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Vermont Municipal Bond Bank

Update to credit analysis

Summary

The Vermont Municipal Bond Bank (Aa2 stable) demonstrates strong pool program characteristics including an overall stable credit quality of pool participants, many of which are supported by the Vermont State Aid Intercept Program (Aa2 stable). The bond bank's pool of participants is large and very diverse with a sound governance structure and legal provisions. The program also benefits from strong and proactive management and oversight. The bond bank's annual debt service is structured to yield just over one times coverage supported by a large debt service reserve fund that results in an adequate default tolerance provided by loan repayments and other available funds. Legal provisions include additional support by the State of Vermont's (Aa1 stable issuer rating) moral obligation pledge to restore the debt service reserve fund.

Credit strengths

» Large size and diversity of pool participants

» Experienced management team

» State aid intercept provision enhances credit quality on large portion of pool participants

Credit challenges

» Limited excess annual cash flow due to program design resulting in low default tolerance

» Maintenance of credit quality and diversity of pool given ability for new participants

Rating outlook

The stable outlook reflects strong structural elements of the pool program and the healthy credit quality and diversity of the loan pool which will be maintained given strong program management and oversight practices.

Factors that could lead to an upgrade

» Improvement in the credit quality of pool participants

» Material increase in annual debt service coverage and the pool's default tolerance

» Upgrade of the State of Vermont's issuer rating

Factors that could lead to a downgrade

» Downgrade of the State of Vermont's issuer rating

» Deterioration in the credit quality of pool participants

» Significant change in pool composition

» Material decline in reserves

Key indicators

Exhibit 1

Vermont Municipal Bond Bank

Vermont Municipal Bond Bank		
Size and Diversity		
Size of Portfolio		192
% of Borrowers with less than 1% of the pool		84.4
% of loans to the top 5 borrowers		22.2
Amount Outstanding		
Total Bonds Outstanding	$574 million	
Total Loans Outstanding	$546 million	
List of Participants	Percent of Pool	
Champlain Valley School District, VT		5.6%
St. Albans (City of) VT		5.1%
South Burlington (City of) VT		5.0%
Middlebury (Town of) VT		3.2%
Stowe (Town of) VT		3.3%

Post issuance of the 2023 series 1 bonds

Source: Vermont Municipal Bond Bank

Profile

The Vermont Municipal Bond Bank was created in 1969 and is authorized to issue bonds in order to provide loans to local governments. Following the August 2022 issuance, the bank will have $546 million in outstanding loans and, since its inception, has provided over $2.5 billion in loans for local infrastructure throughout Vermont. Approximately 98% of the loans are secured by a general obligation of the municipality, school district, or special district.

Detailed credit considerations

Loan portfolio: strong portfolio given large pool size and diversity of participants

Following the issuance of 2023 Series 1 bonds, the program's pool will consist of 192 separate local government borrowers with 492 loans outstanding. Post issuance of the 2023 Series 1 bonds, 84.4% of participants have less than 1% of the total loans outstanding. The loans outstanding of these participants represent 34.5% of the total pool amount. The five largest borrowers account for less than 25% of outstanding loans. The large size and diversity of the pool is a credit strength. Program cash flow is structured to provide a minimum 1.0 times debt service coverage on the bonds.

Credit quality and default tolerance: average credit quality of pool participants and low default tolerance

The pool's credit quality is adequate but the default tolerance is low. The pool's underlying credit quality is generally in the A-range and further enhanced by the application of the Aa2 enhanced rating that is assigned to any participant with sufficient state aid coverage over maximum annual debt service based on the state aid intercept program. Only 6% of loans outstanding carry a public rating, including the City of Burlington (Aa3 stable) and Town of Stowe (Aa3). The pool is 98% secured by general obligation pledges of the participants with only 2% repaid by a revenue pledge of special districts that require 1.25 times revenue pledge. The largest participant is Champlain Valley School District which accounts for 5.6% of loans outstanding which are backed by a general obligation pledge. Participants are geographically diverse with loans allocated to participants in all 14 counties.

The pool has a low default tolerance of 11.1% that reflects the bond bank's program which is designed for achieving 1.0 times coverage for tax backed participant loans. As a result, the bond bank's debt service coverage is generally sufficient and generates minimal excess cash flows. While debt service reserves funds and operating reserve provides only modest improvement of the default tolerance.

Liquidity

The bond bank has healthy liquidity with $22.7 million held in the general operating fund reserve as of the end of fiscal 2022 (December 31). The bond bank maintains a policy to keep an amount above 3% of total loans outstanding in the reserve fund which would equal around $16.4 million. Almost all of the reserves including the debt service reserve fund are invested in State and Local Government Series securities or US Treasuries.

Legal framework, covenants and debt structure: sound legal provisions

The bonds are payable primarily from loan repayments from borrowers that provide for only 1x coverage; this is mitigated by additional revenue from debt service reserve fund balances, interest earnings, and operating reserves if needed. Borrowers' loan payments are due on November 1 and May 1, which are 30 days prior to debt service payment dates on the bond bank's bonds.

Legal security

The bonds are a general obligation of the Vermont Municipal Bond Bank, and the full faith and credit pledge of the bank is pledged for the payment of debt service on their municipal bonds. Additionally, the State provides a moral obligation to replenish the debt service reserve fund, subject to appropriation, if there is a draw on the reserve that reduces the amount below the required debt service reserve.

Debt structure

The debt of the Bank consists entirely of fixed rate obligations. Debt policy limits amortization of debt to the useful life of assets and mandates a flat or front loaded debt service schedule

Debt-related derivatives

The bond bank has no debt-related derivatives.

ESG considerations

Environmental

Environmental considerations are not material to the Bond Bank. As a US state with a wealthy and diverse economy, the flexibility to raise revenue, and support from the federal government, Vermont will continue to demonstrate high resilience to environmental risks. In general, US states face low credit risk stemming from environmental events, the most likely to occur being natural disasters. Even among US states, Vermont's environmental risks are low. With no coastal exposure, Vermont counties are primarily exposed to extreme rainfall risk, according to data from Moody's ESG Solutions. Increased rainfall could result in more frequent local or regional flooding. We expect the state and most of its local governments have the resources and capacity to address flood events. Heavy storms have caused extensive flooding throughout the state, but the state is able to apply its own resources as well as funding from the federal government to address damages. The state is working to build up the flood resiliency of its floodplains and river corridors.

Social

Social considerations are not material to the Bond Bank. Vermont has one of the slowest growing populations in the US and the most rapid decline in prime working age population (residents aged 25-54). Since 2000, the state's prime working age population fell just over 16% and it has fallen nearly 10% since 2010. These are the highest rates of decline over these two periods among the 50 states. Since 2010, the prime working age population in the US grew nearly 5%. Support for health services by the federal government, mainly through Medicaid grants, represents a vulnerability for states and Vermont is no exception. Vermont is more vulnerable to a change in federal policy or funding than other states given that about 25% of its population is enrolled in Medicaid. This is far higher than the 17% of people enrolled across the US. Statewide, housing affordability has not fallen as much in Vermont as it has in many parts of the

US. Though slow population growth could be a drag on future economic growth, it could keep housing affordable in most parts of the state.

Governance

The Board of Directors of VMBB currently has five members including, ex officio, the state treasurer. Members of the board are appointed by the governor for two year staggered terms. Board members have a broad range of experience with a strong background in finance and not for profit management and governance.

The Bank has a small staff. The Board under the direction of the executive director has led the Bank in an update of many of its policies. Substantive to the Bank's rating are updated loan policies and procedures requiring new loan participants to submit annual financial reports and annual monitoring of all pool participants.

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