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CREDIT OPINION
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Vermont Bond Bank

Update to credit analysis

Summary

The Vermont Bond Bank (VBB, Aa2 stable) demonstrates strong pool program characteristics including an overall stable credit quality of pool participants, many of which (approximately 80% of participants) 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 of 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 to add 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

- Material increase in annual debt service coverage and the pool's default tolerance
- Improvement in the credit quality of the pool participants
- 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

Key indicators

Exhibit 1

Vermont Municipal Bond Bank		
Size and Diversity		
Size of Portfolio		196
% of Borrowers with less than 1% of the pool		86%
% of loans to the top 5 borrowers		26.8%
Amount Outstanding		
Total Bonds Outstanding	$612 million	
Total Loans Outstanding	$590 million	
List of Participants	Percent of Pool	
City of South Burlington		7.5%
Fairfax Town School District		6.2%
Champlain Valley School District		5.7%
City of St. Albans		4.5%
Town of Middlebury		2.9%

Source: Vermont Bond Bank

Profile

The Vermont Bond Bank was created in 1969 and is authorized to issue bonds in order to provide loans to local governments. Since its inception, the bond bank has provided over $2.5 billion in loans for local infrastructure throughout Vermont. Approximately 98.5% 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 2024 Series 1 bonds, the program's pool will consist of 196 separate local government borrowers with 496 loans outstanding. Additionally, 86% of the participants have less than 1% of the total loans outstanding. The loans outstanding of these participants represent 33% of the total pool amount. The five largest borrowers account for 26.8% of outstanding loans. The largest participant is the City of South Burlington representing 7.5% of the total loan pool. Participants are geographically diverse with loans allocated to participants in all 14 counties. 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 4.8% of loans outstanding carry a public rating, including the City of Burlington (Aa3 stable) and Town of Stowe (Aa3). The pool is 98.5% secured by general obligation pledges of the participants with less than 2% repaid by a revenue pledge that requires a 1.25 times revenue pledge.

The pool has a low default tolerance of 12% 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, despite being well funded, provide only modest improvement of the default tolerance.

Liquidity

The bond bank has healthy liquidity with $23.8 million held in the general operating fund reserve as of December 31, 2023. The bond bank maintains a policy to keep an amount above 3% of total loans outstanding in the reserve fund which would equal around $17.7 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. The debt policy limits the aggregate debt amortization schedule to provide for level or declining debt service payments.

Debt-related derivatives

The bond bank is not party to debt-related derivatives.

ESG considerations

Environmental

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.

In response to the growing risk of flooding over the last 10 years including Hurricane Irene in 2011 and the more recent events in 2023, the Municipal Climate Recovery Fund has been created in partnership with the Vermont State Treasurer's Office. The fund will assist in lowering the costs of borrowing to bridge FEMA reimbursement or otherwise pay for the many unexpected costs of flooding events. The state is providing the bond bank with $15 million in funds to loan to applicants. The program is outside the bond bank's 1988 bond resolution and security pledge on its outstanding debt.

Social

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 VBB 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 bond bank has a small staff. The board, under the direction of the executive director, adheres to formal fiscal and lending policies. Substantive to the bank's rating are loan policies and procedures requiring new loan participants to submit annual financial reports and annual monitoring of all pool participants.

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