Capital Financing and Debt Management Overview

Vermont State Treasurer's Office

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VERMONT

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What are Bonds?

- Same basic concept as a home mortgage:
  - A loan for a large purchase, that is paid back over time

- Vermont’s bonds also have fixed interest rates like a typical mortgage

- Some ways Vermont’s bonds <u>differ</u> from a mortgage:
  - Usually repaid over 20 years (vs. 15 or 30 years)
  - Payments made every 6 months for interest, and 12 months for principal (vs. monthly principal plus interest)
  - Level <u>principal</u> payments (vs. level principal plus interest payments), so earlier payments are larger than later payments, and the amount borrowed is repaid <u>sooner</u>
  - Can only be refinanced after about 10 years (vs. any time)
  - Vermont guarantees repayment from General Fund (vs. home pledged as collateral that can be foreclosed upon)
  - Each bond issue is actually a package of loans from one to 20 years long
  - Large number of lenders (i.e., bond purchasers) such as investment banks, mutual funds, and even Vermont citizens (vs. a single local bank or credit union)

Capital Expenditure Cash Fund (CECF)

- Created in Sec. E.106.1 of Act 185 (the 2022 Big Bill), added to Title 32:

  32 V.S.A. § 1001b. CAPITAL EXPENDITURE CASH FUND
  (a) Creation. There is hereby created the Capital Expenditure Cash Fund to be administered by the Commissioner of Finance and Management, in consultation with the State Treasurer, for the purpose of using general funds to defray the costs of future capital expenditures that would otherwise be paid for using the State's general obligation bonding authority and debt service obligations.

- Goal of CECF was to create a source of "Pay-as-you-go" or "Pay-Go" funding as an alternative to bonds, to save on bond interest costs as rates have risen

- Sec. 102 of Act 185 also provided funding to the CECF as follows:
  - Sec. 102(b)(12) provided $25 million to the CECF
  - Sec. 102(b)(5)(B) provided $20 million to the Treasurer's Office to redeem G.O. bonds prior to maturity, with reductions in debt service payments starting in FY24 to be transferred and reserved in the CECF (this redemption transaction is pending)

Bonds: The Treasurer's Office's Statutory Role

- The Treasurer's Office is responsible for managing the State's bonds
  - Title 32: Taxation and Finance, Chapter 13: Debts and Claims

- Duties relating to bonds include:
  - Managing the issuance (sale) and ongoing administration of State bonds
  - Paying principal and interest (debt service) when due
  - Monitoring for refinancing (refunding) opportunities for lower borrowing costs
  - Managing the State's bond ratings (credit scores) and ongoing relationships with the bond rating agencies
  - Contracting for all debt-related State vendors and services (investment bankers, lawyers, financial advisors, economists, rating agencies, custodians and paying agents)
  - Ensuring compliance with all Federal and State laws and regulations
  - Chairing the Capital Debt Affordability Advisory Committee (CDAAC), and delivering the CDAAC's annual debt recommendation and report

- Legislative Committees consider the CDAAC debt recommendation when creating the biennium Capital Bill

Vermont Bond Ratings

- The major credit rating agencies are:
  - Moody's Investors Service
  - S&P Global Ratings
  - Fitch Ratings
- In July 2022 Moody's and Fitch affirmed the State's rating at Aa1 and AA+ with Stable outlooks, and in August 2022 S&P affirmed the State's rating of AA+ and upgraded the outlook to Stable
- Vermont has the highest bond ratings of the New England states, resulting in the lowest interest rates (cheapest borrowing cost)

BOND RATINGS CHART				
	Moody's	S&P	Fitch	Meaning
Investment Grade	Aaa	AAA	AAA	High quality; minimal risk of default
	Aa1	AA+	AA+	High quality; very low credit risk
	Aa2	AA	AA	
	Aa3	AA-	AA-	
	A1	A+	A+	Upper-medium grade; low credit risk but somewhat specific susceptible to adverse factors
	A2	A	A	
	A3	A-	A-	
	Baa1	BBB+	BBB+	Medium grade; moderate credit risk; may have some

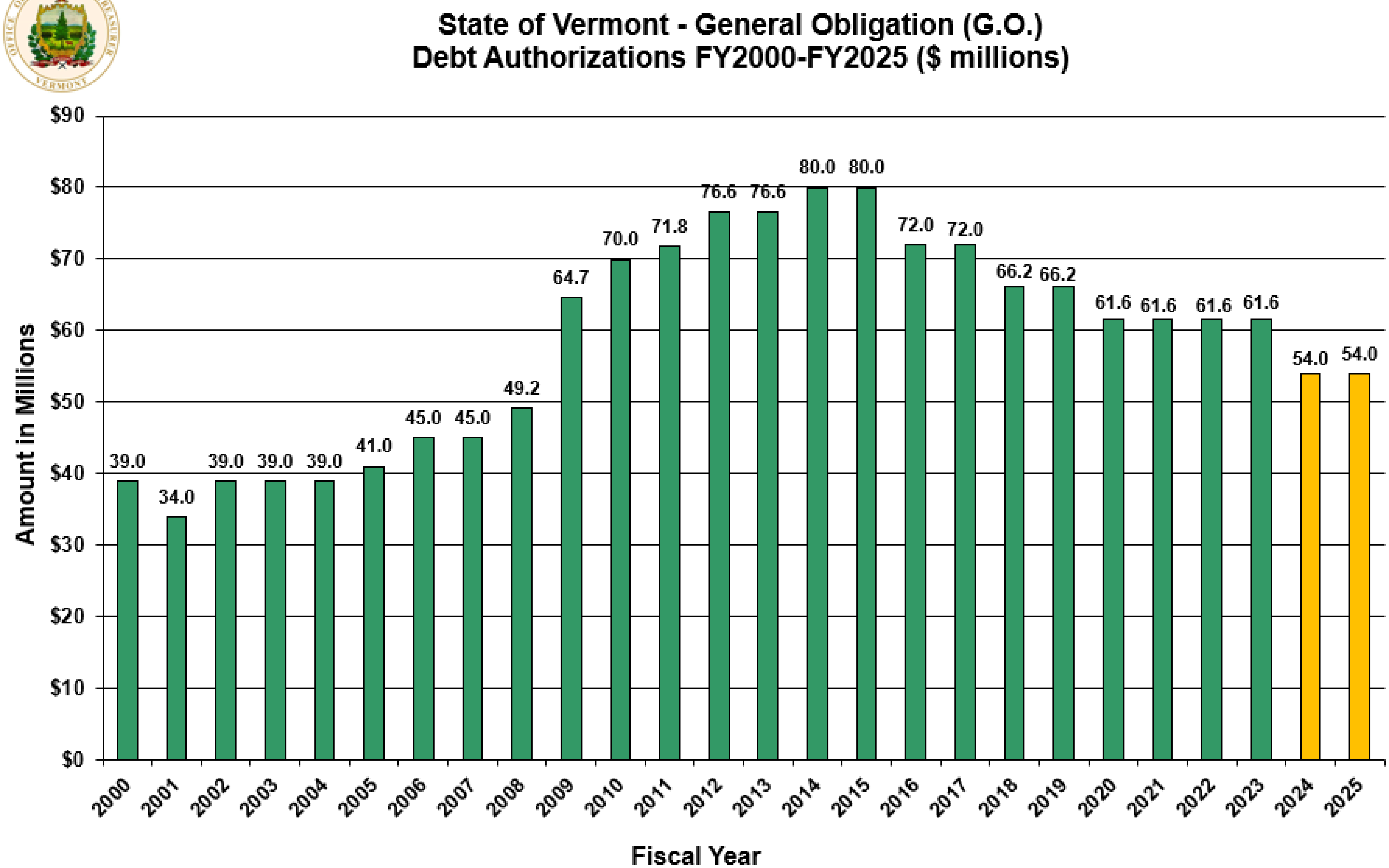
State	Moody's	S&P	Fitch
Vermont	Aa1	AA+	AA+
Connecticut	Aa3	A+	AA-
Maine	Aa2	AA	AA
Massachusetts	Aa1	AA	AA+
New Hampshire	Aa1	AA	AA+
Rhode Island	Aa2	AA	AA

Rating Agency Commentary for Vermont

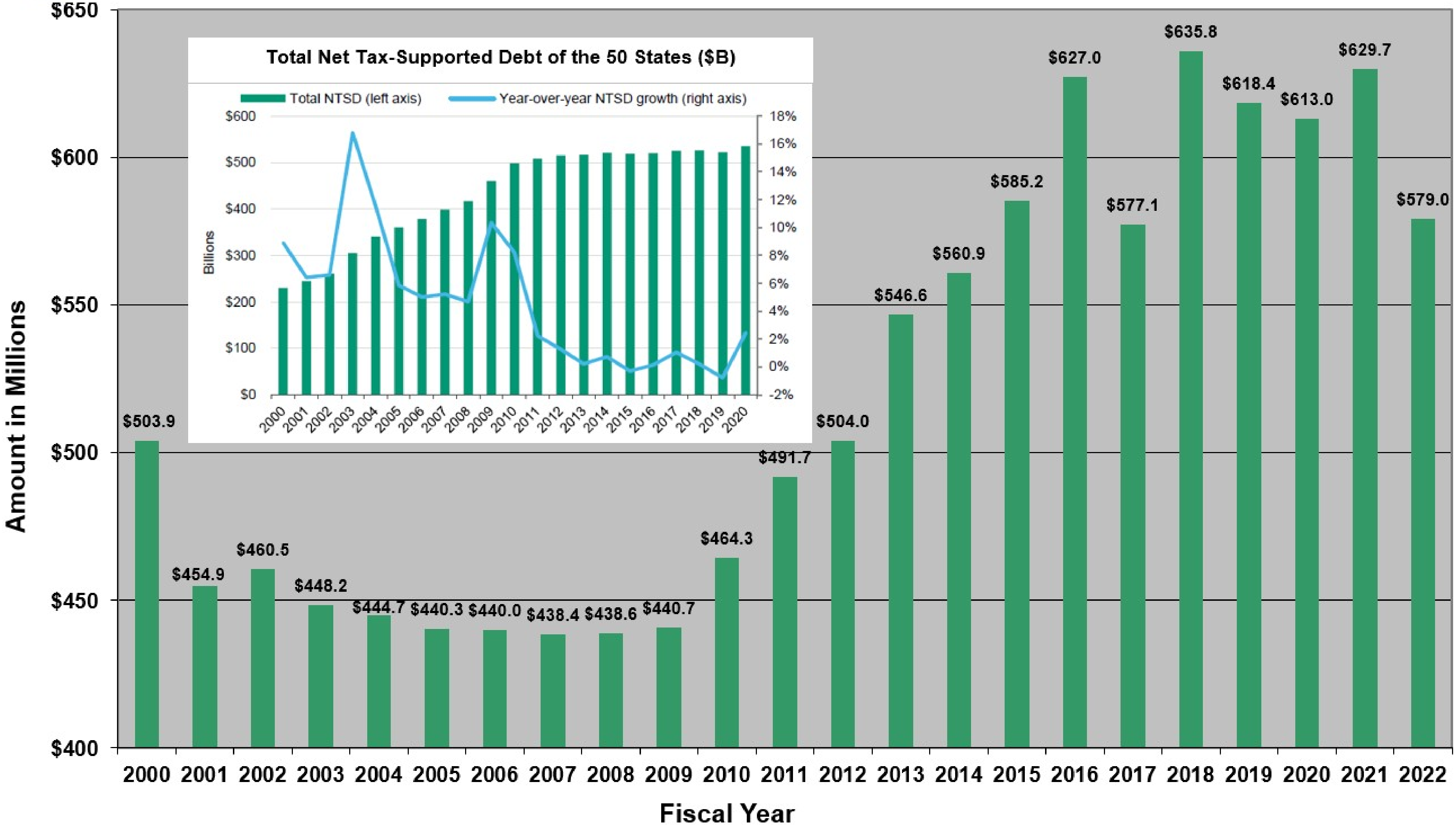
Moody's Investors Service	Standard & Poor's Ratings Services	Fitch Ratings
Aa1 (Stable) *Report Dated: 7/21/22*	**AA+ (Stable)** *Report Dated: 8/19/2022*	**AA+ (Stable)** *Report Dated: 4/23/21*
Credit Strengths		
• Although the state's economy is the smallest of all US states, resident income is above average, educational attainment is high, and unemployment is low • Financial operations and budget reserves are sound and stable, and liquidity is very healthy	• Strong financial and budget management policies that have contributed to consistently good reserve and liquidity levels • Well-defined debt affordability and capital-planning processes that have limited leverage and contributed to a modest tax-supported debt burden with rapid amortization of tax-supported debt	• Conservative financial management • Ample expenditure flexibility with a low burden of carrying costs for liabilities and a broad expense-cutting ability • High educational attainment level could provide potential for economic gains, but the state has not fully benefited to date
Credit Challenges		
• The state's economic performance lags that of the US and many state peers, and an aging population may be a drag on future growth • Relative to state GDP, Vermont's leverage (combined debt and unfunded post-employment liabilities) is higher than most states	• Significant pension and OPEB, which remain sizable relative to those of state peers, although recently enacted retirement reforms should moderate these liabilities over time • Economic growth has been slow and demographic challenges persist, despite some recent improvement	• Small and modestly growing economy has a larger-than-average reliance on health and educational services, manufacturing and tourism; as such, it is exposed to several key large employers. • Population is older than most states, and growth has been relatively limited. • Above the States' median, but still moderate, long-term liabilities burden

Vermont's Overall Debt Strategy

- Vermont has conscientiously and consistently maintained excellent bond ratings, to achieve the lowest possible borrowing costs for Vermont's citizens and taxpayers
- The State has substantially reduced outstanding debt since the 1990s, however there is a need to continue in light of national trend of reductions in bond issuance
- Straightforward debt profile, almost entirely General Obligation (G.O.) debt
  - Transportation Infrastructure Bonds (TIBS) backed by motor fuel assessment issued 2010-2013, fully redeemed in June 2022
- 100% fixed rate bonds
- Level principal produces rapid amortization
- Capital Appropriation changes adopted by the General Assembly have improved the process:
  - Two-year recommendations
  - Use of bond premium used for projects reduces amount of issuance


State of Vermont - General Obligation (G.O.)
Debt Authorizations FY2000-FY2025 ($ millions)
Amount in Millions
Fiscal Year
$0
$10
$20
$30
$40
$50
$60
$70
$80
$90
2000 39.0
2001 34.0
2002 39.0
2003 39.0
2004 39.0
2005 41.0
2006 45.0
2007 45.0
2008 49.2
2009 64.7
2010 70.0
2011 71.8
2012 76.6
2013 76.6
2014 80.0
2015 80.0
2016 72.0
2017 72.0
2018 66.2
2019 66.2
2020 61.6
2021 61.6
2022 61.6
2023 61.6
2024 54.0
2025 54.0

State of Vermont
G.O. Debt Outstanding, FY2000-FY2022 vs. National Trend



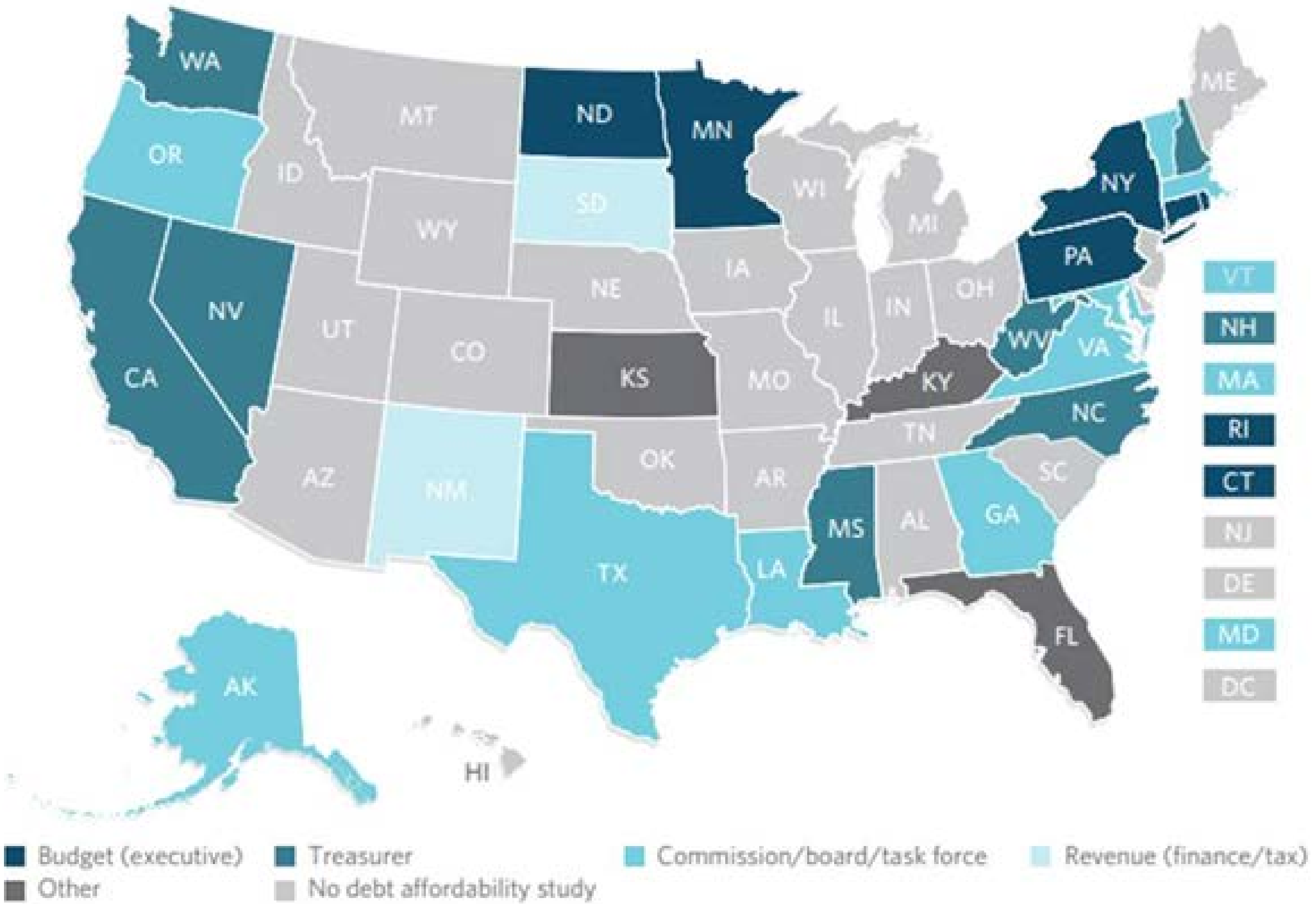
Capital Debt Affordability Advisory Committee (CDAAC)

- The CDAAC was created by State statute in 1989
  - Title 32: Debts and Claims, Chapter 13: Debts and Claims, Subchapter 8: Management of State Debt
- Annually reviews affordability of Vermont's net tax-supported debt
  - Benchmark to debt ratios of other Aaa rated states
    - Debt as a Percentage of Personal Income
    - Debt Service as a Percentage of Revenues
    - Debt Per Capita
- Recommends annual debt issuance to Governor and General Assembly
- Recommendation is advisory; in practice, Governor and General Assembly have always adopted in the biennial Capital Bill and Capital Bill Adjustment
- Reviews amount and structure of bonds, notes, and other obligations for which the State has a contingent liability or moral obligation
- The CDAAC structure is considered a good governance practice by the bond rating agencies

Most U.S. States Conduct Debt Affordability Studies

Figure 10

Varying Offices Produce Debt Affordability Studies

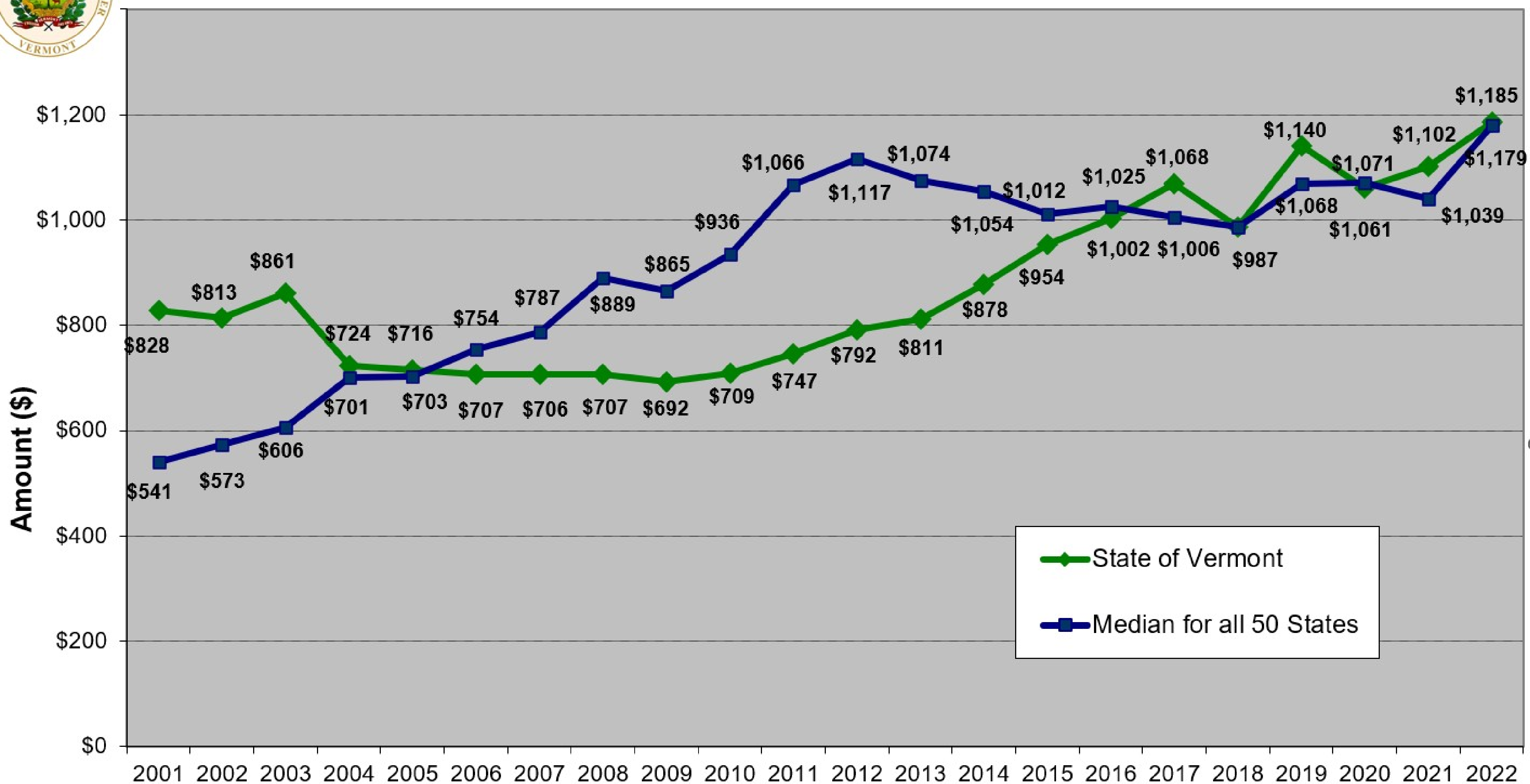


Notes: In Kansas, the study is authored by an independent authority. In Kentucky, a legislative office serves as the author. The Florida Division of Bond Finance, within the State Board of Administration, conducts that state's study.[73] Hawaii produced its first state debt affordability study in December 2016, after the data collection for this report had concluded. The state's study is therefore not included in this analysis.

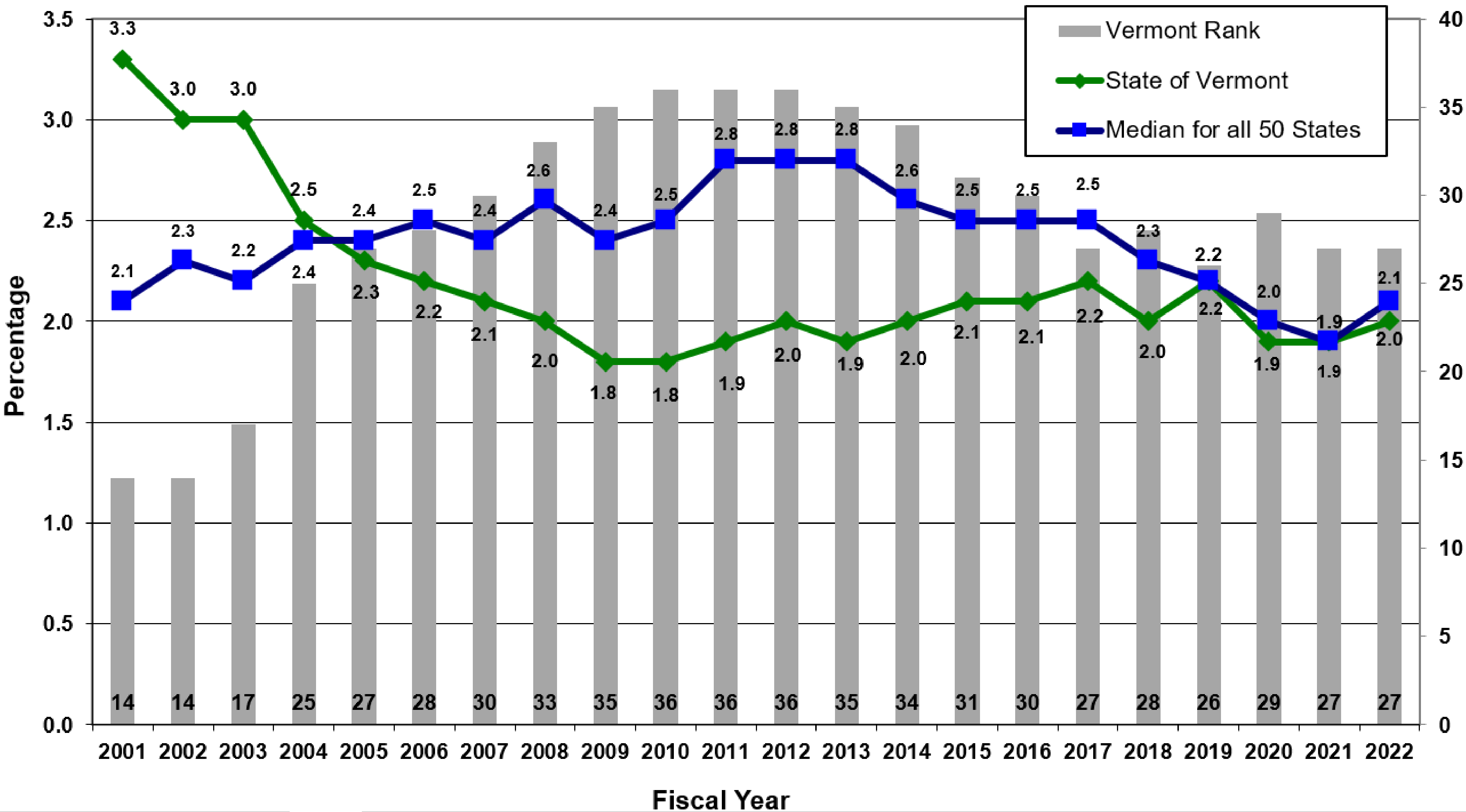
CDAAC Recommendations and Comments

- More limited debt issuance by other states, including our peer Triple-A rated states, has resulted in a weakening of Vermont's debt ratio comparative ratings
- This is the first year of the 2024-2025 biennium and the Committee has a two-year debt recommendation of $108,000,000
- This represents a reduction of 12% from the prior biennium and 37% since the 2014-15 recommendation
- Need to remain disciplined in making actuarially determined employer contributions (ADEC)
- Continued support for reserve increases is also important: The rating agencies are recognizing the need for higher levels of reserves

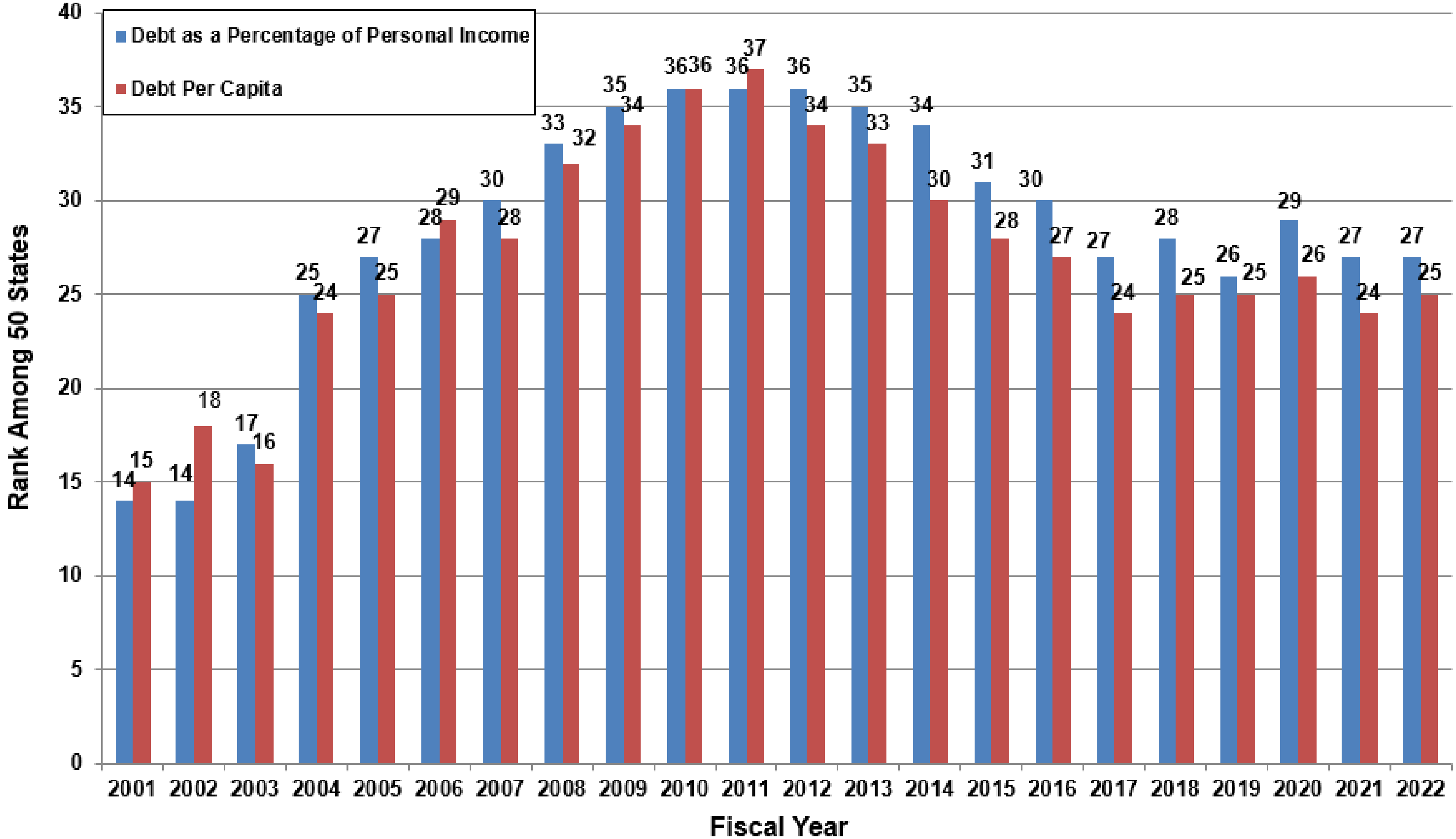
State of Vermont
Net Tax Supported Debt Per Capita



State of Vermont
Net Tax Supported Debt as a Percent of Personal Income



State of Vermont
Historical State Debt Rankings



Bond Rating Credit Priorities

- **PENSION FUNDING:** Continue 100% funding of the annual required contributions (ADECs) to the Vermont State Employees' and State Teachers' Retirement Systems pension funds

- **RESERVES:** Continue to maintain budget stabilization reserves, and build the General Fund Balance Reserve (or "rainy day reserve") incrementally and over time

- **DEBT RECOMMENDATION:** Continue unbroken record of adopting the Capital Debt Affordability Advisory Committee's (CDAAC) biennium recommendation; adopt recommended $108 million debt authorization for the 2023-2024 biennium Capital Bill