ELIZABETH A. PEARCE
STATE TREASURER

RETIREMENT DIVISION
TEL: (802) 828-2305
FAX: (802) 828-5182

UNCLAIMED PROPERTY DIVISION
TEL: (802) 828-2407

ACCOUNTING DIVISION
TEL: (802) 828-2301
FAX: (802) 828-2884

STATE OF VERMONT
OFFICE OF THE STATE TREASURER

TO: Capital Debt Affordability Advisory Committee

FROM: Scott Baker, Director of Financial Reporting

RE: Minutes of Meeting on Thursday, September 12, 2013

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

Members of the General Assembly
REP. MARY HOOPER, House Committee on Institutions and Corrections

Also Attending
MICHAEL OBUCHOWSKI, Commissioner, Buildings and General Services
STEVE WISLOSKI, Deputy State Treasurer
WANDA MINOLI, Buildings and General Services
CATHERINE BENHAM, Associate Fiscal Officer, Legislative Joint Fiscal Office
SCOTT BAKER, Director of Financial Reporting
TOM HUESTIS, Senior Managing Director, Public Resources Advisory Group
CHRISTINE FAY, Vice President, Public Resources Advisory Group

1. Opening remarks and approval of minutes

Ms. Pearce called the meeting to order at 10:05 a.m.

Mr. Coates motioned, Mr. Valente seconded, and the Committee unanimously approved the minutes of the meeting on August 21, 2013.

2. Debt management update

Mr. Wisloski reviewed a brief history of Vermont's debt outstanding, debt authorizations, and critical debt ratios. He pointed out that the recent increase in debt in 2013 was due to the decision to issue the entire amount of authorized but unissued debt in September 2012, based upon the impending "fiscal cliff," the uncertainty of federal receipts, and the State's large capital needs for the Waterbury State Office Complex and Vermont State Hospital. Ms. Pearce noted that the State issued bonds within 2-3 weeks the lowest municipal bond interest rates in history. Mr. Huestis said that long-term rates have risen 130 basis points over the last several months.

(Mr. Spaulding joined the meeting at this time.)

3. Discussion of Moody's US States Rating Methodology

Ms. Pearce and Mr. Wisloski reviewed Moody's new numerical ratings criteria and discussed the scoring categories. Mr. Wisloski said that there are some things over which we have direct control (such as the amount of debt that we issue), and others which we do not (such as the condition of the economy and Vermont's demographic profile). Ms. Pearce said that the CDAAC is a valuable component of Moody's governance criteria, and said that the State's responses to Moody's questions following Tropical Storm Irene regard repair costs, the State's cash position, and the State's ability to pay debt helped our scoring by demonstrating the State's strong financial management.

Rep. Hooper asked why we do not score better on our balances and reserves; Mr. Wisloski replied that Vermont scores very well, Moody's specifies balances in excess of 10% of revenues for the top "Aaa" rating for that category (which very few states achieve). Mr. Spaulding said that we have a 5% budget stabilization reserve which we did not breach during the Great Recession, and that at one point we had over 8% if we added all reserves. Right now, we probably have an additional $12 million in other reserves. Mr. Huestis said that 5% used to be the minimum for highly rated entities; now ratings agencies have increased this to 10%.

4. Discussion of Moody's Pension Liability Medians

Ms. Pearce stated that 2013 actuarial data is expected to be available at the end of October. As of June 30, 2012 the State Employees' Retirement System was 77.7% funded, with an unfunded liability of $401.8 million, and the Teachers' Retirement System was 61.6% funded, with an unfunded liability of $945.5 million. She reminded that Committee that the Systems' assumed rates of return use a "select-and-ultimate" methodology, with a term structure of rate assumptions that starts with 6.25% in year 1, rising to 9.00% in year 17 and later. Further, because this rate structure re-sets each year, with 6.25% as the starting rate, and because the Systems have a closed amortization with a final payment in 2038, another 9.00% rate "drops off" each year, resulting in a slightly lower weighted average rate. This lower rate assumption in turn automatically increases the unfunded liability every year, if all other factors are held constant. Ms. Pearce further explained that large portions of the current unfunded liabilities were due to the 2008 financial crisis; in 2007, the Teachers' System was 84.9% funded, and the State Employees' System was 100.8% funded with an $11 million surplus. In addition, with respect to the Teachers' System, prior to 2007 the State regularly contributed less than the recommended actuarial required contribution or ARC, and used a flawed "frozen initial liability" methodology, which overstated the System's funded status and further understated the required annual contributions.

Finally, she reiterated her warning that the State continues to pay for retired teachers' healthcare from the System's assets, which she referred to as "retrospective funding." The $20 million not contributed to the pension fund will eventually increase the unfunded liability, and cost to Vermont's taxpayers, by $58 million. Mr. Coates emphasized that this approach is not sustainable. Ms. Pearce also said that the 8.6% return on pension investments this year was not doing a lot to help, and that we must come up with an additional $20 million just for health care.

The Committee also discussed the impact of lower ratings on borrowing costs, both for the State and for entities supported by the State's moral obligation. Ms. Pearce said that the Vermont Housing Finance Agency (VHFA) determined that the State's moral obligation results in a 0.25% decrease on the mortgage rate for housing loans. Mr. Wisloski also said that tax-exempt status for municipal bond interest saves an estimated 25% to 30% of borrowing costs.

Ms. Dagan questioned whether there was a point where issuing more debt and potentially incurring a downgrade and higher interest cost was offset by savings from avoided the higher costs related to deferred maintenance. Mr. Valente noted that the effect of a downgrade would also impact municipalities' borrowing costs, again due to the Bond Bank's use of the State's moral obligation. Mr. Giroux noted that the estimated underlying rating for many of Vermont's municipalities was in the A3 range, so the Bond Bank's strong Aa2/AA+ provide substantial cost savings, and towns would not be able to borrow as much for needed infrastructure. Ms. Pearce said we should also look at how much improving the aging infrastructure improves our economy.

Mr. Hoffer asked whether State agencies were providing needs assessments of the types referenced in the CDAAC statutes, and furnishing these to the Committee. He also inquired about 32 V.S.A. §1001(c)(6) and (7), which requires the CDAAC to consider the impact of capital spending upon the economic conditions and outlook for the state and the cost-benefit of various levels of debt financing. Rep. Hooper also noted that the State's capital bills provide funding for projects outside of State government, so any needs assessment extends beyond State-related agencies and departments. Ms. Pearce acknowledged the need for greater capital needs assessments both within and beyond State government. She also pointed out that the Committee had recommended, and the General Assembly enacted, a greater emphasis on long-term capital planning. Finally, she suggested that there still needs to be a process of prioritization of capital needs given finite resources, but that this was not within the CDAAC's mandate.

Mr. Spaulding recalled that the CDAAC's statute had been amended in 2008 to include reviewing economic impacts of capital spending. Mr. Spaulding suggested that we not change our recommendation this year. This will allow us time to review our model and strategy, and to look at the big picture. It will also be helpful to review the Statute dealing with needs reporting. We should have a better picture of what our needs are next year. We do need to be careful, and to be able to prove that we are using best practices.

Ms. Pearce reviewed Moody's new pension methodology and her critiques of their approach, and noted that due primarily to a substantially lower assumed rate of return would show a much larger unfunded liability for both Systems.

5. Review of draft of 2013 CDAAC Report

Mr. Wisloski noted that the draft 2013 Report contained the Committee's recommendation to maintain the $159.9 million issuance for this biennium, as voted at the August 21 meeting. He also noted as an aside that the prior biennium authorization of $153,160,000 ended up $2 million higher due to the 2012 Capital Bill including a contingent authorization for the Community College of Vermont's Brattleboro Campus.

The Committee discussed how to address the possibility of decreasing the amounts of recommended bond issuance in the 2016-2017 biennium. The Committee also agreed that although the numbers currently show this possibility, we will use the next nine months to track and review relevant data and use this to inform the Committee's recommendations in summer 2014. The Committee's recommendations are based on the best information available, and are subject to change based on changing circumstances.

It was suggested that the next meeting scheduled for September 26th be held as a conference call.

6. Public comment and adjournment

Ms. Pearce asked if there were any members of the public on the call who wished to comment; there were none.

Mr. Valente motioned to adjourn the meeting, Ms. Dagan seconded, and the Committee unanimously voted to adjourn the meeting at 12:25 p.m.