STANDARD & POOR'S
RATINGS SERVICES

RatingsDirect®

Vermont; General Obligation

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Credit Profile		
US$46.41 mil GO bnds (Vt Citizen Bnds) ser 2013 B due 08/15/2033		
Long Term Rating	AA+/Positive	New
US$20.225 mil GO bnds (Vt Citizen Bnds) ser 2013 A due 08/15/2023		
Long Term Rating	AA+/Positive	New
US$18.68 mil GO rfdg bnds ser 2013 C due 08/15/2033		
Long Term Rating	AA+/Positive	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' rating, with a positive outlook, to Vermont's series 2013 A, B, and C general obligation (GO) bonds and affirmed its 'AA+' rating on the state's GO bonds outstanding.

The ratings reflect our opinion of the state's:

- Strong financial management that has helped Vermont maintain a good financial position; and
- Rapid GO debt amortization.

The state's GO bonds are secured by the state's full faith and credit pledge. The bond proceeds will be used for various capital projects.

Vermont, with a 2012 population of 626,000, is in northern New England, bordered by New York, Massachusetts, and New Hampshire to the west, south, and east, respectively, and by Canada to the north.

In our opinion, the state's financial position remains good. Vermont ended fiscal 2012 -- the last audited year -- with the budget stabilization reserves in the general fund, transportation fund, and education fund fully funded at their maximum statutory levels of 5% of the previous year's budgetary appropriations, along with some additional reserves in the general fund. These three funds' stabilization reserves remained funded at their statutory maximums through the recent recession. There was a slight general fund operating deficit of $6.3 million in fiscal 2012, which is notable because the fiscal year included two significant events that negatively affected revenues or expenditures: Tropical Storm Irene caused significant flooding in August 2011, which was followed by a mild winter that reduced ski lift ticket sales by an estimated 10%.

Unaudited budgetary basis results for fiscal 2013 indicate a $21.6 million operating gain –- before transfers -- and officials estimate that the state again ended the year with the reserves at the three major funds again at their maximum levels, although Vermont used the remaining $18.5 million balance in the separate human services caseload reserve during fiscal 2013. The 2013 general fund revenues were estimated to have increased by $91.6 million, or 7.7% from fiscal 2012 levels. In addition to the fully funded stabilization reserves, $11.93 million was transferred into the second general fund budget reserve -- called the General Fund Balance Reserve -- that was established in 2012. This reserve can be funded with budget surpluses after the existing budget stabilization fund and other statutory requirements are funded, up to a level of 5% of prior year appropriations. The governor had included a proposal in the fiscal 2013 executive budget to increase the general fund stabilization fund to 5.25% from 5%, but instead, the legislature added this second general fund reserve fund. Officials indicate that the legislature created this new reserve as an easier source of funds for budget flexibility.

The revenue projections for the fiscal 2014 general fund budget are for $1.32 billion of revenues, a 2.8% increase from estimated fiscal 2013 levels. The budgets for the general, education, and transportation funds project ending balances at statutory maximums at the end of fiscal 2014. The main general fund revenue sources are:

- Income taxes, projected to increase by 3.9% from 2013 actuals;
- Sales and use taxes, projected to increase by 0.4%;
- Meals and rooms taxes, projected to increase by 1.9%; and
- Corporate taxes, projected to decline by 3.3%.

Through the first three months of fiscal 2014, officials indicate that general, transportation, and education funds revenues were about on target. The general fund collections were $420,000, or 0.1% above target, driven primarily by meals and room taxes and personal income taxes, which offset below-target performance in inheritance taxes and sales and use taxes. Transportation fund revenues were $1.1 million, or 1.7% above target, and the non-property tax component of the education fund was $10,000 above target for the first quarter.

State officials are currently analyzing the impact that implementation of the Affordable Care Act (ACA) will have on the state's Medicaid expenditures. However, officials note that the state currently enrolls individuals who earn up to 350% of the poverty line in state health programs, and that the ACA eligibility expansion could result in increased recurring federal revenue to the state. In addition, Vermont has recently received more than $120 million in one-time federal grants to develop its health benefits exchange. The 2014 budget projects a Medicaid caseload growth of about 3,700 people before the movement of about 17,100 people to insurance exchange coverage on Jan. 1, 2014. The 2014 budget also projects Medicaid expense growth of $16.8 million, or 1.8% from the fiscal 2013 actual levels.

Although the state's annual pension funding levels had been less than 100% of the ARC as recently as fiscal 2011, officials indicated that any shortfalls were trued-up in the subsequent year. In addition, officials have begun using more conservative payroll projections in an attempt to produce annual pension funding amounts that equal the actuarial required contributions (ARC). The actual pension contributions in fiscal years 2012 and 2013 were significantly above the actuarially determined annual pension costs of the two systems.

Based on the analytical factors we evaluate for states, on a scale of '1' (strongest) to '4' (weakest), we have assigned Vermont a composite score of '1.6'.

Outlook

The positive outlook reflects our view that we could raise the rating over our two-year outlook horizon if Vermont continues to make progress in improving its annual pension funding levels, strengthening its annual pension funded ratios, and increasing its budget reserves through funding of a recently-created additional general fund budget stabilization fund. Sectorwide risk for the rating includes the economic and fiscal implications from the potential for significant reductions in federal funding that currently flows to the state. Standard & Poor's will continue to monitor potential federal consolidation efforts. Once these are identified, we will evaluate their effect on the state's finances and officials' responses to these revenue reductions.

Government Framework

Vermont does not have a constitutional or statutory requirement to enact or maintain a balanced budget, but it has consistently maintained sound finances. In our view, the state has significant flexibility to increase the rate and base of its major tax revenues, which include income taxes, sales taxes, and a statewide property tax that funds the state's support of local education. We view the state's revenue sources as diverse. Voter initiatives cannot affect the state. Vermont maintains the ability to adjust disbursements in order to maintain sufficient liquidity. Debt service can be paid without a budget, but there is no other legal priority for debt.

Revenue structure

Vermont's tax structure is broad, and its revenue sources are diverse across several operating funds. The general fund relies primarily on unrestricted revenues from personal and corporate income, sales and use, and meal taxes.

The education fund relies primarily on a statewide property tax, and an appropriation from the general fund. The education stabilization reserve ended the year at the statutory maximum of 5% of expenditures. The transportation fund relies primarily on federal-match grant revenues, a motor vehicle license fee, and a motor fuel tax.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.6' to Vermont's government framework.

Financial Management

Financial Management Assessment: 'Strong'

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

Much of Vermont's debt and financial management practices are embedded in state statute. These, along with internally developed policies, guide the state's long-term budget and capital planning, debt management, and investing practices.

The state has a well-established consensus revenue-estimating process. According to statute, the joint fiscal office and administration provide their respective revenue estimates for the general, transportation, and federal funds for the current and next succeeding fiscal year to the Vermont Emergency Board.

Vermont law also requires a long-term capital plan. The governor submits a capital budget annually to the General Assembly based on debt management provisions outlined by the state's capital debt affordability advisory committee. The committee's estimate is nonbinding, but the state legislature has never authorized new long-term GO debt in excess of the committee's estimated amount. The state has formal debt management policies, including a statutory debt affordability analysis developed by the capital debt affordability advisory committee that Vermont integrates into the operating budget development process and updates at least annually. Vermont has not entered into any interest rate swaps and does not have an adopted swap management policy. Statutory restrictions and adopted administrative policies govern investment management, and the office of the state treasurer monitors compliance.

Budget management framework

The state has multiple tools to assist financial management. Vermont monitors revenues and publishes results monthly; and the emergency board meets at least twice annually, in July and January, to evaluate the revenue forecast and make adjustments, if necessary. The state forecasts also include Medicaid revenues and spending. These consensus forecasting meetings can be convened more frequently, and were held quarterly during fiscal years 2008 through 2010, due to the recession and the potential impact on revenues and expenditures. The emergency board includes the governor and the legislative chairs of the house and senate fiscal appropriations committees. The forecasting process includes traditional economic and revenue forecasting, which Vermont performs with the assistance of outside economists, for the current and next succeeding fiscal year, as well as a less detailed forecast for the next eight years. The state also forecasts Medicaid revenues and spending.

The governor has statutory authorization to adjust the budget within certain revenue and expenditure change limits when the Vermont Legislature is not in session. Vermont maintains stabilization reserve funds at statutory levels to reduce their effect on annual revenue variations. In 1993, the state created separate budget stabilization reserves within the general and transportation funds. The amount in each of these reserves is not to exceed 5% of previous-year appropriations. In fiscal 1999, the state created an education fund budget stabilization reserve, which is to fund in a range between 3.5%-5.0% of expenditures. Vermont statute requires annual funding of such reserves. The governor included a proposal in the fiscal 2013 executive budget to increase the general fund stabilization fund to 5.25% from 5%, but instead, the legislature added a second general fund reserve fund with a separate cap of 5% of expenditures.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.0' to Vermont's financial management.

Economy

Vermont's population has recently grown more slowly than the nation as a whole; for 2000-2010, its population grew by 2.8% compared with the nation's 9.7%. While the state's per capita personal income in 2012 was slightly above the nation's, at 101% of the national level, its nominal gross state product was only 88% of the U.S. level. Vermont's unemployment rate is significantly better than the nation's, with an August 2013 level of 4.6%, compared with the 7.5% national level.

IHS Global Insight indicates that private-sector jobs will grow by 1% from the first quarter of 2013 to the first quarter of 2014, and that the unemployment rate will improve to 4.1% by that time. Nonfarm employment is projected to reach the pre-recession peak by mid-2014. However, the firm projects that for the five years from 2013 to 2018, many economic growth factors will lag the national average. The key employment driver in this period will be health care, along with administrative support services. Real gross state product and personal income growth are projected to average 2.1% and 2.8%, respectively, over the 2013 to 2018 period.

IBM, which is one of the major employers in the state, laid off about 400 employees around June 2013, and currently employs about 4,000 at the Essex Junction site. The Vermont Yankee nuclear power plant is expected to end operations in 2015, although state officials indicated that this closure is not expected to significantly affect employment -- as the shutdown will take multiple years -- or power prices, given that Vermont power companies do not purchase power from this plant.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.6' to Vermont's economy.

Budgetary Performance

The state maintains separate budget stabilization funds in its general, transportation, and education funds that are available to offset undesignated fund deficits. The statutory maximum for the three stabilization reserves is 5% of the prior-year budgetary appropriations, and the education stabilization fund also has a statutory minimum of 3.5% of the prior-year appropriation. The three stabilization funds have been at their statutory maximums since fiscal 2007. Vermont pools the cash reserves for these major funds, which results in sufficient liquidity for operations during the fiscal year. Officials indicated that the state has not externally borrowed for liquidity since fiscal 2004.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '1.4' to Vermont's budgetary performance.

Debt And Liability Profile

Debt

Including this issue, Vermont's tax-supported debt was about $970 per capita, 2.3% of personal income, and 2.2% of gross state product. The fiscal 2012 tax-supported debt service was about 2% of general governmental expenditures. Vermont's debt portfolio consists of only fixed-rate debt, without any exposure to interest rate swaps. We consider the debt amortization to be rapid, with officials retiring more than 70% of GO debt over the next 10 years. The state has a debt affordability committee that annually recommends a maximum amount of debt issuance for the next fiscal year, and while the committee's recommendations are not binding, Vermont has consistently adhered to them. Debt service can be paid without a budget, but there is no other priority for the payment of debt before other general state expenditures.

Pensions

Vermont maintains three statutory pension plans: the Vermont State Teachers' Retirement System (VSTRS), with about 10,500 active members; the Vermont State Retirement System (VSRS), which includes general state employees and state police and has about 7,800 active members; and the municipal employees' retirement system, with about 6,600 active members. The state appropriates funding for the first two systems; the municipal system is supported entirely by municipal employers and employees. The pension systems' funded ratio for the combined teachers and state employees pension systems ratios declined as of June 30, 2013, to 67.4% from 70.4% two years earlier. The combined unfunded actuarial accrued liability (UAAL) was $1.46 billion. Officials indicate that the majority of the UAAL increase was due to reducing the actuarially assumed rate of return. The new interest rate assumption is based on the "select and ultimate" method, which assumes a blend of annual interest earnings between 6.25% and 9.0%, and which results in an expected annual rate of return of 8.1% for VSRS and 7.9% for VSTRS. The new interest rate assumptions increased the ARC beginning in fiscal 2013.

The state implemented pension changes that reduced the VSTRS pension ARC for fiscal 2011 and future years. The primary changes were a longer eligibility period to qualify for normal retirement and an increase in the retirement contribution made by all teachers. After these changes, officials project that the ARC for fiscal 2011 was reduced by about $15 million. Officials also projected the other postemployment benefits (OPEB) ARC to be reduced by these changes.

Other postemployment benefit liabilities

Vermont offers postemployment medical insurance, dental insurance, and life insurance benefits to retirees of the single-employer VSRS and the multiemployer VSTRS. The unfunded OPEB liability for the two systems as of June 30, 2013 improved to $1.64 billion from $1.78 billion two years earlier. The actuarial annual OPEB cost in fiscal 2013 was $47.3 million for VSRS, of which the state paid 38% under pay-as-you-go funding. The VSTRS also uses pay-as-you-go funding, but the state does not break out the actual employer contribution, instead including it through the pension fund without an explicit appropriation. The actuarial annual OPEB cost for VSTRS in fiscal 2011 was $43.5 million, a reduction of about $17 million from fiscal 2010, primarily due to benefits changes negotiated with the teachers' union that reduced the VSTRS OPEB cost by about $15 million for fiscal 2011. The state has established an OPEB trust fund for VSRS, but as of June 30, 2013, it only contained $15.7 million of assets, for a 1.7% actuarial asset funded ratio. The separate multiemployer Vermont Municipal Employees Health Benefit Fund for local government is administered by the state, but has no liability to the state, and is not included in our OPEB calculations.

On a scale of '1' (strongest) to '4' (weakest), we have assigned a '2.4' to Vermont's debt and liability profile.

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- State And Local Government Ratings Are Not Directly Constrained By That Of The U.S. Sovereign, Aug. 8, 2011

Ratings Detail (As Of October 29, 2013)		
Vermont GO		
Long Term Rating	AA+/Positive	Affirmed
Vermont GO bnds		
Long Term Rating	AA+/Positive	Affirmed
Vermont GO bnds (Citizen bnds)		
Long Term Rating	AA+/Positive	Affirmed
Vermont GO bnds (Vermont Citizen Bnds)		
Long Term Rating	AA+/Positive	Affirmed