S&P Global Ratings

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Summary:

Vermont Bond Bank; State Revolving Funds/Pools

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Credit Profile		
US$45.95 mil local invest bnds ser 2020 2 due 12/01/2040		
Long Term Rating	AA+/Stable	New
Vermont Mun Bnd Bank		
Long Term Rating	AA+/Stable	Affirmed
Vermont Mun Bnd Bank		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings has assigned its 'AA+' rating to Vermont Bond Bank's (VBB) series 2020-2 (Local Investment Bonds). In addition, we affirmed our 'AA+' rating on the bank's previously issued bonds. The outlook on all the ratings is stable.

The bond bank will use 2020-2 bond proceeds to fund new loans, make a deposit to the reserve fund, and pay the costs of issuance.

Securing debt service on the bonds are loan payments from municipalities, pursuant to various loan agreements, as well as a pledged revenue bond reserve fund. Also, by statute, bonds are considered general obligations (GOs) of the bank.

The stable outlook reflects our expectation that strong program features, the borrowers' diverse credit profiles, and sound reserves associated with the program will continue.

Credit overview

The ratings reflect our view of the following characteristics:

- A very strong enterprise risk profile, given that the pool has explicit statutory support from the state government to support debt service, if needed, and was also established by statute; and
- An extremely strong financial risk profile, reflecting the program's loss coverage score (LCS), operating performance, and financial policies.

Following mobility restrictions and closure of large segments of the economy due to COVID-19 and the swift onset of recession, all of S&P Global Ratings' sector outlooks in U.S. public finance are now negative. For long-term municipal pools, the majority of the underlying cash flows that are either pledged for repayment of bonds or guaranteed by the programs originate from U.S. public finance asset classes. While the VBB program benefits from additional over-collateralization and diversity, we believe that ratings on these programs could be pressured if the exceptionally low rate of loan delinquencies at or near 0% that we have typically observed balloons to significant levels for an extended period. However, the amount of excess cash flows well beyond what is needed to pay debt service on the outstanding bonds acts as a cushion to any downside pressure at this time.

Stable Outlook

Downward scenario

Within the two-year outlook horizon, the rating or outlook could be pressured downward if pledged reserve funds and cash held both inside and outside the resolution do not remain at levels we consider consistent with the LCS.

Upside scenario

Given that we do not expect the enterprise risk profile to change, we do not expect to raise the rating within this same time horizon.

Credit Opinion

We view the program's enterprise risk profile as very strong. This is due to a combination of the low industry risk profile for municipal pools and the program's market position, which we also consider very strong. VBB was established in 1970 as outlined in Title 24, Chapter 119 of the Vermont Statutes Annotated. Explicit statutory language exists for state support of debt service, if needed, through both a state aid intercept mechanism and a moral obligation of the state to replenish the debt service reserve (DSR) to the required level if it should ever fall below this point. All funds remain in the bank and are not transferred to other agencies or departments.

We view the financial risk profile of the program as extremely strong. The profile reflects the combination of the LCS, historical operating performance, and management policies. Annual debt service coverage (DSC) from pledged loan repayments, interest earnings on investments, and planned annual draws of reserve fund investments has been shown by management to be slightly more than 1x, with surplus revenues then able to accumulate over time and also be available to cure defaults if needed. The debt service reserve fund (DSRF) accreted value will total $56.5 million after issue of the 2020-2 bonds, with 100% funded with bond proceeds, and the cash flows are structured to have most of the reserves be used to eventually repay bond debt service, but always exceed the required level (the lowest of maximum annual debt service [MADS] on the bonds, 125% average annual debt service, or 10% of par). If any loan repayments default and are not recovered at 100%, the bank would have to use accumulated cash balances to make bond payments. We have allowed for 95% recovery of defaulted revenues.

However, VBB does have some pledged and unrestricted cash available that it would not need to pay debt service in a baseline, nondefault case. The bank also holds cash in various funds pledged to bondholders totaling $3.9 million, and $26.1 million of general operating funds that it could use anytime for debt service payments, but are outside of the pledged revenue stream. Management has a policy of maintaining unrestricted funds that represent at least 3% of the loan portfolio. Combined, the pledged reserves and available cash are sufficient to produce an extremely strong LCS. The existence of revenues specifically not needed to pay bond bank debt service is of particular importance to the extremely strong financial risk profile, and if the availability of these revenues would be significantly reduced or curtailed, there could be downward pressure on the rating.

We have allowed for 95% recovery of defaulted revenues due to the presence of a moral obligation to replenish the DSRF to the required level (see above) outlined in Title 24, Section 4675 of the state's statutes. The bank's chairperson will, no later than Feb. 1, make and deliver to the governor (or governor-elect) a certificate stating the sum required to restore the fund to the required level. This delivery is performed annually, and then, by March 1, the governor (or governor-elect) is required to submit a request for appropriations in the same amount. However, the legislature is not required to take action on the submission, and this provision has never been tested.

The credit quality of the underlying borrowers is also supported, in our view, with a state aid intercept mechanism. Title 24, Section 4555 of the Vermont Statutes established this state aid intercept provision. If a governmental unit fails to make a scheduled principal or interest payment on its municipal bonds held by the bank, the state treasurer will pay VBB an amount sufficient to cure the overdue payment from any state and federal funds held by the treasurer and due to the governmental unit. If there is still an overdue amount, then the treasurer must continue to withhold money otherwise payable to the governmental unit until the deficiency has been repaid or arrangements to make the bank whole are made.

Averaging all of the financial policies and practices, we view the corpus of these as generally strong. Management performs credit reviews and has underwriting policies for all new loans and performs annual surveillance on VBB's largest borrowers, as well as all borrowers who execute a loan agreement starting in January 2019. Management is working to implement annual surveillance for all outstanding borrowers and currently has surveillance in place for over 90% of outstanding loans by volume. It is the policy of the bank not to issue bonds for deficit financing, but only for capital assets or equipment. Program staff sends payment invoices to all borrowers 75 days before loan repayment due dates to ensure payment compliance, but does not require all borrowers to submit annual disclosure documents. Loan payments are due 30 days before debt service. Management can fund loans from bond proceeds as it receives applications. Given the nature of the bank's operations, multiyear loan demand planning is a challenge, but management is working to expand this forecasting by strengthening relationships with current and potential borrowers throughout the state. Investments are reported on at least quarterly and are monitored by staff as needed.

Management has indicated that there have been no loan defaults or delinquent payments since the program began in 1970.

Program characteristics

VBB was established in 1970 and has issued $2.3 billion of bonds under its current (1988) resolution to support infrastructure projects for both municipalities and schools throughout the state (a prior resolution is closed and has no debt outstanding). It is governed by a board of directors. After the issue of the 2020-2 bonds, the bank will have approximately $597 million of loans and $56.5 million of pledged DSRF reserves (at accreted value) supporting repayment of $619 million of bonds. Approximately 200 municipalities and school districts have outstanding loans with the bank. Management has indicated that it will continue to issue debt on an ongoing basis to finance loans, consistent with past practices.

We consider the bank's loan portfolio diverse, and management reports that it has had no issues with delinquencies or late payments. The five leading participants, representing about 23% of the loan portfolio, are Winooski School District, St. Albans, Champlain Valley School District, South Burlington, and Middlebury. None of these participants nor most of the others in the pool carry a rating of S&P Global Ratings. However, 98% of loans from the bank are considered GOs by statute, which include the ability to levy an unlimited property tax. Supporting the rating are the state aid intercept and moral obligation provisions, as discussed above.