2
	Hawaii	Aa3	Kansas	Aa1
	Kansas	Aa1	Nevada	Aa1
	Montana	Aa3	North Carolina	Aa1
	Nevada	Aa2	Oklahoma↑	Aa3
	North Carolina	Aa1	Pennsylvania	Aa2
	Pennsylvania	Aa2	Rhode Island↓	Aa3
	South Carolina	Aaa	South Dakota↓	-
	Washington	Aa1	Texas↓	Aa1
	West Virginia	Aa3	Washington	Aa1
Tier 4	Alaska	Aa2	Alabama↓	Aa2
	Arizona	Aa3	Alaska	Aa2
	Colorado	-	Arizona	Aa3
	Connecticut	Aa3	Colorado	-
	Louisiana	A1	Connecticut	Aa3
	Massachusetts	Aa2	Louisiana	A2
	Michigan	Aa1	Massachusetts	Aa2
	New Jersey	Aa3	Michigan	Aa2
	New Mexico	Aa1	Missouri↑	Aaa
	Oklahoma	Aa3	New Mexico	Aa1
Tier 5	California	A3	California	A2
	Illinois	Aa3	Illinois	Aa3
	Kentucky	Aa2	Kentucky	Aa2
	Maine	Aa2	Maine	Aa3
	Mississippi	Aa3	Mississippi	Aa3
	Missouri	Aaa	New Jersey↓	Aa3
	New York	A1	New York	Aa3
	Ohio	Aa1	Ohio	Aa1
	Oregon	Aa3	Oregon	Aa3
	Wisconsin	Aa3	Wisconsin	Aa3

↑ Upward tier movement
↓ Downward tier movement

** NM has not yet released GAAP financial audits for fiscal 2004 and fiscal 2005. As a result, some of their financial measures are not comparable with those of the other 49 states. In addition, CT's fiscal 2005 GAAP financial statements are preliminary and unaudited at this time.*

Appendix C

2005 Scorecard and 2006 Scorecard Rankings by Finance, Economy, Debt, and Governance Framework Categories

(states listed alphabetically by quintile)

	FINANCE RANKING		ECONOMY RANKING		DEBT RANKING		GOVERNANCE FRAMEWORK	
	2005	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
Tier 1	Alaska	Alaska	Arizona	Arizona	Georgia	Arizona↑	Connecticut	Delaware
	Arkansas	Arkansas	Colorado	Delaware	Idaho	Delaware↑	Delaware	Illinois
	Delaware	Delaware	Delaware	Florida↑	Indiana	Georgia	Illinois	Indiana
	Hawaii	Florida↑	Maryland	Maryland	Montana	Idaho	Indiana	Maryland
	Kansas	Hawaii	Minnesota	Nevada↑	Nebraska	Nebraska	Iowa	Minnesota
	New Mexico*	Kansas	New Hampshire	New Hampshire	North Dakota	South Dakota	Maryland	North Carolina↑
	North Dakota	Montana↑	North Dakota	North Dakota	South Dakota	Tennessee	Massachusetts	South Carolina↑
	South Dakota	North Dakota	Vermont	Vermont	Tennessee	Texas	Minnesota	Utah
	Vermont	Vermont	Virginia	Virginia	Texas	Vermont	Utah	Virginia
	Wyoming	West Virginia↑	Wyoming	Wyoming	Vermont	Wyoming↑	Virginia	Washington↑
Tier 2	Florida	Alabama↑	Florida	Colorado↓	Arizona	Arkansas↑	Florida	Connecticut↓
	Georgia	Georgia	Idaho	Idaho	Delaware	Indiana↓	Kansas	Florida
	Idaho	Louisiana↑	Maine	Maine	Iowa	Iowa	Louisiana	Iowa↓
	Maryland	Maryland	Montana	Minnesota↓	Maryland	Maine↑	Michigan	Kansas
	Minnesota	Minnesota	Nebraska	Montana	Minnesota	Maryland	Nevada	Michigan
	Missouri	Missouri	Nevada	Nebraska	New Hampshire	Minnesota	North Carolina	Nevada
	Nebraska	New Mexico↓	Rhode Island	Rhode Island	Oklahoma	Montana↓	Rhode Island	Oregon↑
	Oklahoma	Oklahoma	Texas	South Dakota↑	Pennsylvania	North Dakota↓	South Carolina	Rhode Island
	Pennsylvania	South Dakota↓	Utah	Texas	Virginia	Pennsylvania	Washington	West Virginia
	West Virginia	Wyoming↓	Washington	Washington	Wyoming	Virginia	West Virginia	Wyoming↑
Tier 3	Alabama	Arizona	Alaska	Alaska	Alabama	Alabama	Alabama	Arkansas↑
	Arizona	Idaho↓	Connecticut	Georgia	Arkansas	Florida	Georgia	Georgia
	Indiana	Indiana	Georgia	Hawaii	Florida	Kentucky	Hawaii	Hawaii
	Louisiana	Nebraska↓	Hawaii	Massachusetts↑	Kentucky	Michigan	Mississippi	Louisiana↓
	Massachusetts	Nevada↑	Iowa	New Jersey	Louisiana	Missouri	New Hampshire	Massachusetts↓
	Montana	Pennsylvania↓	New Jersey	New Mexico↑	Maine	New Hampshire↓	New Jersey	Mississippi
	New Hampshire	South Carolina↑	Oregon	Oklahoma↑	Michigan	North Carolina	Oregon	New Hampshire
	Ohio	Tennessee	South Carolina	Oregon	Missouri	Oklahoma↓	Tennessee	New Jersey
	Tennessee	Utah↑	South Dakota	Utah↓	North Carolina	Utah↑	Vermont	Tennessee
	Virginia	Virginia	Wisconsin	West Virginia↑	Wisconsin	Wisconsin	Wyoming	Vermont
Tier 4	Colorado	Colorado	Arkansas	Arkansas	California	Colorado	Arkansas	Alabama↓
	Iowa	Connecticut↑	California	California	Colorado	Connecticut	Idaho	Idaho
	Michigan	Iowa	Kentucky	Connecticut↓	Connecticut	Louisiana↓	Kentucky	Kentucky
	Mississippi	Kentucky↑	Massachusetts	Iowa↓	Nevada	Nevada	New Mexico	Nebraska↑
	Nevada	Massachusetts↓	Missouri	Kansas↑	New York	New York	New York	New Mexico
	New Jersey	Michigan	New Mexico	Missouri	Ohio	Ohio	North Dakota	New York
	Rhode Island	Mississippi	Oklahoma	Pennsylvania	Rhode Island	Oregon↑	Oklahoma	North Dakota
	South Carolina	New Hampshire↓	Pennsylvania	South Carolina↓	South Carolina	Rhode Island	Pennsylvania	Pennsylvania
	Texas	Ohio↓	Tennessee	Tennessee	Utah	South Carolina	Texas	Texas
	Utah	Washington↑	West Virginia	Wisconsin↓	Washington	Washington	Wisconsin	Wisconsin
Tier 5	California	California	Alabama	Alabama	Alaska	Alaska	Alaska	Alaska
	Connecticut*	Illinois	Illinois	Illinois	Hawaii	California↓	Arizona	Arizona
	Illinois	Maine	Indiana	Indiana	Illinois	Hawaii	California	California
	Kentucky	New Jersey↓	Kansas	Kentucky↓	Kansas	Illinois	Colorado	Colorado
	Maine	New York	Louisiana	Louisiana	Massachusetts	Kansas	Maine	Maine
	New York	North Carolina	Michigan	Michigan	Mississippi	Massachusetts	Missouri	Missouri
	North Carolina	Oregon	Mississippi	Mississippi	New Jersey	Mississippi	Montana	Montana
	Oregon	Rhode Island↓	New York	New York	New Mexico	New Jersey	Nebraska	Ohio
	Washington	Texas↓	North Carolina	North Carolina	Oregon	New Mexico	Ohio	Oklahoma↓
	Wisconsin	Wisconsin	Ohio	Ohio	West Virginia	West Virginia	South Dakota	South Dakota

↑ Upward tier movement
↓ Downward tier movement

** NM has not yet released GAAP financial audits for fiscal 2004 and fiscal 2005. As a result, some of their financial measures are not comparable with those of the other 49 states. In addition, CT's fiscal 2005 GAAP financial statements are preliminary and unaudited at this time.*

Appendix D
2005 Scorecard and 2006 Scorecard Underlying Data Medians for Finance, Economy, and Debt Variables*

	High	Median	Low
Finance Variables			
Five-Year Average Fund Balance Ratio			
2005	44.5%	4.5%	-17.0%
2006	79.9%	3.8%	-18.4%
Five-Year Tax Revenue Growth			
2005	122.8%	18.7%	2.1%
2006	66.0%	23.1%	4.1%
Five-Year Expenditure Growth			
2005	52.1%	28.8%	-0.1%
2006	81.3%	33.3%	6.5%
Number of States that Incurred Deficit Borrowing in Most Recent Year			
2005		7	
2006		2	
Economy Variables			
Ten-Year Growth in State Per-Capita Income as % of U.S. Average			
2005	12.1%	0.6%	-11.7%
2006	16.7%	0.9%	-13.2%
Five-Year State Employment Growth			
2005	17.3%	2.1%	-4.1%
2006	19.2%	1.5%	-6.2%
Five-Year Domestic Net Migration			
2005	791,904	4,052	(771,944)
2006	1,029,341	6,283	(960,686)
State Poverty Rate			
2005	18.1%	11.2%	5.8%
2006	18.6%	11.6%	5.4%
Debt Variables			
Ten-Year Growth in Net Tax-Supported Debt as % of State Personal Income			
2005	3.7%	0.2%	-4.1%
2006	4.3%	0.3%	-4.2%
Net Tax-Supported Debt to State Tax Revenues			
2005	145.5%	46.9%	2.7%
2006	162.0%	45.0%	1.6%
State Pension Funding Ratio			
2005	112.1%	85.0%	43.5%
2006	112.1%	85.0%	43.5%

**The 2006 Scorecard rankings are based predominantly on underlying data from 2005, and the 2005 Scorecard rankings are based predominantly on data from 2004. Pension funding and poverty rate data lag by an additional year. See Appendix A for information on the calculation and reporting of each variable.*

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Report Number: 98088

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Credit Profile

US$15. mil GO "citizen bonds" ser 2005E due 07/15/2015	AA+
Sale date: 06-DEC-2005	
AFFIRMED	
$515.400 mil. Vermont go	AA+
OUTLOOK:	STABLE

Rationale

The 'AA+' rating on Vermont's series 2005E GO "citizen bonds" reflects the state's:

- Strong financial management with conservative debt and budgeting practices, including consensus revenue forecasting in place for more than a decade;
- Varied economy, with tourism as an anchor and high-tech manufacturing a sizable presence; and
- Favorable debt position with a low debt burden, rapid amortization, and a trend of more debt being retired than being issued.

The state's full faith and credit pledge secures the bonds.

Vermont's financial position remains strong. Fiscal 2005 is estimated to have closed with a $54 million surplus. Following transfers to the health trust account ($21.1 million), the transportation fund ($4.8 million), the teachers retirement fund ($4.0 million), and various other smaller transfer amounts, $19.6 million fell to the general fund budget stabilization reserve. At fiscal 2005 close, the state reserve funds were fully funded at statutory levels, providing more than $112 million in available reserves. The reserve levels were as follows:

- General fund budget stabilization fund balance, $44.5 million;
- Budget reserve surplus, $15.6 million;
- Transportation fund stabilization fund balance, $11 million;
- Education fund budget stabilization reserve, $22.9 million; and
- Human service fund caseload reserve balance, $18.54 million.

The fiscal 2006 general fund budget is conservatively set at just 3.3% above the fiscal 2005 adopted budget. Through September 2005, revenues are up $16 million, or 6.5% of budget. The July revenue estimating conference also increased the projections for fiscal 2006 revenues, after the budget was adopted, and, to date, $20 million of the newly projected revenues are yet to be appropriated. The General Assembly will meet in early January to make budget adjustments, but current estimates project a $25 million-$30 million budget adjustment action, well within available revenues.

Of note in the fiscal 2006 budget is a restructuring of the state's Medicaid system. Through negotiations at the federal level, Vermont has entered into an agreement capping and locking federal Medicaid reimbursements for five years at a 9% rate of increase. In return for the federal level appropriation certainty, the state receives a reduction in reporting requirements and restrictions on what the funds can be used for will be less restrictive. With the program changes, the state expects to be able to manage Medicaid cost increases to be within the capped amount over the five-year period. Should this assumption be inaccurate, the state will make up for any shortfalls. State officials believe that the state has a $522 million margin of error over the five-year period as that is the amount between what the guaranteed cap will provide and their estimates to total cost.

Vermont's economic diversification plays a central role in its relatively stable economic performance. The state's annual unemployment rate has been below national levels for more than 20 years. The August 2005 unemployment rate of 2.9% was below the nation's 4.9% rate, continuing that trend.

Vermont continues to maintain a conservative approach to debt issuance. Tax-supported GO debt outstanding was $440 million as of June 30, 2005, and is projected to be down to $439 million at June 30, 2006. At fiscal 2005 close, debt ratios are estimated to be an average $749 per capita and 2.1% of personal income. Amortization is rapid, with about 83% retired within 10 years. Vermont has been able to adhere to an annual debt cap for more than a decade.

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Outlook

The stable outlook reflects the expectation that the state's prudent financial and debt management practices will lead to continued sound financial operations. Standard & Poor's will continue to monitor the Medicaid cap five-year agreement for potential savings or losses. The stable outlook also anticipates that the state's economy continue to diversify.

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Economy

The state weathered the 2001-2002 recession comparatively well, but the layoffs of a single employer (IBM) slowed its full recovery. IBM, the state's leading employer with 6,200 employees, is beginning to rehire after a period with considerable layoffs. Through the national economic slow-down, IBM laid off more than 1,800 employees in Vermont, but in recent months has filled 250 new positions. Following IBM, the state's leading employers are stable and quite diverse. The only other private company employing more than 2,000 is Fletcher Allen Health Care (BBB/Stable/--) with 4,709 employees. Based in Burlington, Vt., Fletcher Allen Health Care is the parent company of Fletcher Allen Hospital, the state's leading hospital and a 500-bed teaching hospital associated with the University of Vermont (A+/Stable/--). A number of firms exceed 1,000 employees, including Chittenden Trust, General Electric Co., Rutland Regional Medical Center, Middlebury College, and a number of retail chains.

Vermont has increased its interdependence with the northeastern U.S. regional and Canadian economy, while its local economy has become more diverse. The increased diversity is important to reduce the effect of economic downturns or periods of stagnant growth, particularly in manufacturing or tourism. Vermont's population has above-average education levels and is currently ranked seventh in the nation as the percent of the population with a college degree. Median household effective buying income continues to strengthen and is currently just below the national average at 98.3% of the national level. Vermont's 2003 income of $30,740 per capita was slightly below the nation's $31,632 per capita average.

The fall foliage and winter ski seasons play a great role in Vermont's economy. The state's chief competitor for the prized ski tourism revenue is Colorado. Increasingly, areas like Killington are being marketed as ski resorts and locations for summer recreational activities, lengthening the tourist season and increasing sales, meals, and lodging taxes.

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Finances

Unlike many states, Vermont never fully depleted its reserves during the 2001-2002 recession; in addition, the state already replenished its reserves to statutory levels in fiscal 2004. Audited fiscal 2004 results indicate a $55.0 million general fund operating surplus. After transfers of $26.1 million to various internal service funds and $20.9 million to the general fund budget stabilization reserve, the surplus was reduced to $10.0 million. The $20.9 million added to the budget stabilization fund returned the fund to its statutorily set level: $44.5 million. The state's transportation fund closed fiscal 2004 with a strong $17.0 million surplus, increasing the transportation fund balance to $21.4 million. The education fund, following two years of deficit operations, returned to the positive with a $33.9 million surplus resulting in a $18.2 million undesignated fund balance and a fully funded budget stabilization reserve of $22.8 million. At fiscal year-end 2004, reserves on hand were nearly $73.5 million, including $44.5 million in the general fund stabilization fund, $18.5 million in the human services caseload reserve, and $10.5 million in the transportation fund.

In July 2001, Vermont converted to a new statewide financial management software system. The VISION system is currently operational, but start-up problems caused a delay in the release of the fiscal 2002 comprehensive annual financial reports (CAFR), which in turn has delayed both the fiscal 2003 and fiscal 2004 CAFRs. The state expects that the fiscal 2005 CAFR can be released by Dec. 31, 2005. The fiscal 2002, 2003, and 2004 CAFRs are fully GASB 34 compliant, and received unqualified audit opinions.

Fiscal 2006 budget/'Global Commitment'

The fiscal 2006 budget is conservative, with increases of just 3.4% in general fund expenditures and 3.3% in transportation fund expenditures. Base general fund appropriations will increase to $1.03 billion in fiscal 2006 from a revised $981.3 million in fiscal 2005. The proposed transportation fund appropriations level will increase to $225.9 million in fiscal 2006 from $213.7 million in fiscal 2005. Among other things, the budget funds retention of 10 previously federally funded state troopers, a $10 million increase in the general fund transfer to the education fund, and various tax reform measures designed to close loopholes. The corporate income tax is set to be reduced in two phases implemented on Jan. 1, 2006, and Jan. 1, 2007. This lost revenue is expected to be fully recaptured with changes increasing taxes from corporations with headquarters not located within Vermont but operating within it.

The budget looks to address a growing Medicaid funding deficit through changes in the program being viewed as a national pilot. The change has been labeled 'Global Commitment' by the state as it now expects to be able to use federal funds for previously nonreimbursable sectors. The reform caps the federal reimbursement at a set amount in return for loosening of federal fund use restrictions within the state over a five-year period. The change allows the federal government a more predictable level of annual assistance to Vermont. Vermont estimates that the cost to run the Medicaid program over five years is $4.17 billion and the cap will provide $4.70 billion in funding. The risk the state is assuming is that Medicaid reimbursement costs will not increase more than 9% annually or more than $522 million over the five-year period.

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Debt

In fiscal 2005, the state capital debt affordability advisory committee increased the debt cap to $41 million, the first increase over the $39 million limit set in fiscal 1999. The cap increased in fiscal 2006 to $45 million, and is currently set at $45 million again for fiscal 2007. Even with the increase, Vermont will continue to retire more debt than it issues annually. At fiscal year-end 2005, debt ratios were a manageable $749 per capita and 2.1% of personal income. In the Standard & Poor's report titled, "Public Finance Report Card: U.S. States Debt Profiles", available on RatingsDirect, Standard & Poor's Web-based credit analysis reference system, Vermont's conservative debt practices reflected well in the national comparisons. On a total tax-supported debt peer comparison, Vermont ranked 42nd. The state was in the middle of the peer group, 24th and 25th, respectively, in comparing debt per capita and debt to personal income. The state has no current plans to issue variable-rate debt or enter into any swaps.

Unlike many national pension systems, Vermont's state pension system remains strong. The $1.49 billion Vermont Teachers' Retirement System is funded at 90.7% through June 30, 2005, with a $138.1 million unfunded pension liability. The $1.2 billion Vermont State Retirement System is funded at 97.8% through June 30, 2005, with a $25.9 million unfunded pension obligation. The Vermont Municipal Employees' Retirement System is overfunded by 3% and has a $7.8 million surplus. The state expects to be compliant with the new government accounting standards board (GASB) statement 45 addressing other post employment benefits (OPEB). The current assumed OPEB unfunded liability is $828 million.

NEW ENGLAND ECONOMIC PARTNERSHIP
(NEEP)

Vermont Economic Outlook

May 2006

VERMONT ECONOMIC OUTLOOK

Summary Observations

- The revised May 2006 NEEP forecast revision expects that the current up-cycle for the Vermont economy will endure through calendar year 2010, traversing through an expected modest sub-cycle in calendar 2007and into early 2008.

    - The State's economy overall is expected to post decent, but slightly lower than the U.S. average rates of output, job, and income growth over the period—but generally exceed New England regional averages.

    - Job and income growth is expected to move back closer to the national average following the orderly unwinding of the real estate boom in the state ripples through the economy.

    - Vermont's unemployment rate over the period is expected to remain well below both the national and New England regional rates—although it may increase slightly during the period corresponding to the 2007-08 sub-cycle.

- This forecast revision represents a modest downgrade for calendar year 2006, reflecting the significant and negative re-benchmarking adjustments to the State's payroll job survey data and high and volatile energy prices.

    - This means the State will start the forecast period from a somewhat lower level for output, job and income growth than was expected last Fall at the end of calendar 2005.

- Higher energy prices have and will likely continue to exert a significant drag on many parts of the State's economy. These impacts range from curtailing household spending and increasing business costs to dampening most forms of visitor spending.

    - As energy prices have once again begun to approach levels first experienced last Fall, it is worth noting that such increases add an additional layer of increased costs for State businesses at a decidedly inopportune time in this increasingly competitive global economy.

    - Impacts will be especially difficult for those firms in the State's energy-intensive sectors such as resource-processing, chip fabrication, and food processing which are already in sharp global-wide cost competition.

- Among the State's macro variables, Vermont's rates payroll job growth (at +1.0% per year), inflation-adjusted Personal Income growth (at 1.9% per year), and inflation-adjusted output growth (at 3.1% per year) are expected to remain historically restrained and uneven for this point in the business cycle.

    - All of those readings represent rates of growth that are equal to or significantly higher than the rate of growth experienced during the first half of the decade.

    - As with last Fall's forecast, the manufacturing sector is expected to lose some additional employment ground over the forecast at -0.3% per year, but that represents a significant improvement from the 2000-05 time period when this sector lost jobs at the rate of 4.5% per year.

   - The elevated and volatile energy price environment also suggests that this sector will remain "at a heightened level of risk" for even more significant job losses over the 2006-10 period.

- The highest rates of job growth are expected in the Professional & Business Services sector (at +2.1% per year), Education & Health Services sector (at +2.0% per year), and the Leisure and Hospitality sector (at +1.8% per year) over the 2006-10 forecast period.

   - A total of 11 of 12 major NAICS sectors (except for the manufacturing sector) are expected to recover-add jobs over the next 5 years.

   - All major NAICS categories except for manufacturing are expected to cross the line from recovery to expansion by the end of the 5 year forecast.

- As of May 2006, there remains a number of threats to the national and State economic outlook, any one of which could restrain, if not derail, the current up-cycle.

   - Clearly, the recent increase and volatility in energy prices represents a clear and present danger to the Vermont economic upturn.

   - So does the continued double-digit rate of increase in housing prices and the inevitable correction that is likely to occur within the next year to 18 months—if this correction is not orderly and manageable.

   - The current forecast expects the national and State economic upturns to continue despite these threats.

   - But the negative drags exerted by the above will keep forward progress restrained by past recovery-expansion standards.

- The recent hurricane-induced energy price spike, the blackout of August of 2003, and the continuing geopolitical uncertainty in much of the energy producing regions of the world have once again drawn attention to the weaknesses in the U.S., regional and State energy policies and infrastructure.

   - For the New England region in general and in the state of Vermont, price increases and volatility tend to result in even higher levels of price increases and greater instability (a.k.a. reduced reliability).

   - For a region where stable sources and relatively low energy price levels are so important to the economic performance and growth of the economy, it is vitally important for energy—in what ever form it is needed—to: (1) be available and affordable on an "as needed, 24-7 basis," and (2) come from a portfolio of sources with enough diversity so that the system can accommodate most routine disruptions.

- The challenge to Vermont's energy future is to find a way to meet its energy needs that is affordable, efficient, reliable, and minimizes environmental impacts.

- There currently is no known single energy source that simultaneously meets all of those criteria.

- The situation is further complicated by the fact that these decisions involve time horizons of 20 years or more—when little is known with any degree of certainty about the market conditions, market structure and the regulatory approach that will be in force that far out into the future.

- Even so, the State has a huge stake in the outcome of such policies, since households and businesses in the State and the entire New England region pay among the highest energy costs in the country.

➢ The recent run-up in energy prices is a good illustration of the negative impact of higher energy prices on the Vermont economy.

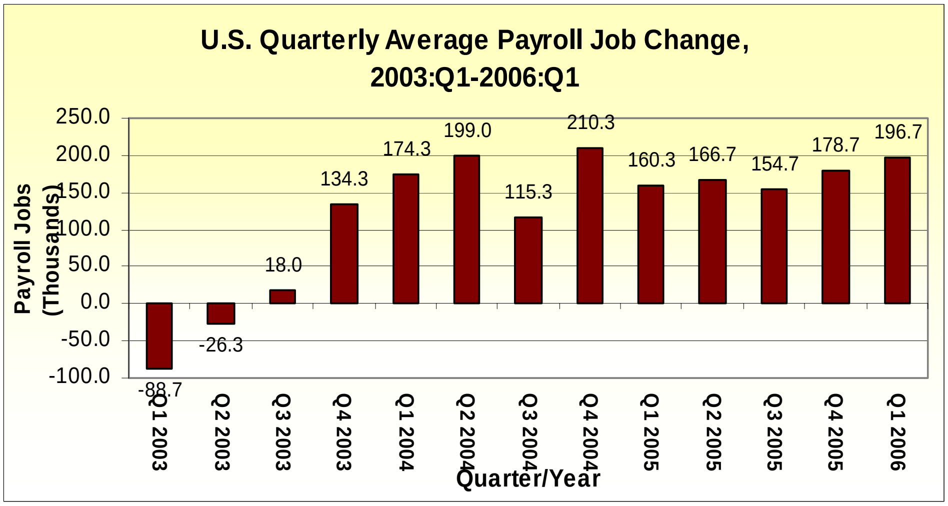
- An impact simulation was run to estimate the impact of higher energy prices on the Vermont economy if they were maintained for an entire year.

- Impacts included: (1) a reduction of 1,380 full-time and part-time jobs, (2) a reduction of $51.9 million in state personal income, (3) a reduction of $121.3 million in personal consumption, and (4) a net negative fiscal impact of $7.1 million.

- While the 1,380 job impact may not sound significant, that level of job impact would have represented over half (or 57.5%) of the total net new payroll jobs added in the Vermont economy during the calendar year 2003-2004 period—before this latest run-up in energy prices began.

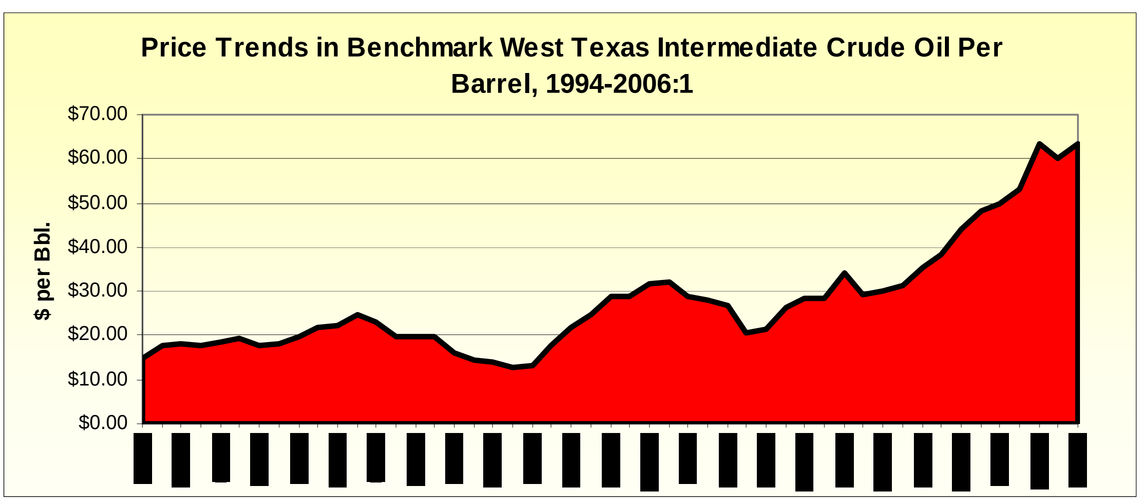
Overview of the U.S. Economy's Recent Performance

The recent performance of the U.S. economy as a whole has so far in calendar year 2006 has been favorable. Real Gross Domestic Product (GDP) is on pace for a greater than 5% annualized rate of increase during the January-to-March quarter following the hurricane-depressed 3¼ % rate of inflation-adjusted output gain during calendar year 2005. U.S. labor markets over the first quarter of 2006 have seen relatively strong payroll job gains at an average of 196,000 jobs per month—representing roughly 50,000 new jobs per month more than is required to absorb productivity gains and labor force growth. Payroll job gains have been strong in the financial activities sector, business/professional services, and education/health services. The mild weather during the first quarter also underpinned relatively upbeat payroll job gains in the construction sector during the quarter.



During the January to March period, labor market conditions continued to tighten and the economy overall appears to be operating near capacity. The unemployment rate in March fell to the 4.7% level, corresponding to a new cyclical low. The nation's factories, mines and utilities are operating at levels that are at or higher than 80%--the level considered by many analysts to be "at capacity." In fact, the national unemployment rate is now at a level that is well below the so-called full employment unemployment rate. There is increasing concern that the combination of tightening labor market conditions, at or above capacity factory utilization, and surging commodity prices (for items that go far beyond just oil and gas prices) will soon bring the extraordinary period of well-contained inflation to an end.

One of the most significant challenges for monetary policy through the years has been how to distinguish between what is real with respect to underlying trends in output, labor market activity, and inflation and what is simply a function of the noise and shocks associated with global and national economic developments. Over the past year, the national economy has had to contend with the exceptional shocks associated with the 2005 hurricane season and surging energy prices related to the loss of a significant percentage of the nation's energy production and refining capacity. The resulting curtailment of activity likely held down the pace of output and job growth during the October to December quarter of 2005. The restarting-rebuilding activity associated with



the recovery of the Gulf Coast region is likely providing a boost to output activity this calendar year—even if the precise level of assistance is not really understood for the upcoming quarters in calendar 2006. In addition, it is no secret that this Winter's warm temperatures likely boosted the construction sector during the first quarter of calendar 2006, likely at the expense of building activity that might have otherwise been undertaken later on in the Spring. All told, the above factors appear to be underpinning a sizable, albeit temporary, boost to output growth during the first quarter of calendar year 2006.

Following the first quarter acceleration in output growth, the consensus forecast is for the U.S. economy to return to a more moderate and sustainable rate of GDP growth (and job growth) for the rest of calendar 2006 and into calendar 2007. This view is underpinned by the economy's still strong underlying fundamentals, including: (1) still historically low long-term interest rates—even though they have recently moved higher, (2) very strong corporate balance sheets and continued robust levels of corporate earnings, (3) recent gains in jobs, housing prices, and equity markets that have led to solid wealth gains for many households and have helped to maintain a level of household consumption that has provided a critically important source of growth for the current recovery/expansion.

Certainly, one of the obvious challenges for the U.S. economy in the current situation is the recent climb and persistent volatility in world energy prices—principally crude oil and natural gas (and by implication gasoline). Calendar year 2005 marked the third year in a row where domestic energy prices increased. Further, last year in particular, energy prices experienced a very damaging level of price volatility following the unusually destructive hurricanes that struck the Gulf of Mexico and Gulf Coast energy production, refining, and shipping infrastructure. That level of higher energy prices seriously reduced household spending power and cut significantly into the profits of non-energy businesses. Over the past year, strong business balance sheets and near record levels of profitability allowed businesses to absorb much of the relatively short-lived energy price spike without passing it on through the distribution chain.

However, it is noteworthy that as of this writing in late April of 2006, global crude oil prices have now once again have risen to over $70 per barrel. The price of a gallon of regular gasoline has likewise risen back upwards of $2.75 per gallon. That price level is roughly $0.50 per gallon or 23.8% higher than at this time last year and is close to where prices were back in mid-October of 2005. The point here is that it is now decidedly unclear how much longer businesses will be able to absorb higher energy prices as productivity gains inevitably moderate and profit margins narrow. The longer these higher energy prices persist, businesses will at some point need to attempt to pass at least a part of these costs on to their customers. This would complicate the long-running, but still delicate balance between a very tame core inflation (especially for this point in the economic cycle), recent emerging wage cost pressures, and the Fed's interest rate policy—as executed under its new leadership.

The Moody's Economy.com U.S. Economic Outlook

Factoring in the unusual plethora of recent noise and shocks that have been impacting both the pace and profile of economic activity over the past year, most economic forecasters are expecting that the pace of output, job, and spending growth will moderate to a sustainable rate following a sizable jump during the January to March quarter. The March 2006 Moody's Economy.com national forecast scenario, which formed the national basis for the Vermont economic forecast update, follows this view. After posting a strong +4.9% annualized rate of inflation-adjusted GDP growth during the quarter, Moody's Economy.com expects the national GDP growth rate to moderate to the +3.0%-to-3.5% range over the rest of the 2006-2010 time frame. On a year-to-year basis, inflation-adjusted GDP growth is expected to range from a high of +3.5% in calendar year 2006 to a low of +3.0% for calendar years 2007 and 2008.

The Moody's Economy.com scenario also is consistent with a view that the prospects for on-going gains in consumer spending and business capital investment remain good. Recent positive reports on retail spending and the recovery in vehicle sales levels following the depressed period in the aftermath of "employee pricing incentives" indicate that March was a reasonably upbeat month for consumption spending and a bounce-back quarter for the January to March quarter overall following the fourth quarter of 2005's sluggish +1.2% reading. The outlook for moderate consumption increases in the +2.5% to +3.0% range, as expected in the Moody's Economy.com forecast scenario, is consistent with expected labor market gains—averaging between a high of +1.9% in calendar 2006 to a low of +1.0% in calendar 2008 over the calendar 2006-2010 forecast period—and the latest consumer confidence readings . In addition, recent indicators of businesses' capital spending plans[1] suggest that calendar 2006 should be a solid year for spending on new plant and equipment in the economy. The Moody's Economy.com scenario also reflects this view, with nonresidential fixed investment expected to post an annual gain north of 6.0% in calendar year 2006—but slowing to annual rates of between +2.8% during the sub-cycle in calendar year 2008 to +3.3% in the out-year of the forecast period (or during calendar year 2010).

Another key growth supporting factor in the U.S. economic outlook is the continuing positive outlook for the global economy. The global economy is in the midst of a solid expansion, with economic activity in China and the emerging Asian economies growing strongly. The economic outlook for Japan also has improved as that previously struggling economy has strengthened. The outlook for the Canadian economy likewise includes the expectation for sustained, moderate economic growth. That outlook bodes well for continued growth in exports for U.S. businesses over both the near-term and longer-term time horizons. Re-building activity in the Gulf Coast region resulting from the significant federal stimulus tied to hurricane relief should also provide a boost to near-term activity. However, this near-term stimulus related to re-building and hurricane-related repairs will likely be off-set to some degree by the expected slowdown in overall residential construction elsewhere in the country. The most recent readings from the home sales and residential construction indicators suggest that housing demand has peaked, and many markets are already beginning to experience moderating trends in the rate of home price inflation.

On the inflation front, although higher energy and commodity prices have yet to work their way into the economy's general inflation rate to a significant degree, higher energy prices remain as one of the principal threats to the inflation outlook. So far, businesses—with their record profit margins—have apparently been willing to absorb energy cost increases (and high commodity prices in general) to-date. However, inflationary expectations appear to be on the rise, and the ability and inclination of businesses to simply absorb energy price increases (and commodity price increases in general) will decline the longer commodity prices remain elevated—and as productivity wanes and profit margins become inevitably become narrower over the next several quarters. The Moody's Economy.com forecast expects that the price of the benchmark West Texas Intermediate Crude Oil price per barrel will average just under $60 per barrel during calendar 2006—an increase of 2.3% over the hurricane-inflated average price level during calendar 2006. The baseline forecast then expects the price to begin to decline later this Summer and fall back into the $40 per barrel (by calendar 2009 and 2010) after experiencing a roughly $47 per barrel range (for calendar 2007). The Moody's Economy.com baseline acknowledges that forecasting energy

[1] Such as the recent survey by the National Association of Business Economists (NABE) completed at the end of calendar year 2005.

prices is a risky endeavor. The recent spike in prices is expected to moderate demand for energy, and these prices are likewise expected to engender some type of positive production response from producers over both the near-term and longer term time horizons. To support this view, the baseline forecast notes that the worldwide rig counts are now at their highest level since the early 1980s. Overall, the baseline forecast calls for inflationary pressures to develop more fully over the forecast period, with core inflation rising from its current +2.0% to +2.5% pace to between 2.5% to 3.0% later in calendar 2006. Beyond that point, CPI inflation is expected to remain relatively well-contained. This is consistent with longer-run price expectations that by most counts (e.g. inflation-protected treasury securities) remain well contained.

Turning to interest rates, the Moody's Economy.com baseline forecast expects that monetary policy will remain committed to what the Fed has termed "removing accommodation" at a "measured pace." The forecast expects the Fed will continue its series of tightening moves that began back in June of 2004 and tighten again at the May FOMC[2] meeting, raising the federal funds rate to 5%. The 5% federal funds rate is a level that many monetary policy observers believe is a more neutral rate, one that is neither stimulating nor constraining to economic growth. Driving that expected action is an economy that is operating near capacity, a dark and still eroding long-term federal budget outlook, and increasingly tight labor market conditions—including the lowest unemployment rate in 5 years (which is now below the economy's natural unemployment rate) and a rate of payroll job addition that exceeds 200,000 per month (a level 50,000 more than what is understood to be needed to keep up with productivity gains and labor force growth).

All of this has significant implications for the pace and profile to expected U.S economic activity over the next 5 years. The top-line macro indicators follow an expected profile where total output and payroll job growth experience above trend 5.0% plus GDP growth and payroll job growth of around 200,000 new jobs per month. Inflationary pressures will intensify over the period and interest rates will rise through mid-year, peaking at 5% federal funds rate and 10-year treasuries rise to more than 5% by the middle of the year. Output growth then moderates to a more sustainable and inflation-stable 3.0% range through the rest of the forecast period. Job growth follows a similar pattern with annual job growth throttling down to the 1.0% (by calendar 2008) during the upcoming sub-cycle, rising back to the to 1.4% range (in calendar 2009) and 1.3% in calendar 2010. Much of that performance will depend on the expected moderation in housing markets. Sales indicators suggest that the market overall has peaked, and prices have already started to moderate as investors have left the market. Mortgage originations have slowed as rates have edged higher, and homebuilders are beginning to experience a slowdown in orders and increased cancellations as inventories of unsold homes have increased. A soft-landing for housing markets is still the consensus forecast. This would be a key development for the economy given the far-reaching job, wealth, and mortgage equity withdrawal impacts (on consumer spending) that the housing sector has had on recent economic growth.

If the composition of growth is expected to shift from a housing and wealth dependent consumer spending-led expansion over the next year to one led by increased business investment, export growth will be a key driver to U.S. economic growth. Exports are expected to grow over the forecast period within a range of between +7.0% (in calendar years 2006 and 2007) to +8.5% in calendar 2010. That trade performance will depend on a tricky and still evolving interaction between global financial flows from regions with surplus financial reserves (e.g. China and Asia) and U.S. domestic monetary policy.

[2] The term FOMC means Federal Open Market Committee, the interest rate policy making committee (among other functions) of the Federal Reserve.

Overview of Vermont's Recent Economic Performance

With that discussion as a backdrop, the Vermont economy this Spring continues on its historically sluggish recovery-expansionary path. The latest vitals relating to the recent performance of the Vermont economy include: (1) output growth that appears to be running in the range of +3.0% to +4.0%, (2) payroll job growth in the +1.0% to +1.5% range following the late Summer-Fall energy price spike, (3) a statewide unemployment rate that is among the lowest in the nation (at an estimated 3.3%—seasonally adjusted—or sixth lowest in the nation and lowest among the six New England states), (4) real personal income growth of between +1.0% and +1.7% on a quarterly basis, and (5) persistent double-digit rates of housing price appreciation (at an estimate +15.7% in Q1 of calendar year 2006. In addition, the state has made impressive gains in reducing poverty in recent years. Vermont also was among the top states in median household income growth during calendar 2004, and the state's 96.1% of the U.S. average in per capita (or per person) personal income in calendar 2004 (with 2004 being the latest year available) was its highest reading in modern postwar economic times.

On a sector-by-sector basis, the labor market data show that the Vermont labor market continues to make forward progress—albeit on a somewhat restrained basis in comparison to the mid-1990s labor market recovery-expansion. Fully six of eight major NAICS categories have crossed the line from recovery to expansion. Only the hard-hit manufacturing sector and the still struggling Leisure and Hospitality sector have yet to fully recover the employment ground lost during the last labor market recession in the state. The former is a well documented fact and is a reflection of the realities associated with increasingly sharp, global competition in manufacturing. The later is a reflection of the hang-over effect of the tragic terrorist attacks of September 11, 2001, the Fall of 2005 hurricane-induced energy price spike, and the exceptionally poor weather that plagued Vermont's 2005-2006 ski season.

In fact, initial estimates of Vermont's calendar year 2005 economic performance indicate that 2005 was in many respects a forgettable year for the Vermont economy. Total payroll job growth finished the year at only a +0.8% versus 2004's +1.3% annual growth performance. Total output growth, adjusted for inflation, rose at the rate of +3.3% versus 2004—a throttling down of 1.6 percentage points relative to calendar year 2004's more robust +4.6% growth rate performance. Inflation-adjusted total personal income likewise grew only modestly during calendar year 2005, increasing at the rate of +2.3% for the year. That growth rate was down significantly from the +3.1% annual growth rate performance for inflation-adjusted personal income during calendar year 2004.

This is reflected in the results of the annual re-benchmark revisions of the state's payroll job estimates. The re-benchmarking process involves a process where estimated payroll job counts determined through the Department of Labor's monthly survey of employers during the previous year (and part of the year before that) is trued up to actual job counts and wage data filings by employers under the State's Unemployment Insurance Tax program. These data are now commonly referred to as the **Q**uarterly **C**ensus of **E**mployment and **W**ages (QCEW). This year, Vermont experienced the second largest downward revision among the 50 states (at -1.3% of its total jobs), with only the state of Kansas experiencing a larger downward revision (see Table 1). Nearly all of the New England states experienced the same downward revision fate, with only the state of Massachusetts experiencing a small positive re-benchmark revision for the spring of 2006.

Table 1: Impact of the 2006 Re-Benchmark Revisions by State

Rank	State	Change in 12/05 # Jobs	Difference
		000s	%
1	Mississippi	22,900	2.1%
2	Texas	177,300	1.8%
3	Arizona	43,700	1.7%
4	Oklahoma	23,700	1.6%
5	Georgia	60,000	1.5%
9	Florida	86,800	1.1%
38	Massachusetts	3,800	0.1%
42	Rhode Island	-1,000	-0.2%
43	Maryland	-6,700	-0.3%
44	Delaware	-1,300	-0.3%
45	Connecticut	-6,700	-0.4%
46	Montana	-2,800	-0.7%
47	New Hampshire	-5,600	-0.9%
48	Maine	-6,400	-1.0%
49	**Vermont**	**-4,100**	**-1.3%**
50	Kansas	-20,500	-1.5%

Table 2 presents the year-to-year comparison of the survey and re-benchmarked payroll job count data. The table shows that a total of 2,450 total payroll jobs (or 0.8% of the total) that were thought to be present in the Vermont economy during 2005 from the original survey data turned out not to be present in the Vermont economy after the re-benchmarking process. The result of this revision means that what was originally thought to be a +4,600 annual change in jobs (corresponding to a relatively healthy +1.5% rate of growth[3]) turned out in the revision to be only a +2,400 payroll job gain (corresponding to only a +0.8% rate of increase) between calendar years 2004 and 2005. For private sector jobs, the revision process reduced the survey indicated number of new jobs added by 2,250 (or by 1.0% of the total). Those revisions resulted in the originally reported +1.6% rate of payroll job increase in calendar year 2005 over 2004 turning out to be only a +0.7% rate of increase during calendar year 2005 versus calendar year 2004.

[3] A level that was equal to the year-over-year rate of payroll job change nationally in calendar year 2005 versus calendar 2004.

Table 2: Overview of February 2006 Vermont Payroll Job Rebenchmarking Revisions

		1st Revision/ 1st Survey [1][2]	Re-Bench-marked [3][4]	# Difference	% Difference
Total Nonfarm Jobs					
	2004	303,250	303,000	-250	-0.1%
	2005	307,850	305,400	-2,450	-0.8%
Annual Change 2003-2004					
	Number Change	4,600	2,400	-2,200	---
	Percent Change	1.5%	0.8%	---	---
Private Nonfarm Jobs					
	2004	250,950	250,650	-300	-0.1%
	2005	255,050	252,500	-2,550	-1.0%
Annual Change 2004-2005					
	Number Change	4,100	1,850	-2,250	---
	Percent Change	1.6%	0.7%	---	---

NOTES:

[1] 2005 data are survey data for that year

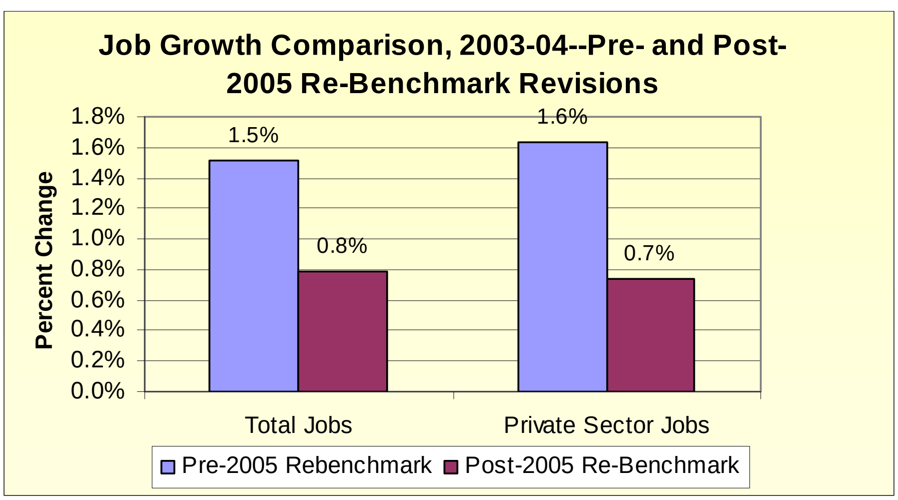
[2] 2004 data reflect the first re-benchmark revision for that year (pre-October)

[3] 2005 re-benchmarked data correspond to first re-benchmarking revision for that year (Through September)

[4] 2004 re-benchmarked data correspond to the second and final re-benchmarking revision for that year (Through September)

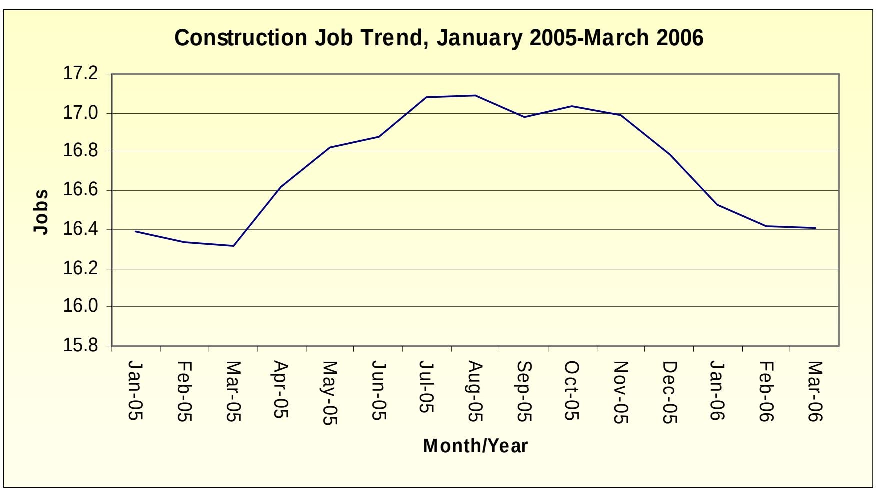
Basic Data Source: VT Department of Labor

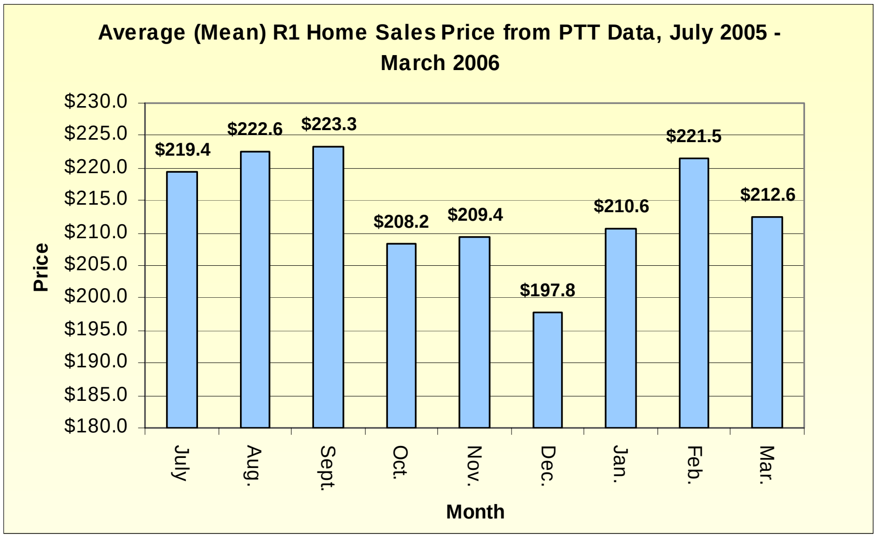
The re-benchmark revisions also have changed what had been previously understood about the level of labor market expansion across the state. With these Spring 2005 re-benchmark revisions, the level of labor market recovery-expansion from a total payroll jobs standpoint has changed from an expansion with 5,300 jobs added following 7,100 total jobs lost during the 2000-2002 recession to one where roughly 2,500 jobs have been added in the post-recovery period. In the private sector total payroll job category, the re-benchmark revisions indicate that the Vermont labor market has not yet completely recovered and crossed over the line to expansion. The re-benchmarked data indicate that the state has roughly one of every nine private sector jobs lost during the last recession left to recover as of March 2006. Moreover, the pace of job recovery-expansion has dropped back from the pre-revision survey data indicated level of about 75% to 80% of the pace of recovery relative to that experienced during the recovery during the early 1990s to just under one-half of the pace of that recovery-expansion.



While it certainly should not be expected that Vermont, which had a shorter and shallower recession than the U.S. economy overall, would outpace the rate of job recovery-expansion in harder-hit U.S. labor markets, it is clear that Vermont no longer enjoys the best of both worlds. Before the re-benchmark revision, it looked as though Vermont labor markets had been enjoying a roughly proportionally to slightly faster rate of labor market recovery-expansion relative to the U.S. in the post-recession period, even though the state had experienced a shorter and milder labor market recession earlier in the decade.

Looking at the month to month data, one of the major factors behind the relatively lackluster 2005 payroll job performance and the so-so performance during the January to March period of calendar 2006 was the seasonally-adjusted 700 job decline in Construction jobs since last August. That construction job decline coincided with the post-hurricane energy cost spike that appears to have shook consumer confidence in the state, adversely impacted the state's tourism industry (since roughly half of the state's visitors still drive to Vermont and stay with family and/or friends), and apparently made the state's residential real estate markets wobble with some uncertainty for a period of three to four months. This uncertainty was somewhat less pronounced in the state's vacation home sector over the nine month post-hurricane period—although it should be noted that the month of January looked to be a poor one for sales of vacation homes. Since that time, the state's real estate markets have apparently stabilized and even turned around to some degree. However, this apparently improved condition is not yet reflected in any kind of significant resumption of job growth in the state's construction Industry. Indeed, it appears the re-emergence of increasing energy prices and a heightened level of uncertainty in the energy price outlook has resulted in an overall pause in recovery-growth across most of the state's job categories over that eight to nine month period as well.





This is perhaps best reflected by recent job change trends in the state's manufacturing sector—where the on-going pattern of one step forward, two steps back, and another one side ways continues to dominate employment changes. In many respects, the state's factory sector is demonstrating good resilience in the face of rising business costs (e.g. rising energy costs—including oil and gas currently and electrical energy almost surely in the future) and the intensely competitive global arena. In fact, companies such as IBM of Essex Junction have recently been out aggressively looking for additional production workers in the northwestern Vermont job market as their order situation has improved, national capital spending has strengthened, and the global economy has continued to grow at a solid pace. Overall, Vermont manufacturing companies that serve niche or specialty markets—including such companies as NRG Systems, Northern Power Systems, Green Mountain Coffee Roasters, Vermont Butter and Cheese, Hubberton Forge, Wild Apple Graphics, and Franklin Foods—continue to do well in the state. On the other side, Vermont manufacturers that are in maturing industries and/or are in the state's resource processing sectors continue to face stiff competitive challenges and rising costs that will continue to place significant downward pressures on jobs in these categories. As a result, several major Vermont manufacturers have announced major employment downsizings over the past year (the most recent being announced by Fibermark, Inc. just last month), mostly the result of off-shoring, cost-cutting to remain competitive, and/or corporate consolidation in the aftermath of acquisition by out-of-state owners.

As a result, Vermont's relative rank among the New England states and among the other 49 states in the country in year-over-year job change through March echoes the above discussion. Table 3 shows that Vermont still ranks first in the New England region in terms of year-over-year change growth in manufacturing (and 22nd nationally), but has fallen back somewhat with respect to other comparative year-over-year job change benchmarks, For both major payroll job aggregates, the state ranked 45th and 44th national ranking in terms of total payroll job and private sector payroll job growth (including a 5th and 4th in New England ranking in each, respectively). The state also ranks in the 33rd nationally and 2nd and 3rd regionally in the Trade, Transportation and Utilities category and the Education and health Care sectors. Vermont has fallen to 4th regionally and 44th nationally in terms of the year-over-year change in Construction jobs, despite a record of more than $600 million in residential housing permits during calendar 2005. The state also in March of 2006 continued to be ranked relatively low in year-over-year job growth in the Leisure and Hospitality sector (6th regionally and 48th nationally), Professional and Business Services (6th regionally and

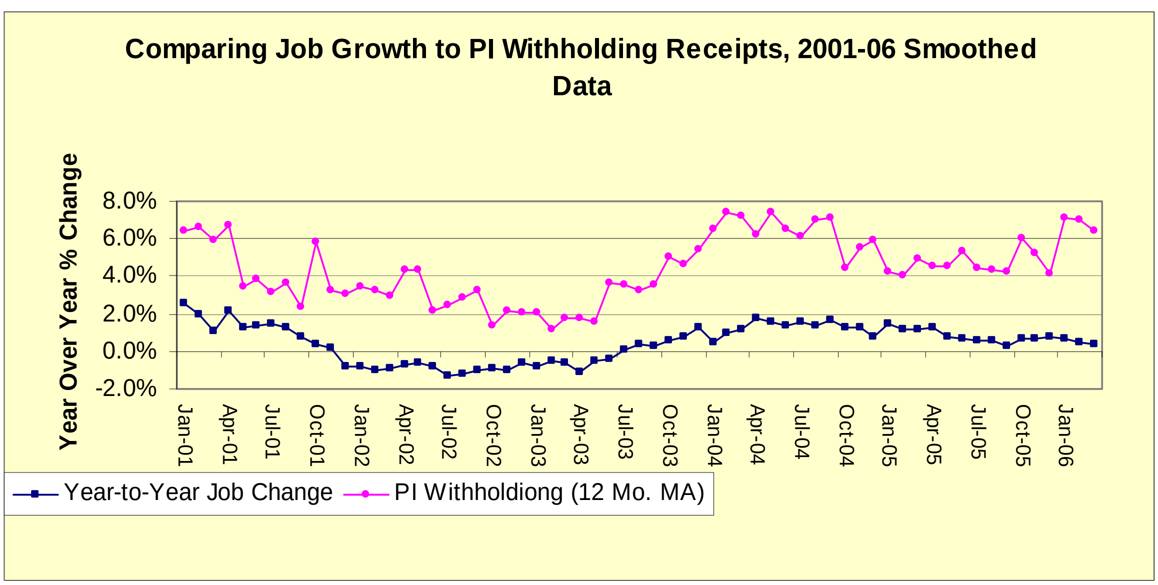
44th nationally), and in the Financial services category (5th regionally and 44th nationally). Rounding out the list of NAICS super-sectors, Vermont ranks in the middle of the pack when it comes to the year-over-year job change in the government.

Table 3: Vermont's Year-Over-Year Job Change Rank By Selected NAICS Sector

March 2006 versus March 2005	Rank in New England	Rank in U.S.
Total-Private and Public Sector Jobs	5th	44th
Total-Private Industries	4th	44th
Construction	4th	42nd
Manufacturing	1st	22nd
Trade, Transportation and Utilities	2nd	33rd
Financial Activities	5th	45th
Professional & Business Services	6th	44th
Education and Health Care	3rd	33rd
Leisure & Hospitality	6th	48th
Government	3rd	26th

Source: U.S. Department of Labor

At this point, it should be noted that the drop in Vermont's relative job growth ranking as a result of the re-benchmarking process is perplexing—given the still strong level of Personal Income Withholding tax collections and the reported still robust level of construction activity throughout the state.[4] Currently, a comparison of smoothed PI Withholding tax collections look to be recently on a plane that would imply significantly stronger year-over-year job growth—perhaps as high as +1.0% instead of the recent three month average of less than 0.5%. This situation again raises the possibility—as it did two years ago—that the payroll job establishment survey may again be under-estimating the true number of payroll jobs present in the Vermont economy.



[4] The 700 decline in Construction jobs since last August and the state's is particularly troubling, give the record year of more than $600 million in housing construction permits 42nd highest ranking in year-over-year job growth nationally

The Updated Vermont Economic Outlook

Against the backdrop of that national economic scenario and existing Vermont conditions, the Spring 2006 Vermont Economic outlook update again charts a familiar, well-worn course. Once again, the overall tone to the Vermont outlook is positive, but the pace of economic and labor market activity is expected to remain restrained and uneven throughout the 2006-10 forecast time horizon. Payroll job growth is expected to, for the most part, fluctuate within a +1.0% to +1.8% range over the next four quarters—following the 2006:Q1 quarter's expected +0.8% annual rate reading—before experiencing a total of five quarters of sub-1.0% annualized job growth rates during the upcoming 2007-2008 sub-cycle. Job growth is then expected to recover and post quarter-to-quarter annual growth rate performances of between +0.9% to +1.2% through 2010:Q4. Output growth in inflation-adjusted dollars is forecasted to follow a similar pattern over the course of the forecast, averaging +2.8% in calendar 2006, +2.9% in 2007, and between +3.2% and +3.5% over the 2008-2010 period. The +3.1% average annual rate of output growth in the Vermont economy expected over the 2006-10 period corresponds to a level that is roughly 0.5 percentage points below the +3.7% output growth average experienced during the first half of the 2000s decade.

This expected annual and quarterly profile of forecasted activity reflects the fact that the Vermont economy is entering the forecast period at a slightly lower level than was understood to be the case with last Fall's NEEP outlook based on the initial payroll job survey data. In addition, it was expected that energy prices would be in a moderating trend at this point following the production and refining disruptions associated with Hurricanes Katrina and Rita. Although energy prices did in fact moderate significantly over the Fall and early Winter time frame, the combination of global geopolitical uncertainty with supply, the Iran nuclear standoff, complications with the change over to ethanol from the MTBE additive, and still surging demand in China and Asia have resulted kept prices high and recently energy prices have once again begun to rise. In Vermont, the price of regular unleaded gasoline remains 17.4% higher in early April than the same time last year. The price of No. 2 Heating Oil in early April was up by a similar margin—at +14.5% versus early April of last year. During the past month and in recent weeks, prices have started to once again climb significantly, with per gallon gasoline prices in Vermont increasing by 31 cents per gallon between March and April. The price of a gallon of regular gasoline in Vermont is now the highest it has been since last October in the aftermath of the very damaging, hurricane induced price spike.

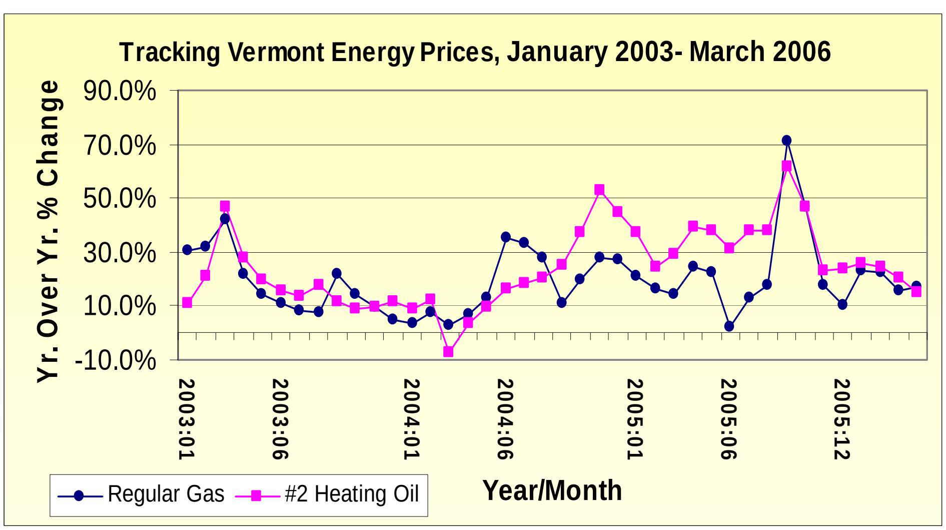


Table 4 highlights the direction and magnitude of the changes by major macro-indicator in this Spring outlook revision versus the previous six NEEP forecast updates. As with previously published economic forecasts for the state, the size of the forecast revisions are for the most part relatively small, falling within a +/-0.5 to 1.0 percentage points range for all of the state's major macro indicators. Again, it is important to point out that there were significant downward revisions to recent GSP, payroll job, and real personal income history. Despite those revisions, the forecast for inflation-adjusted personal income for calendar 2006 and 2007 is significantly upward versus the projected growth rate in inflation-adjusted personal income growth expected in the Fall 2005 NEEP forecast. This reflects a combination of revisions in the historical data series and the apparent strong underlying income growth momentum in the state economy despite relatively tepid performance by the state's major labor market and output indicators again this Spring.

Table 4: Historical Comparison of NEEP Forecasts for Vermont (May 2006)

Calendar Years	2002	2003	2004	2005	2006	2007	2008	2009
Real Gross State Product				<History<	>Forecast>			
May 2003	1.2	1.6	2.7	2.6	2.9	2.5		
October 2003	1.5	1.8	2.7	2.1	2.6	2.3		
May 2004	1.5	0.4	3.6	2.9	3.1	3.0	2.8	
November 2004	1.5	0.4	3.3	3.4	2.8	2.8	2.9	
May 2005	2.8	3.5	3.7	2.9	2.7	2.4	2.7	
November 2005	2.2	4.3	5.3	3.7	3.5	1.8	2.4	2.7
May 2006	2.2	4.3	4.6	3.3	2.8	2.9	3.2	3.5
Diff. Pct. Pts. 11/05-5/06	**0.0**	**0.0**	**-0.7**	**-0.4**	**-0.7**	**1.1**	**0.8**	**0.8**
Payroll Job Growth								
May 2003	-0.8	0.2	0.9	1.7	1.3	1.1		
October 2003	-0.8	1.4	0.4	1.2	1.1	1.0		
May 2004	-0.9	-0.2	1.1	1.7	1.3	1.0	1.0	
November 2004	-0.9	-0.2	1.1	1.9	1.1	0.9	1.1	
May 2005	-0.9	0.0	1.4	1.6	1.2	0.7	0.9	
November 2005	-0.9	0.0	1.4	1.5	1.4	0.2	0.7	1.2
May 2006	-0.9	-0.1	1.3	0.8	1.2	1.2	0.8	1.1
Diff. Pct. Pts. 11/05-5/06	**0.0**	**-0.1**	**-0.1**	**-0.7**	**-0.2**	**1.0**	**0.1**	**-0.1**
Real Personal Income								
May 2003	1.8	0.8	1.8	2.5	2.6	2.5		
October 2003	1.6	2.7	2.3	1.7	1.8	1.9		
May 2004	1.7	2.1	2.7	2.4	2.0	2.3	2.3	
November 2004	1.8	2.1	3.1	2.3	1.7	2.2	2.4	
May 2005	1.1	1.7	3.7	3.9	1.8	1.9	2.2	
November 2005	2.3	2.0	3.6	2.9	0.8	-0.2	2.0	2.4
May 2006	0.3	1.4	3.1	2.3	1.7	1.5	1.9	2.2
Diff. Pct. Pts. 11/05-5/06	**-2.0**	**-0.6**	**-0.5**	**-0.6**	**0.9**	**1.7**	**-0.1**	**-0.2**

Source: New England Economic Partnership (May 2006)

On the sector-by-sector front, the highest rates of job growth over the 2006-10 forecast period are expected in the Professional & Business Services sector (at +2.1% per year) and the Education & Health Services sector (at +2.0% per year). The Leisure and Hospitality sector is expected to bounce-back somewhat and post a more healthy +1.8% per year job growth rate—bouncing back from a discouraging first half of the 2000 decade. The manufacturing sector is once again expected to experience the most restrained job change performance (at -0.3% per year)—improving significantly from the -4.5% per year job change record of the first half of this decade covering the 2000-2005 time frame. In fact, 11 of the 12 of the state's major NAICS categories are expected to recover-add jobs over the 2005-10 forecast period, representing a significant improvement from the 2000-2005 period where 5 of 12 major NAICS categories actually lost jobs. Notably absent among the leading job growth sectors is the Construction sector which is expected to gain at the rate of just under 1.0% per year—a significant down-shifting from the heady +2.5% average job growth rate per year experienced by this sector during the 2000-2005 time frame. However, all major NAICS categories, with the notable exception of the manufacturing sector, are expected to cross the line from recovery to expansion by the end of the five year forecast.

The following table presents comparative statistics from this NEEP outlook update for the Vermont, New England regional, and U.S. economies. The U.S. data correspond to the assumed macroeconomic environment for the Vermont economy as provided by Moody's Economy.com for the upcoming five year period. The Vermont statistics present the specific detail for the Vermont economic forecast that was developed over that same period and published in May of 2006. The table highlights the fact that the Vermont economy experienced a generally milder economic downturn over the 2001-03 period relative to both the New England region and the nation as a whole. The State's rate of job recovery and income growth performance through March 2006 has been somewhat more restrained than the U.S. average, but has outpaced the New England regional average. Over the rest of calendar 2006 and into early calendar year 2007, Vermont is expected to experience somewhat lower rates of growth in output, jobs, and income versus the U.S. economy due in part to the greater negative impact that higher energy prices have had are expected to have on the state's economy.

Except for the initial year of the forecast (corresponding to calendar year 2006), the state's rate of job and inflation-adjusted income growth is expected to exceed the regional average. Output growth in Vermont is expected to mirror both the pace and pattern of the New England region, but trend slightly below the regional growth rate average. Although the State's relative economic performance in output, jobs, and personal income is expected to be mixed over the 2006 to 2010 period relative to the U.S. and New England averages, this revised forecast includes the expectation that Vermont's unemployment rate will continue to track consistently below both the U.S. and New England averages. This continues the longer-standing trend where the State's unemployment rate has consistently tracked roughly 1¼ percentage points and 1 percentage point below the U.S. and New England regional averages, respectively. In fact, Vermont's unemployment rate has consistently been among the lowest of any state in the county—along with the state of New Hampshire—over the most recent five year period.

Table 5: Calendar Year Forecast Comparison: United States, New England, and Vermont

	Actual					Forecast				
	2001	2002	2002	2004	2005	2006[1]	2007	2008	2009	2010
Real Output (% Change)										
U.S. Gross Domestic Product	0.8	1.6	2.7	4.2	3.5	3.5	3.0	3.0	3.2	3.0
N.E. Gross Domestic Product	1.0	0.0	2.6	4.6	3.9	2.2	2.9	3.3	3.6	3.4
Vermont Gross State Product	3.9	2.2	4.3	4.6	3.3	2.8	2.9	3.2	3.5	3.2
VT Gross State Product ($2000 Bil.)	$18.3	$18.7	$19.6	$20.5	$21.1	$21.7	$22.3	$23.1	$23.9	$24.6
Non-Farm Payroll Jobs (% Change)										
U.S.	0.0	-1.1	-0.3	1.1	1.5	1.9	1.2	1.0	1.4	1.3
New England	0.1	-1.6	-1.1	0.3	0.6	1.0	0.9	0.6	0.9	0.9
Vermont	1.1	-0.9	-0.1	1.3	0.8	1.2	1.2	0.8	1.1	0.9
Personal Income										
%Change (2000 Dollars)										
U.S.	1.4	0.4	1.3	3.3	2.6	2.9	2.7	2.6	2.8	2.7
New England	1.9	-0.7	0.3	3.5	2.3	1.9	1.5	1.7	2.1	2.0
Vermont	2.9	0.3	1.4	3.1	2.3	1.7	1.5	1.9	2.2	2.0
Unemployment (Percent)										
U.S.	4.7	5.8	6.0	5.5	5.1	4.8	4.9	4.9	4.7	4.6
New England	3.6	4.8	5.4	4.9	4.7	4.5	4.7	4.6	4.5	4.4
Vermont	3.3	4.0	4.5	3.7	3.5	3.5	3.6	3.5	3.4	3.3

Notes:

[1] 2005 variables are estimated and subject to further revision, and 2006 through 2010 values in this table reflect projected data as of April 2006.

Sources: Economy.com (U.S.), New England Economic Partnership May 2006 Forecast Update (New England, Vermont)

Forecast Risks: The Economy is in the Midst of a Tricky Transition…

There are a multitude of risks associated with this May 2006 NEEP forecast revision. If these risks look familiar, they are essentially unchanged from the nation and regional-state risks that have been itemized in past NEEP outlook revisions. Each of these risks, individually or collectively, could act to curtail, and/or cause a premature end to the current U.S. and Vermont economic expansions. These include:

(1) The persistently high and increasing U.S. current account deficit that threatens to disrupt/undermine international financial flows. This is becoming particularly acute as the financial dynamics of the global economy have begun to change,
(3) The dramatic deterioration of the federal budget situation and the potential for that to disrupt the current favorable international financial flows that have kept U.S. interest rates lower than they otherwise would have been,
(4) The threat of rising interest rates and their drag on consumption associated with the curtailment of equity extractions from consumers' homes—which heretofore had been a significant source of financial resources for making "big-ticket" purchases and home improvement expenditures,
(5) A further deterioration in the military operations currently underway in Iraq and/or a political impasse in another major oil producing country (such as Iran) and its impact on U.S. consumer and business sentiment, and
(6) The continuing threat of another psyche-damaging terrorist attack or major national disaster in the U.S., somewhere in the western world, and/or in the oil producing regions of the world.

Vermont-specific threats to this revised NEEP outlook that deserve mention as well. These include:

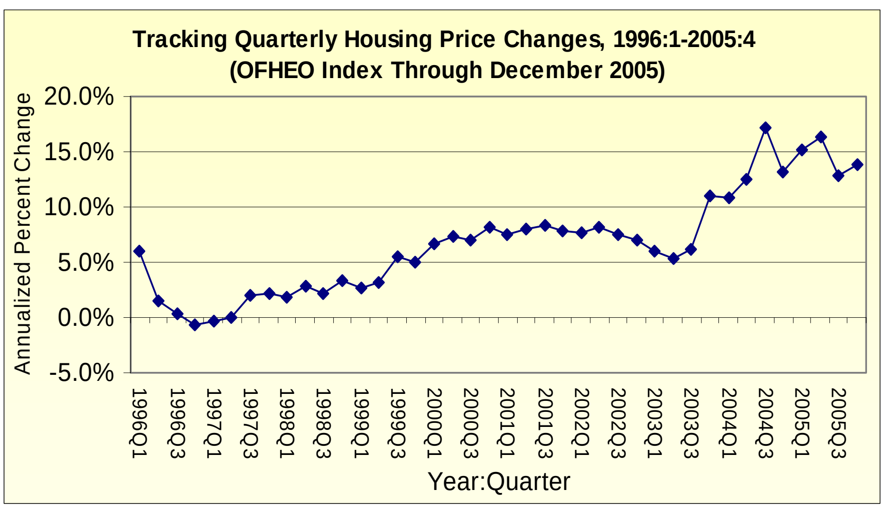
(1) The relatively high, even non-competitive, level of electrical energy costs in Vermont versus the national average (which threatens Vermont's fragile manufacturing sector) and the possibility of more upward pressure from current fossil-fuel indexed long-term power supply contracts, and
(2) The recent run up in energy prices (e.g. for oil and gasoline) and the relatively higher dependence of the State's travel and tourism sector to increases in auto operating costs.

These risks in total add up to a much higher level of downside risk in this latest NEEP forecast than has been the case in past NEEP outlook revisions. Currently, the economy is in the midst of a tricky transition from a predominantly consumer-led and housing-led recovery-expansion, to a period where business investment, and export-led expansion—that will still need a healthy boost from consumption (fueled by job and wage growth instead of equity extractions) to continue. This means the economic fortunes of the state will increasingly be vulnerable to a policy mistake from both fiscal policy and monetary policy. Each area will increasingly have much less margin for error as this transition moves forward. In addition, this transition also means that the current expansion will also be less able to weather the impact of any unforeseen, negative events, such as another large natural disaster and/or another significant terrorist attack. Although a continuation of the current expansion remains as the most-likely forecast—the possibility of one or more of these risks raising their individual or collective ugly head(s) is too high to be ignored as the expansion now moves toward middle-age.

Update on State Housing Markets-An Ongoing Source of Forecast Risk

Certainly one source of special downside forecast risk involves the current situation with respect to the housing price situation and how the unwinding of the current housing price "bubble-let" in Vermont is transpiring. Following up on last Fall's NEEP outlook revision, this discussion is intended to provide an update on state housing prices that at this time still seem to be on a clear upward trend—despite last Fall's energy price spike. Since last Fall's NEEP update, the OFHEO[5] price index series added yet another annualized, double-digit rate of increase for the fourth quarter of calendar year 2005—corresponding to the October to December quarter. This latest reading appears to confirm that while Vermont's rate of housing price appreciation has indeed slowed during the second half of calendar year 2005. However, these data indicate housing price appreciation remains strong—still in the low double-digit rate range of year-over-year increases. The fourth quarter reading (at +13.8% on a year-over-year basis) was one full percentage point higher than the third quarter of calendar 2005 reading at +12.8% (on a year-over-year basis). Each of these readings stood well below the +16.3% year-over-year change reading from the second quarter of calendar 2005 and the +17.2% during the third quarter of 2003.

With this latest data point, the OFHEO housing price index has been increasing at a double-digit rate for the last nine quarters (or for more than two full calendar years). The rate of home price appreciation has been an important economic driver from the standpoint of the wealth effect, and the ability of households to use their home as an asset against which to borrow to support spending. The forecast is for one more quarter of year-over-year double digit price increases in the OFHEO index before the index begins its orderly decline back into single digits—and eventually bumping along the bottom at between 0% and 3% year-over-year price increases (or less than the general rate of inflation) in calendar years 2007 and 2008.



Clearly, the escalating housing price situation has not yet been resolved, and the forecasted orderly transition—as opposed to a sharper decline—towards a more normal housing price-sales situation remains that—a forecasted outcome. The state's real estate markets are at a very difficult juncture, with a wide range of potential outcomes as the market moves toward rationality. As mentioned last Fall, there is a complex interplay between rising materials costs on the new construction side of the ledger, a wide band of uncertainty on the resale market—including a "very tight" demand-supply situation in the middle price ranges, and strong seasonal home demand—most of which appears to be from out-of-state sources. The current profile of sales includes price levels that remain

[5] OFHEO refers to the Office of Federal Housing Enterprise Oversight.

unsupportable by the state's underlying economic fundamentals. An adjustment is forthcoming, the only outstanding questions are the rate of speed and how high-and-then how low the adjustments will go.

This correction is a critical part of the State's near-term outlook because of the pervasiveness of the real estate up-cycle's impact on job and income growth (e.g. in construction, real estate sales, the legal sector, and financial services, etc.) and tax revenues. While it is true that nearly all real estate cycles include at least some level of speculative sales activity that get out of sync with the economy's fundamentals for at least some period of time. In such speculative price situations, extended periods of "unsupported" price increases can result in larger, steeper corrections in real estate markets that can be harmful economically because the industry is heavily tied into the local economy. That represents the risk to the Vermont near-term economic forecast. Currently, this forecast includes an orderly unwinding of the State's current housing market situation that will slow overall economic growth in Vermont when it occurs. This unwinding it is not expected—as long as it transpires in a generally orderly manner—to short-circuit the State's current economic up-cycle.

A sharper, "less than orderly" unwinding of the current housing price escalation situation would more significantly and adversely impact the short-term performance of the state's economy—and potentially push it over the edge into a recession. This "more severe, less than orderly" unwinding of the state's current strong price up-cycle still represents one of the most significant downside forecast risks for the State's economy. The critical period for this downside risk continues to include mostly the late-calendar year 2006 to early-calendar year 2007 time period.

Conference Theme: New England's Power Puzzle: Price, Supply, Infrastructure and Prices

The recent hurricane-induced energy price spike of last Fall, the blackout of August of 2003, and the continuing geopolitical uncertainty in much of the energy producing regions of the world have once again drawn attention to the weaknesses in the U.S.', New England' and Vermont's energy policies and infrastructure. For the New England region in general and in the state of Vermont, price increases and volatility tend to result in even higher levels of price increases and greater instability (a.k.a. reduced reliability). For a region where stable sources and relatively low energy price levels are so important to the economic performance and growth of the economy, it is vitally important for energy—in what ever form it is needed—to: (1) be available and affordable on an "as needed, 24-7 basis," and (2) come from a portfolio of sources with enough diversity so that the system can accommodate most routine disruptions.

The challenge to Vermont's energy future is to find a way to meet its energy needs that is affordable, efficient, reliable, and minimizes environmental impacts. There currently is no known single energy source that simultaneously meets all of those criteria. In fact, all sources and potential sources involve trade-offs of some kind. The best example of this is the debate that surrounds the long-term decision-making process surrounding the construction and operation of the state's electric energy infrastructure. The cost, reliability, efficiency, and environmental impacts associated with acquiring and or siting and construction generation capacity have long lead times and often involve millions of dollars of the taxpayers'/ratepayers' money. Often times, these decisions involve time horizons of 20 years or more—when little is known with any degree of certainty about the market conditions, market structure and the regulatory approach that will be in force that far out into the future.

In 2002, Vermont's energy source portfolio consisted of roughly 1/3 nuclear (at 34% of the total), roughly 1/3 large hydro (Hydro Quebec at 32% of the total), 13.5% system[6] (the market), 6.5% Demand Side Management (DSM), 6.4% small scale, in-state hydro, 4.6% Other Renewables, and 2.5% oil and gas.[7] Under current contracts in the current supply configuration, the state has enough resources to meet its needs through 2012. In 2012, the state will need to replace 300 MW of supply from the Vermont Yankee nuclear plant, unless its current license and power supply contracts to Vermont distribution utilities are extended. In addition to the Vermont Yankee plant situation, 2012 marks the beginning of the ramping down of committed supply under the Hydro Quebec/Vermont Joint Owners contract as well. From 2012 through 2016, committed supply will drop from 305 MW to 31 MW by 2016. Further reductions are planned for the post-2016 period.

Complicating this is the fact that under the utility re-structuring process during the late-1990s and early-2000s, that way the electric energy business was conducted changed significantly. While Vermont largely took a "wait and see" attitude on re-structuring, many of the state's retail utilities largely divested themselves of the large, capital intensive "build and operate your own" generation assets. This was consistent with a greater industry trend where electricity became more like a commodity, traded in a wholesale market aided and administered by a regional **i**ndependent **s**ystem **o**perator known today as ISO-NE (or ISO-New England).

In today's period of already high and now rising energy prices, the reasons for New England's and Vermont's on-going negative cost differential are once again returning to the forefront of business climate and economic development discussions. High performance economies with good economic development and growth potential normally include reliable and affordable sources of electric power and other sources of energy. For the most part, ISO-NE and other analysts attribute this to three factors. First is the region's disproportionately high reliance on faster time-to-market sources such as natural gas (which also is a clean source that helps with air quality issues) and oil-fired generation capacity. Second is the lack of the needed additional natural gas infrastructure that would help balance the region's growing demand with the current more slowly growing supply.

The third reason often cited involves the region's generally inadequate transmission assets and efforts to conserve. Vermont has undertaken efforts to try to address these factors, including the so-called Northwest Reliability Project (designed to boost the transmission capability in the congested northwest part of the state), aggressive state-level and utility demand side management programs, and diversification of its source/generation portfolio into the area of renewable energy sources. While the first two efforts may help to keep electric energy prices in the state below where they might otherwise rise to in the years down the road, it is not at all clear that emphasizing renewable sources will accomplish that goal of lowering the negative regional and state price differential versus the other regions of the U.S. and the world.[8]

From a policy perspective, The New England Policy Center Reports that public policies that encourage: (1) the maintenance of fuel diversity, (2) the reduction of demand growth, and (3) improve the process of infrastructure investment and siting offer the most promise for promoting reliability and lowering prices. It seems that Vermont has done reasonably well in policy areas 1 and 2. In area 3, siting and permitting energy infrastructure—whether a gas pipeline, a generation asset, or electric transmission facilities—is always a contentious item. This is also the case in the State of Vermont. This contentiousness is a particular problem for both the region and Vermont for

[6] This refers to any combination of instruments including contracts, options or spot market purchases
[7] See the 2005 Vermont 20 Year Electric Plan, pages 9-2 through 9-3.
[8] Although it should be noted that Vermont has the lowest rates and price level among the states in the generally higher priced New England region.

electric generation and transmission infrastructure, where it is often very difficult to find communities that are willing to host such facilities. This is understandable, since nearly all of the costs are borne by the residents of those localities and the benefits of such infrastructure investments are distributed very broadly across many states in a region—or even nationally. There is currently no real policy consensus for how to move forward on such infrastructure investments—especially in the area of merchant plant generation—where benefits under Vermont certificate of public good evaluation process must still accrue in some identifiable way to Vermont residents.

State residents have a major interest in rational policy outcomes to all aspects of the state's energy needs—both electrical and fossil fuel use. While the state cannot hope to influence global oil, natural gas, and gasoline prices, rising oil and gasoline prices have significantly negative short-term and long-term impacts on the Vermont economy. In the short-term, rising oil, natural gas, and gasoline prices serve to reduce household disposable income, increase business costs—especially in the transportation and farming sectors, and reduce the number of visitors to the state and their associated spending. Over the longer term, escalating fossil fuel and other energy prices will lead to electric and other utility rate cases—which already have begun. Vermont Gas Systems Inc. in October of 2005 filed for a 16.7% rate increase in response to rising natural gas prices. Green Mountain Power—the second largest of the states investor owned electric distribution utilities recently filed for an 11.95% rate increase. With fossil fuel price escalators embedded in the state's hydro contracts with Hydro Quebec, more electric utility rate cases are likely to follow.

The state's economy has a significant stake in rational policy outcomes to this debate. To gain a better understanding of how significant the stake is economically, a macroeconomic[9] and net fiscal impact[10] simulation was run for the State that attempts to quantify the annual impact of the recent energy price increases through early March—if they were continued for an entire year. In order to complete this simulation, estimates of the recent change in oil and gasoline prices through early April of 2006 relative to the U.S. increase were developed. The portion of these price increases that mirrored the U.S. increase were modeled as reductions in disposable personal income (for the household portion) and increased business costs (for the commercial-industrial portion). The portion of the Vermont state increase that exceeded the U.S. increase was modeled as a relative increase in energy prices for households, commercial, and industrial sectors. Of the two impacts, the portion impacting disposable personal income and increased business costs represented the bulk of the recent energy price increases' impact on the Vermont economy.

The results of this simulation were significant. Specific impacts included: (1) a reduction of 1,380 full-time and part-time jobs, (2) a reduction of $51.9 million in state personal income, (3) a reduction of $121.3 million in personal consumption, (4) a reduction of $9.5 million in state tax revenues, and (5) a reduction of $2.4 million in total state costs. As a result, the State would experience a -$7.1 million net negative fiscal impact. While the 1,380 job impact may not sound significant, it should be remembered that total would have represented over half (or 57.5%) of the total net new payroll jobs added in the Vermont economy during the calendar year 2003-2004 period—before this latest run-up in energy prices began.

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[9] Using an input-output model for the state from Regional Economic Models. Inc. of Amherst, MA.
[10] Using the state fiscal impact model from the Vermont Economic Progress Council.