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INVESTORS SERVICE

Rating Update: Moody's upgrades Burlington VT's GO to Baa2 from Baa3; outlook is positive

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Upgrades COPs to Baa3 and Ba1

BURLINGTON (CITY OF) VT
Cities (including Towns, Villages and Townships)
VT

NEW YORK, March 03, 2015 --Moody's Investors Service has upgraded the City of Burlington's (VT) general obligation rating to Baa2 from Baa3, affecting $99 million in rated long-term debt. Concurrently, Moody's has upgraded $2 million of Certificates of Participation (COPs), Series 2000 (city multi-purpose) to Baa3 from Ba1 and $6.8 million of Certificates of Participations, Series 1999A and 2005 (parking) to Ba1 from Ba2. The outlook is positive.

SUMMARY RATING RATIONALE

The upgrade of the city's general obligation rating to Baa2 from Baa3 reflects an improved financial position, although reserves and liquidity remain narrow. The upgrade also incorporates the dismissal of the Burlington Telecom (BT) lawsuit through a settlement agreement that is favorable to the city. The rating also factors in the city's strength as the economic center of Vermont (Aaa stable) and its manageable debt and pension liability.

The Baa3 and Ba1 ratings on the COPs reflect the city's general credit profile while incorporating the appropriation risk of the COPs and essentiality of the projects.

OUTLOOK

The positive outlook reflects a trend of balanced financial operations over the last two years, which will likely continue over the near term. Additionally, the dismissal of the BT lawsuit and favorable settlement reduces the risks related to the enterprise. The settlement has also allowed the city to address the large nonspendable, advances to BT from the General Fund.

WHAT COULD MAKE THE RATING GO UP

- Trend of General Fund operating surpluses resulting in an increase in reserves

- Development of a formal recovery plan or financial goals to return to a satisfactory financial position

WHAT COULD MAKE THE RATING GO DOWN

- Structurally imbalanced General Fund operations, reducing the city's financial flexibility

- Increased exposure to losses from the city's various enterprise or other nonmajor funds

STRENGTHS

- Stable underlying economy and tax base serving as the economic center of the state

- Manageable debt profile

CHALLENGES

- Maintenance of balanced operations and improvement in reserves to satisfactory levels

- Development of a long-term capital plan to address deferred maintenance given the financial pressures in recent years

RECENT DEVELOPMENTS

The fiscal 2014 audited financials reflect an operating surplus of $2.5 million prior to the write-off of the BT advances, resulting in a positive, but still-limited reserve position. Additionally, the BT lawsuit has been dismissed through a settlement agreement with minimal impact to the General Fund.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: STRONG HEALTHCARE AND HIGHER EDUCATION ANCHOR STABLE TAX BASE

Burlington's $4.2 billion tax base will remain stable over the near term given the diversity of the city's local economy, its regional importance, and a stabilizing institutional presence. Education and health services and government sector employment represents approximately 37% of total jobs, including two of the city's five largest employers, Fletcher Allen Health Care (A3 stable) and the University of Vermont & State Agr. Coll., VT (Aa3 stable), which comprise a combined 8,294 jobs, or 7.2% of the city's workforce. In the private sector, concerns remain regarding the future of Vermont's largest single employer, International Business Machines Corporation IBM (long-term Issuer Rating Aa3 stable) which has sold its Essex Junction facility to Globalfoundries. The facility provides approximately 5,400 jobs to the area and questions remain regarding future job levels as both Vermont and New York (Aa1 stable) discuss economic incentive packages with Globalfoundries.

The full value (estimated fair market value) increased by 5.9% in 2014, bringing the five year compound average annual growth to 1.2%. Taxable value remains stable, with seven consecutive years of limited growth averaging 1.0% annually. The city's wealth levels are just below state and national averages, with median family income equal to 98.7% and 102.9%, respectively. Also, the city's unemployment rate of 3.1% (December 2014) remains well below the state (3.9%) and US (5.4%).

FINANCIAL OPERATIONS AND POSITION: TREND OF POSITIVE PERFORMANCE EXPECTED TO CONTINUE OVER NEAR TERM

The city has improved its financial position through the issuance of deficit financing bonds, conservative budgeting and proactive revenue and expenditure enhancements which are expected to result in balanced operations over the near term. After a $9 million issuance of deficit financing bonds in April 2013, the city has stabilized its cash flow and operations, resulting in a two-year trend of operating surplus. The fiscal 2014 audited financial statements include an unqualified auditor's opinion for the first time since before BT's financial problems became publicly known in late 2009 and reflects an operating surplus of $2.5 million, excluding a special item of $16.9 million, representing a write-off of city advances to BT following the dismissal of the BT lawsuit. The surplus is attributed to positive variance in revenues and expenditures as well as $1 million from the sale of land. The elimination of the BT advances reduces the total fund balance given its allocation in previous years as a nonspendable reserve. However, all other fund balance allocations improved as a result of the $2.5 million operating surplus. The surplus increased the available fund balance to $2.1 million or 3.9% of revenues up from a negative $928,000 or -1.9% of revenues in 2013.

The 2015 expenditures increased by 2.6% from the prior year and the budget was balanced with a 4.6% tax levy increase. Year-to-date results show revenues and expenditures trending on budget with an additional one-time revenue source of $750,000 paid from the Burlington (City of) VT Electric Enterprise (BED, Baa2 positive) for multiple years of overbilling the city for electricity. The city expects to over-expend its snow and ice budget given the harsh winter, but also expects to offset the additional costs with positive variance in other line items. Given the unbudgeted, one-time revenue from BED, the city expects to end the year with an operating surplus.

The fiscal 2016 budget will be finalized in April and will address increases due to collective bargaining and retirement contributions. The city is also developing formal financial policies which will help to outline its financial recovery going forward.

Liquidity

Burlington's General Fund net cash position at the end of fiscal 2014 remains narrow at $2.6 million, or 4.7% of revenues. Given the liquidity provided by the deficit financing bonds, the city has reduced its line of credit with KeyBank National Association (A3 stable) to only $7 million with no draws to date in fiscal 2015.

DISMISSAL OF LAWSUIT DUE TO SETTLEMENT AGREEMENT IS FAVORABLE TO CITY

The BT lawsuit was dismissed on February 2, 2014 through a $10.5 million settlement agreement with Citibank, N.A. (A2 stable). The settlement was favorable to the city's General Fund because it required only $475,000 to be paid by the city which represents less than 1% of revenues and which came from the $1 million sale of city property. BT revenues and insurance also contributed to the settlement . Additionally, $6 million of the settlement came from bridge financing provided by Blue Water Holdings, LLC, which is led by a local investor and financed by a loan from Merchants Bank. The entity purchased BT assets and has leased the BT infrastructure back to the city for continued operations. We estimate the financing, which carries a 7% interest rate, will cost the BT system $558,500 annually, based on a 20-year amortization. The city's leaseback agreement with Blue Water Holdings specifies that the lease payments will be subject to appropriation, but made solely from BT revenues. Based on the city's audited financials, BT's operating income provides 1.5x coverage on the annual lease payments.

The lease agreement term is five years, providing the city with time to seek a buyer for BT over the next four years. If a sale takes place in the first three years, the city gains 50% (split with Citibank) of the net proceeds after repayment of the $6 million sale price and other deal costs. If the city fails to find a buyer in four years, Blue Water Holdings can oversee the sale and the city could collect only 10% or less of net proceeds. We will continue to monitor the operations and efforts to sell BT during the term of the bridge financing and how any sale could impact the city's financial profile.

DEBT AND OTHER LIABILITIES: DEBT BURDEN AND LONG-TERM LIABILITIES REMAIN MANAGEABLE

Exclusive of the revenue bonds supported by the city's airport, electric and wastewater enterprise funds, the city's General Fund-supported net direct debt burden of 1.9% of full value is expected to remain manageable. Since the end of fiscal 2014, the city has borrowed $14.8 million through the Vermont Municipal Bond Bank (Aa2 stable). Future debt plans include the city's annual issuance of approximately $7 million for annual capital needs. The city will determine how to finance its capital plan - either through the bond bank, private placements or direct public issuance - on a case by case basis. Additionally, the city is drafting a ten-year capital improvement plan to begin to address the deferred maintenance due to its recent fiscal pressures as well as additional capital needs over the medium term.

Debt Structure

Amortization of outstanding principal is below average, with 54.8% retired within ten years. Debt service in fiscal 2014 represented 5% of General Fund expenditures and the city's debt portfolio is comprised entirely of fixed rate debt.

Debt-Related Derivatives

Burlington has no derivatives.

Pensions and OPEB

The city participates in the Burlington Employee Retirement System, a single-employer, defined benefit retirement plan. The city's annual required contribution (ARC, net of BED and school department) for the plan was $5.4 million in fiscal 2014, or 10.8% of General Fund expenditures. The city's 2013 adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is $162.7 million, or an above average 1.4 times General Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city contributed 86% of its annual Other Post Employment Benefit costs in 2014, representing $381,268. The city's OPEB UAAL as of June 30, 2013 is $3.9 million. Fiscal 2014 total fixed costs including pension, OPEB and debt service was $9.3 million or 18.3% of expenditures.

MANAGEMENT AND GOVERNANCE

Vermont cities have an institutional framework score of "Aa" or strong. Cities rely on property taxes which are highly predictable and can be increased annually without statutory limit. Primary expenditures are for public safety and general government services. Expenditures are largely predictable and cities have the ability to reduce expenditures.

The city's management team since 2012 continues to show commitment to addressing the city's financial pressure with a sound approach and fiscal responsibility which we expect will be aided by development of more formal policies and capital planning.

KEY STATISTICS

- 2014 Full Valuation: $4.2 billion

- 2014 Equalized Value Per Capita: $98,751

- Median Family Income as % of US Median: 102.86%

- Fiscal 2014 General Fund balance as a % of Revenues: 3.91%

- 5-Year Dollar Change in Fund Balance as % of Revenues (2010-2014): -4.97%

- Fiscal 2014 Cash Balance as % of Revenues: 4.71%

- 5-Year Dollar Change in Cash Balance as % of Revenues, adjusted (2010-2014): -1.64%

- Institutional Framework: "Aa"

- 5-Year Average Operating Revenues / Operating Expenditures (2010-2014): 0.95x

- Net Direct Debt as % of Full Value: 1.92

- Net Direct Debt / Operating Revenues: 1.47x

- 3-Year Average of Moody's ANPL as % of Full Value: 3.66%

- 3-Year Average of Moody's ANPL / Operating Revenues: 2.80x

OBLIGOR PROFILE

Burlington is located in northwestern Vermont along the coast of Lake Champlain. The population is approximately 42,284.

LEGAL SECURITY

All GO debt is secured by the city's general obligation unlimited tax pledge.

USE OF PROCEEDS

Not applicable

PRINCIPAL METHODOLOGIES

The principal methodology used in this general obligation rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in this lease rental rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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