S&P Global Ratings

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Vermont; General Obligation; School State Program

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Credit Profile		
US$61.155 mil GO bnds (Competitive) ser 2023A due 08/15/2043		
Long Term Rating	AA+/Stable	New
US$53.465 mil GO rfdg bnds (Vermont Citizen Bnds) ser 2023B due 08/15/2033		
Long Term Rating	AA+/Stable	New
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to the State of Vermont's $61.2 million series 2023A general obligation (GO) bonds and $53.5 million series 2023B GO refunding bonds.
- At the same time, S&P Global Ratings affirmed its 'AA+' rating on the state's GO debt outstanding and its 'AA' rating on the Vermont Municipal Bond Bank's Vermont State College System bonds, which are supported by a state aid intercept mechanism.
- The outlook is stable.

Security

The 2023A and B bonds are secured by Vermont's full faith and credit GO pledge. Officials will use 2023A proceeds to fund or reimburse capital bill projects, while 2023B proceeds will go toward refunding a portion the state's series 2012 and 2013 GO bonds outstanding.

Credit overview

At the beginning of fiscal 2024, Vermont finds itself in an unusually strong financial position emerging from the pandemic, with coffers that have been bolstered by a windfall of federal funds through various rounds of federal fiscal stimulus and a budget that over the past three years has seen some of the largest surpluses in the state's history. At the same time, the state saw an uptick in domestic in-migration of high-income earners in 2020 and 2021, as the wider acceptance of remote work alongside Vermont's largely rural location, with access to ample outdoor recreation, continues to be a draw for out-of-staters.

Whether the state can capitalize on this recent momentum to promote stronger long-term demographic and economic growth, both of which have historically underperformed relative to that of the U.S., remains to be seen, in our view. But Vermont is devoting significant policy attention and investment to targeting these legacy issues--for example, through housing policy reform and the use of federal stimulus dollars to target areas such as housing, broadband, and workforce development. As we have stated in the past, Vermont's economic performance relative to that of more highly rated peers is a key upside rating constraint, and we expect it will remain so until the state can establish a clear trend of stronger growth.

The impact of the July floods on the state's economy, infrastructure, and private property has yet to be fully tallied. As with similar natural disasters including the flooding wrought in Vermont by Tropical Storm Irene in 2011, we expect that the availability of Federal Emergency Management Agency disaster relief funds and private insurance will aid in recovery and might even enhance Vermont's near-term economic performance from the influx of out-of-state dollars. While state capital and state offices were flooded, Vermont officials indicate that the damage on other public infrastructure was more limited than in 2011 largely because of measures taken after Tropical Storm Irene to fortify infrastructure and enhance flood resiliency.

The fiscal 2024 budget anticipates weaker revenue performance than in 2023, as the broader macroeconomic slowdown is forecast to push unemployment up and weigh on personal income and corporate earnings through the next fiscal year. The state has generally forecast revenues conservatively and structures its base budget around conservative revenue estimates, which provides some inherent cushion should revenues decline more than currently expected. Vermont also regularly updates its revenue forecast during the year and typically makes midyear adjustments to accommodate changes in the forecast. We therefore expect that operations will remain balanced through the next year even supposing an economic slowdown, which S&P Global Economics is also forecasting in its latest outlook (see "Economic Outlook U.S. Q3 2023: A Sticky Slowdown Means Higher For Longer," published June 26, 2023, on RatingsDirect). We expect that key priorities in the next fiscal year will largely revolve around the state's ongoing recovery from the July floods along with the expansive investment of federal dollars from various federal stimulus bills received in the past few years.

Vermont's tax-supported debt liabilities are modest relative to those of state peers and are projected to decline over the next decade, particularly as the state created and seeded a designated pay-as-you-go capital fund in 2023 for the purpose of reducing reliance on bonded debt. Its pension and other postemployment benefit (OPEB) liabilities remain elevated compared with those of peers, even after the passage of pension reform last year. We believe that the changes introduced in the pension reform legislation--which included reduced benefits, higher contributions, and pre-funding OPEB--place the state's retirement liabilities on a more stable long-term footing, but that it will take some time before the liabilities are paid down to levels that better align with those of most other states.

The 'AA+' rating reflects our view of Vermont's:

- Economy, which is experiencing a slower jobs recovery than the rest of the nation, although with historically low unemployment and some signs coming out of the pandemic that the state could be in the early stages of a path toward stronger demographic and economic performance than in years past, albeit with significant uncertainty around the sustainability of pandemic-era trends;
- Strong budgetary performance, with the past three fiscal years ending with some of the largest budget surpluses in the state's history, most recently driven by higher-than-forecast corporate income tax receipts and investment income in fiscal 2023;
- Historically high cash balances that have ballooned to more than $2 billion compared with a typical pre-pandemic average of $200 million-$500 million, with reserve balances that continue to be fully funded at the statutory maximums;
- Robust financial management and governance framework because the state has substantial autonomy to raise revenues without limits, regularly monitors and adjusts its budget during the year, and uses a consensus revenue

forecast that is updated twice annually to track revenue performance;

- Well-defined debt affordability and capital-planning processes that we believe have limited leverage and contribute to a modest tax-supported debt burden with rapid principal amortization; and
- Significant pension and OPEB liabilities that remain sizable relative to those of state peers, although last year's retirement reforms will moderate these liabilities over time.

Based on the analytic factors we evaluate for states, on a four-point scale in which '1.0' is the strongest and '4.0' is the weakest, we have assigned a composite score of '1.8' for Vermont, which is associated with a 'AA+' indicative credit level.

Environmental, social, and governance

Vermont is susceptible to flooding, so events comparable to the July floods could become more frequent as warmer temperatures contribute to more regular extreme precipitation events. Following Tropical Storm Irene in 2011, the state implemented a range of measures designed to fortify infrastructure and enhance flood resiliency; consequently, based on the state's preliminary assessment, the amount of infrastructure damage this July was considerably less than in 2011. Physical climate risks remain neutral within our analysis because Vermont has not seen significant long-term economic or revenue disruption related to flooding, and we expect that it will continue to take active measures to reduce future risk as it recovers from the recent flood and updates its hazard mitigation plan later this year.

Our view of the state's risk management for pension governance has improved following last year's pension reform legislation, which we believe places Vermont's pension and OPEB on a more sustainable long-term cost trajectory. Social capital risks are elevated relative to those of state peers because despite the significant policy attention and funding the state is directing toward addressing its long-term demographic challenges, we have yet to see an unequivocal, sustained trend in favor of stronger population growth and stronger economic output than was typical in the decade preceding the pandemic.

Outlook

The stable outlook reflects our expectation that Vermont will continue to realize structurally balanced operations with fully funded reserves and robust cash balances in the coming few years, despite the likelihood of a near-term economic slowdown.

Downside scenario

Last year's pension reform, the state's historically high cash levels and large structural budget surplus, and the availability of substantial federal funds that Vermont plans to deploy strategically to target legacy economic and demographic vulnerabilities, together have created positive momentum that we believe will limit downside credit pressure through the two-year rating outlook horizon. Downside rating pressure would most likely emerge outside the two-year outlook period if, despite the state's efforts, Vermont's economy and demographics significantly underperform relative to those of similarly rated peers, particularly if slow revenue growth were to strain the state's ability to sustain structural balance in outyear budgets.

Upside scenario

We could raise the rating with clear evidence that the state's economic and demographic trajectory is on a path of accelerating long-term growth that aligns with what we typically see among 'AAA'-rated peers, while the state also making inroads in paying down its still-sizable retirement liabilities.

Credit Opinion

Economy

Vermont is trailing the national level in jobs recovery, with year-over-year job growth of 2.1% in the first quarter of 2023, ranking 38th in the U.S. and still 2.2% below the pre-pandemic employment peak, according to S&P Global Market Intelligence. As with other New England states, Vermont's comparatively weak labor force growth will weigh on long-term economic growth, underscoring the need for the state to attract and retain qualified workers to achieve stronger economic performance.

The good news is that unemployment is also quite low. The June 2023 release from the Bureau of Labor Statistics has Vermont tied for the third-lowest unemployment rate in the country at only 1.9%. Although we expect Fed rate hikes to erode domestic demand growth through the next few quarters resulting in national unemployment drifting toward 4% by year-end, S&P Global Market Intelligence forecasts Vermont slightly outperforming the U.S. through the coming economic slowdown, with the baseline forecast showing the state unemployment rate rising to 3.3% by the middle of next year. The state's employment diversity by sector is generally in line with that of the U.S. with no material concentration and or unusual cyclicality. Per capita personal income improved relative to the U.S. level in 2022 to 97%, up from 94% in 2021.

We continue to expect that long term lackluster demographic trends will remain a key constraint on economic growth, although, as noted, Vermont is positioning itself to capitalize on the now widespread acceptance of remote work to attract new residents and leverage private sector investment for in-state job creation. The state's 10-year annual population growth rate through 2022 was less than half the U.S. rate and its median age of 42.9 is considerably higher than the U.S. median of 38.8. Net in-migration in 2020 and 2021 accelerated, in particular among prime working aged individuals (25-54) with adjusted gross incomes of greater than $100,000. However, this was followed by growth of just 92 residents in 2022 (0.01%), and S&P Global Market Intelligence currently forecasts a return to tepid growth trends through 2026.

Vermont will use a significant share of its remaining American Rescue Plan Act allocation for investments in areas such as housing, broadband, and workforce development, and will similarly leverage funds from the Infrastructure Investment and Jobs Act to upgrade its broadband and transportation infrastructure. State officials indicate that Vermont's housing shortage has been a major impediment to attracting new residents and note that the state has seen a historic runup in home prices over the past few years. Last year the legislature passed housing regulatory reform via Act 47 that, among other things, eliminates single-family zoning, allows for greater density in designated areas, and allows for the construction of accessory dwelling units. In general, we expect that the policy attention as well as significant investment designed to address long-standing vulnerabilities (such as the lack of housing) have the potential to meaningfully alter the state's demographic trajectory, especially given the prevalence of remote work. But we also expect that it might take some time for these investments to result in a clear, sustainable record of stronger growth, and we also note that in the near term slower economic growth with rising unemployment could stymie progress.

The state's economy is driven by tourism, higher education, electronics, consumer goods manufacturing, and agriculture (including dairy farming). Economic growth has historically been slower than that of the U.S. but has basically aligned with the U.S. since 2020. Real gross state product (GSP) has grown by less than half the national growth rate over the past 10 years and, before 2020, fell below the U.S. GDP growth rate in every year going back to 2011. Growth in 2020 and 2021 was comparable to that of the U.S., and Vermont's 2022 real GSP exceeded national growth at 2.8%, compared with 2.1% GDP for the U.S. Despite the recent improvement in the growth rate, the state's GSP per capita still lags the national level considerably at 82% of the U.S. GDP.

Vermont has a highly educated workforce, with 49.4% of the population holding an associate's, bachelor's, or advanced degree, compared with 43.8% nationally. The largest employers include the University of Vermont Medical Center, the University of Vermont, Global Foundries (which produces semiconductors), and several regional medical centers. The state saw the largest percentage increase of any state in venture capital investment during the pandemic, although it lags in other areas such as research and development spending. Vermont is also a high tax state, which the Tax Foundation ranks as the 10th worst in terms of its business tax climate.

On a four-point scale, with '1.0' being the strongest, we have assigned a '2.4' to Vermont's economy.

Budgetary Performance

The July 2023 consensus revenue forecast update shows fiscal 2023 revenue for the general, education, and transportation funds closing at 1.2% ($39.7 million), higher than the January forecast $3.27 billion, with general fund revenues 2.0% above target and the education fund essentially on target. The general fund experienced some softening in personal income tax receipts, which fell by 4.2% ($53 million), but this was more than offset by corporate income taxes coming in at 27.1% ($60 million) above target and other revenues (primarily interest income) 32.8% higher ($36 million). Vermont received record-setting corporate income taxes in 2023 in part due to a shift to market-based taxation that expanded the base of taxable activity following legislation passed in 2019, alongside the high inflation environment of the past fiscal year, which conferred stronger pricing power to businesses. The state's interest income has far outpaced historical averages because Vermont's cash balances have swelled since 2021 due to high interest rates and the influx of federal funds that the state has deposited to interest bearing accounts. All told, fiscal 2023 ended with a large unallocated general fund surplus of $337.5 million (18% of base appropriations), with surplus results likewise reported in the transportation and education funds and budget stabilization reserve accounts funded at statutory maximum levels.

Looking to fiscal 2024, general revenues are forecast to decline by 5.5% to $2.1 billion and base appropriations--including for the Act 76 childcare bill passed in the 2023 legislative session--will increase by 13% to $2.1 billion. The state's economic forecast anticipates a slowdown through 2024, although not a recession, and the revenue forecast anticipates both personal and corporate income taxes declining in the current fiscal year, before beginning a slow recovery in fiscal 2025. Vermont also plans to use $231 million of its 2023 carry-forward balance on one-time appropriations in 2024, as it has done in the past few fiscal years, and expects to fully fund its reserve accounts. In general, we expect the state will continue to realize structurally balanced operations, as the economic assumptions underlying its revenue forecast more or less align with those in S&P Global Economics' macroeconomic forecast, and we note the state's record of making regular midyear budget updates via budget adjustment acts to sustain structural budgetary balance, which we expect will continue.

The operating budget (which we define as the combined general and education funds) has a diverse revenue mix with the largest sources including personal income taxes (32% of combined revenues), a statewide education tax (a property tax, 30%), and sales and use taxes (14%). The state has fully funded its budget stabilization reserve accounts in the general, education, and transportation funds since the Great Recession, which provides some flexibility to offset fund deficits should they emerge. Vermont pools its cash across major funds and has seen its cash levels increase considerably since 2021, to an average monthly balance of about $2.3 billion in 2023 compared with a typical balance of several hundred million in the years leading up to the pandemic. Given that much of the increase has come from federal stimulus dollars that will be spent over the next several years, we expect cash balances will normalize eventually, but that they will likely remain exceptionally strong in the interim.

On a four-point scale, with '1.0' being the strongest, we have assigned a '1.4' to Vermont's budgetary performance.

Debt and Retirement Liabilities

Debt

Vermont's debt liabilities are low to moderate relative to those of state peers and are projected to decline over the next decade. The state's pension and OPEB liabilities, however, remain elevated even following the passage of pension reform legislation in 2022, and we expect will remain significantly higher than those of similarly rated peers for some time.

We calculate direct debt at $1,045 per capita, 1.7% of personal income, and 1.6% of GSP, when including the new money portion of the 2023 issuance. Debt service carrying charges were 1.7% of general government spending in fiscal 2022 and we expect will remain below 2.0%. The state's debt portfolio consists entirely of fixed-rate GO debt--it has no variable-rate debt, interest rate swaps, or direct placement debt.

In fiscal 2023, a joint initiative of the treasurer and governor led to the creation of a new fund designated for pay-as-you-go capital financing (the cash fund), with the express goal of reducing future reliance on bonded debt. The cash fund was initially seeded with $25 million and received additional transfers totaling $45.8 million at the close of fiscal 2023, and the fiscal 2024 budget includes a transfer of $67.2 million. The cash fund will be supported through an ongoing funding mechanism based on general fund transfers calculated as 4% of prior-year appropriations, less debt service. With this new source of capital financing in place, we expect that the state's tax-supported debt burden will likely lessen over time.

Pensions and OPEB

Last year's pension reform legislation included several measures to shore up the state's retirement accounts and place pension and OPEB costs on a more sustainable trajectory. These measures included raising state contributions above actuarially determined levels and creating a long-term funding mechanism for higher contributions, raising employee contributions, and lowering cost-of-living adjustments, as well as changing employee eligibility, prefunding OPEB, and providing a one-time state contribution of $200 million to the pension funds. With the changes, we believe that retirement liabilities are less of a source of credit pressure than they were before pension reform but are still sizable relative to those of state peers.

The state provides pension benefits through two defined-benefit pension plans: the Vermont State Employees' Retirement System (VSERS) and the Vermont State Teachers' Retirement System (VSTRS). As of June 30, 2022, VSTRS was 55% funded, with a net pension liability of $1.9 billion, and VSERS was 67% funded, with a $1.1 billion liability. The three-year average pension funded ratio is 61%, with net pension liabilities totaling $4,690 per capita and 7.4% of personal income, placing Vermont in the bottom fifth of all states in terms of the size of its pension liabilities.

The $200 million one-time contribution in fiscal 2022 allowed total plan contributions to exceed our minimum funding progress calculation, but we expect contributions will continue to fall short of minimum funding progress in a typical year for some time. In particular, the level percentage of payroll amortization method used for both plans results in lower upfront employer contributions that rise progressively along with assumed payroll growth, and the plans' 7% investment rate of return assumption results in lower employer contributions in favor of investment returns than would an assumption that more closely aligns with our 6% guideline. State contributions have exceeded the actuarially determined contribution (ADC) for the past decade and the ongoing payment of the ADC plus additional contributions pursuant to last year's reforms will result in gradual funding improvement over time. However, as noted, the plans rely on a funding structure that, while improved, still results in meaningful cost deferrals that increase outyear risk.

The 2022 pension reform legislation created prefunding schedules for both VSERS and VSTRS, which contributed to a significant decline in the calculated liability for the most recent plan valuations because the state is now permitted to discount liabilities by the 7% expected long-term rate of return for both plans. As of June 30, 2022, the net OPEB liability for VSERS was $802.5 million (previously $1.5 billion) and for VSTRS it was $717.9 million (previously $1.3 billion), and the plans were 11.6% and 5.3% funded, respectively. As with the favorable changes to Vermont's pension liabilities, we believe the improvements represent meaningful gains, but note that the per capita OPEB liability of $2,350 is still large and well above what is typical among other states. (For more information, see "Market Swings Could Signal Contribution Volatility For U.S. State Pensions and OPEBs," published Aug. 3, 2022, on RatingsDirect.)

On a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a '2.6' to Vermont's debt and liability profile.

Government Framework

Although Vermont is the only state without a constitutional or statutory balanced budget requirement, this has not had a significant effect historically, as in practice the state has demonstrated a commitment to structurally balanced budgets regardless. Vermont has significant revenue autonomy and can generally levy taxes and alter taxing structures (including modifying tax rates and bases) without constitutional constraint or having to meet an extraordinary legislative threshold. The state has significant legal authority to alter disbursements and assistance to local governments but could face practical limits in exercising this ability due to a comparatively high level of essential service provision and support for local governments. Vermont is not a voter-initiative state. While there are no express statutory provisions giving priority to bondholders over other claimants to state resources, Vermont has no limits on its ability to impose taxes to pay debt service on GO debt and can pay debt service without a budget.

On a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a '1.6' to Vermont's government framework.

Financial Management

Vermont uses a consensus revenue forecast that is based on recommendations from the state's two economists (representing the legislature and the administration) and is required to be approved each January and July by the state's Emergency Board (the E-Board), which includes the governor and chairpersons from each of the legislature's finance-related committees. The state monitors and reports revenues and spending monthly, while the E-Board meets at least twice a year to adopt the updated consensus forecast and make budgetary adjustments. The E-Board can hold interim meetings to evaluate the budget and has done so in the past during periods of heightened economic uncertainty, such as during the Great Recession and the COVID-19 pandemic.

The CDAAC oversees the state's long-term capital planning and debt levels. It publishes an annual report each September with recommendations on future bonding limits to enable the administration to complete its annual capital budgeting proposal as part of its long-term capital planning process. Although the CDAAC's recommendation is nonbinding, the state has never authorized GO debt in excess of its recommendations. The state treasurer's office oversees Vermont's state investment portfolio in accordance with statutory limits on allowable investments, and it publishes monthly reports detailing investment holdings and unrestricted cash balances.

The three major operating funds--the general, transportation, and education funds--have budget stabilization reserve accounts that have been funded at the statutory maximums each year since the Great Recession. The general and transportation stabilization reserve maximums are calculated as 5% of prior-year appropriations, and the education fund reserve is calculated as 5% of nonproperty tax revenues. In 2013, the state created a second general fund reserve called the general fund balance reserve, and it has various other reserve accounts that are restricted for specific purposes.

Vermont has a strong and largely formalized budget management framework with a history of effective budget tracking and adjustment to maintain structural balance. In addition to the monitoring and reporting mechanisms already mentioned, the state can and does adjust its budget in response to variances through a variety of mechanisms that include administrative action at the departmental level, through the E-Board, or through the legislature via a budget adjustment act.

On a four-point scale, with '1.0' being the strongest score, we have assigned a '1.0' to Vermont's financial management.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of August 16, 2023)		
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed
Vermont GO		
Long Term Rating	AA+/Stable	Affirmed
Vermont Bond Bank, Vermont		
Vermont		
Vermont Mun Bnd Bank (Vermont) SCHSTPR		
Long Term Rating	AA/Stable	Affirmed