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Vermont Municipal Bond Bank

Update to Credit Analysis

Summary

The Vermont Municipal Bond Bank's (Aa2) credit quality reflects the weighted average credit quality of the participating borrowers that is further enhanced by the Vermont State Aid Intercept Program (Aa2 stable). The rating also incorporates the very large and diverse pool of program participants, the bank's strong legal covenants and debt structure, and an experienced management team.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for the Vermont Municipal Bond Bank However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Vermont Municipal Bond bank. changes, we will update our opinion at that time.

Credit strengths

» Highly rated state and strong legal provisions

» Sizeable and diverse pool of participants

» Experienced management team

» Healthy debt service reserve and operating reserve funds

Credit challenges

» Very small excess cash flows due to program design

» Decline in state aid

» Pool credit quality is dependent on state intercept rating

Rating outlook

The stable outlook reflects our view that the Bank continues to manage operations and improve monitoring, and the pool's large size will remain diverse. The outlook also incorporates the adequate reserves that are available to cure potential defaults or delayed participant payments, if necessary. Additionally, we believe that the number of participants who currently receive enhanced ratings based on the state's pre-default intercept program will remain stable over the medium term, thus ensuring no material change in pool credit quality.

Factors that could lead to an upgrade

» Improved credit quality of the borrower pool

» Increase in state aid to borrow pool

» Substantially higher unrestricted reserve levels

» Upgrade to state intercept program

Factors that could lead to a downgrade

» Deterioration of the credit quality of the pool participants

» Decline or delays in state aid for borrower pool

» Material reduction in reserve levels

» Downgrade of state intercept program

Key indicators

Exhibit 1

Size and Diversity	
Size of Portfolio	201
% of Borrowers with less than 1% of the pool	87.88%
% of loans to the top 5 borrowers	21.83%
Total bonds outstanding ($ millions)	$597,539
List of significant participants	
St. Albans (City of)	5..09%
Champlain Valley School District	4.99%
South Burlington (City of)	4.84%
Middlebury (Town of)	3.66%
Burlington (City of)	3.25%

Source: Moody's Investors Service and 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. The bond bank will have approximately $597 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 receiving the loans.

Detailed credit considerations

Credit Strength and Default Tolerance: Pool credit quality benefits from a general obligation pledge of borrowers, state intercept, and state moral obligation

We expect the credit quality of the pool to remain stable. The average pool rating is A1. Of the $598 million in outstanding debt, 98% is secured by a general obligation pledge, designed to provide sum sufficient coverage. The remaining 2% are revenue bonds with a 1.25x revenue pledge. In addition to the standard covenants outlined in the bond documents the bond bank benefits from strong state law protections requiring any borrower securing their loan with a general obligation pledge to assess and collect funds owed to the Bank.

The state provides strong support of borrowers and pool structure. Approximately 86% of the pool benefits from the Vermont state intercept (Aa2) enhancement. Intercept mechanics provide sufficient time for the trustee to receive funds should the intercept be needed. The intercept has not been used to date. In fiscal 2019, 73% of the pool received interceptable aid greater than 1.5x maximum annual debt service, in contrast only $10 million of maximum annual debt service was not covered by at least 1x annual interceptable state aid. Separately, the state provides a moral obligation allowing annual appropriation of an amount equal to the required debt service reserve. As of fiscal 2019 the debt service reserve fund balance was approximately $71 million.

In addition, credit quality benefits from the Bank's strong policies and reserve levels. The bank general operating policy requires unrestricted reserves to be at least 3% of the outstanding loan balance. As of fiscal 2019 the Bank had $41 million of unrestricted fund balance compared to a policy requiring approximately $20 million and debt service of $65 million.

Diversity of Portfolio: Very large and diverse pool

The Bank currently has 201 borrowers. Its pool includes municipalities (60%), school districts (36%), fire districts, water and sewer districts/departments, and other various local districts (4%). The top five borrowers represent 22% of the pool. Of the 201 borrowers 174 account individually for 1% or less of the pool. Four of the top five borrowers benefit from a strong state aid intercept. The Town of St. Albans with 5.09% of the pools outstanding debt does not. As a result this puts modest downward pressure on the weighted average credit quality of the pool.

The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to tourism, hospitality, healthcare, and, retail could suffer particularly severe impacts. While we believe the diverse nature of the bank provides a cushion, we recognize the challenges many local governments will have going forward which may put additional pressure on the tax base and municipal operations.

Debt structure: Strong debt structure benefits from state support

The security pledge for the pool includes a general obligation pledge of the Bank, including it's general operating reserve fund and available cash; general obligation unlimited tax pledge of the pool participants; a state intercept; and a three prong debt service reserve fund backed by a moral obligation pledge of the state.

The debt of the Bank consists entirely of fixed rate obligations. Debt policy limits amortization of debt to the useful life of assets, mandates a flat or front loaded debt service schedule, and does not provide for use of interest rate swaps or other derivative products.

Borrowers loan payments are due on November 1 and May 1, which is 30 days prior to debt service payment dates on the bank's bonds. The borrowers with strong semi-annual coverage (including state aid) qualify for an enhanced rating based on the state intercept. The remainder of the borrower's who have state aid, but only have average or weak coverage (including state aid) have an enhanced rating that is notched off the programmatic rating. Some borrowers do not receive state aid so the intercept is not applicable to them and for pool purposes they receive an internal rating or credit estimate.

Environmental, social, and governance considerations

No material environmental consideration. 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 affiliate Four Twenty Seven. 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

No material social consideration. 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 and the District of Columbia (Aaa stable). 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.

The Board of Directors of VMBB currently has six 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. In the past year the Bank has added the position of Director of Capital planning who will bolster community outreach and has expanded pool monitoring capacity to nearly 100% of the loan portfolio. 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 to support an effort to move to annual monitoring of all pool participants. The bank instituted a new website that will allow online loan application and reporting. Going forward, the Bank expects that monitoring will cover 100% of loan participants

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