

CREDIT OPINION

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 Rate this Research

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Burlington (City of) VT

Update to credit analysis following upgrade to Aa3

Summary

Burlington (Aa3), VT, benefits from a growing and strong reserve position and very strong cash position. This is supported by an expanding tax base which incorporates the city's strength as the economic, higher education, and medical center of Vermont (Aa1 stable). Additionally, the resolution of the Burlington Telecom litigation highlights an experienced management team and eliminates significant financial risk. Going forward, the city is focused on maintaining a stable credit profile while addressing the challenges of rising fixed costs with a growing debt burden and pension expenses.

On July 23, 2019, we upgraded the city's general obligation bond rating to Aa3 from A2 and upgraded the Certificates of Participation to A1 and A2, respectively.

Credit strengths

- » Stable underlying economy and tax base serving as the economic center of the state
- » Strong reserve levels and cash position
- » Elimination of risks associated with Burlington Telecom litigation

Credit challenges

- » Growing fixed costs with increasing debt burden and pension expense
- » Economy that may have limited ability to continue to grow at current rates

Rating outlook

Outlooks are generally not assigned to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Reduction in debt levels and pension liabilities

Factors that could lead to a downgrade

- » Structurally unbalanced operations leading to a decline in reserves
- » Significant increase in debt burden and leverage

Key indicators

Burlington (City of) VT	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value (\$000)	\$4,019,395	\$4,137,177	\$4,267,608	\$4,474,475	\$4,608,608
Population	42,342	42,570	42,556	42,453	44,020
Full Value Per Capita	\$94,927	\$97,185	\$100,282	\$105,398	\$104,694
Median Family Income (% of US Median)	106.6%	109.5%	112.8%	109.3%	109.3%
Finances					
Operating Revenue (\$000)	\$126,310	\$56,762	\$61,886	\$63,288	\$61,786
Fund Balance (\$000)	\$4,358	\$5,912	\$9,300	\$13,238	\$16,855
Cash Balance (\$000)	\$9,974	\$8,652	\$10,017	\$15,139	\$16,874
Fund Balance as a % of Revenues	3.5%	10.4%	15.0%	20.9%	27.3%
Cash Balance as a % of Revenues	7.9%	15.2%	16.2%	23.9%	27.3%
Debt/Pensions					
Net Direct Debt (\$000)	\$65,274	\$80,903	\$77,949	\$84,289	\$106,468
3-Year Average of Moody's ANPL (\$000)	\$111,019	\$106,901	\$108,576	\$120,114	\$137,112
Net Direct Debt / Full Value (%)	1.6%	2.0%	1.8%	1.9%	2.3%
Net Direct Debt / Operating Revenues (x)	0.5x	1.4x	1.3x	1.3x	1.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.8%	2.6%	2.5%	2.7%	3.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.9x	1.9x	1.8x	1.9x	2.2x

Fiscal year end June 30

Source: City of Burlington, VT financial statements and Moody's Investor service

Profile

Burlington is located in northwestern Vermont along the coast of Lake Champlain, approximately 216 miles north west of Boston, MA and 96 miles south of Montreal, QC, Canada. The population is approximately 42,899 (American Community Survey 2018 estimate). The city has multiple enterprise funds including the [Burlington Airport Enterprise \(Baa2 Stable\)](#); and [Burlington Water Enterprise \(A1\)](#); and [Burlington Electric Enterprise \(A3 Stable\)](#). The city is the home of the state's flagship [University of Vermont & State Agricultural College \(Aa3 Stable\)](#) and the University of Vermont Medical Center.

Detailed credit considerations

Economy and Tax Base: Diverse economy anchored by health care and education

Burlington is Vermont's largest city and economic center. It has a strong and diverse economy supported by higher education, technology, and health care. Additional strength is added with a strong entrepreneurial focused business culture. Additionally, the city has won awards for its environmental sustainability practices and policies including being the first city in the country to provide 100% renewable electricity to its residents.

These attributes have led to a growing and diverse tax base with full value over \$4.6 billion in 2018 and a 5 year CAGR of 2.6%. The top 10 taxpayers account for a low 4.8% of the tax base and no taxpayer accounted for more than 0.7% of the tax base reflecting the broad diversity of taxpayers.

Burlington City Place, continue to move forward with Brookfield Properties currently the site developer. The project is estimated expects to create a significant number of residential units, and office and retail space.

Offsetting the strong economy and high quality of living are continued challenges including a very tight labor market and limited affordable housing. While the city continues to improve policies and grow the affordable housing stock it remains an ongoing challenge given current demographics. Median family income is 109.3% of the US, however median home values are 138.2% of the US

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Financial Operations and Reserves: Strong reserve and cash position supported by operating surpluses

The financial position continues to strengthen and reflect conservative budget management resulting in surplus income, building of reserves and cash. Fiscal 2018 available fund balance of \$16.9 million is a strong 27.3% of operating revenues and is 33% over fiscal 2013 levels. The growth of reserves tapered off in fiscal 2018 and we expect modest reserve growth going forward as fixed cost growth increases expenses and reduces net income.

In fiscal 2019 the city expects to grow the fund balance again by ending the year with a \$500,000 - \$800,000 surplus. Significant budget items include public safety at 33.2% and general government at 27% of budget. Public safety expense increase is in part attributed to merging building inspection services into the category, the general government expense line increase to 27% from 19% is driven primarily by debt service and pension expense, both of which will be primary challenges for the city going forward.

The fiscal 2020 budget is \$79 million approximately 4% over the fiscal 2019 budget and 12% over fiscal 2019 projected actual. Major revenues of taxes and payments in lieu of taxes are expected to increase by 5% and 2% respectively over fiscal 2019 and debt service is expected to increase by 13% to \$5 million for fiscal 2020.

Positively, in March 2019 the city completed the sale of Burlington Telecom to Shurz communications [removing a contingent liability risk from its credit profile](#). The city has also settled contracts with all its unions with expiration dates in June 2022 and has worked with the union to share health and pension costs going forward.

LIQUIDITY

Burlington's General Fund net cash position at the end of fiscal 2018 grew to a strong \$16.9 million, or 27% of revenues, and the city has had no cash flow borrowing since fiscal 2014.

Debt and Pensions: Manageable liabilities limited by a growing debt burden and elevated pension liability

The net direct debt of \$106.5 million (2018) is moderately elevated at 2.3% of full value and includes \$53.7 million of general obligation debt; \$30.4 million of school department debt supported by the general obligation of the city; \$4.7 million of COPs; and \$17.6 million in state loans, capital leases, and other city guaranteed obligations. The school department pays its own debt service, but the debt is secured by the city's general obligation pledge. Net the \$30.4 million, the city's \$76 million debt burden is a more manageable 1.6% of full value. The debt burden is expected to increase over the near term with city expecting to issue approximately \$30 million of debt as a mix of BANs and bonds in the fall of 2019, \$12 million of which would be supported by the school department.

DEBT STRUCTURE

All debt is fixed rate and amortization of principal is below average, with 67.8% retired within ten years. Fiscal 2018 debt service costs of \$4 million (net of GO debt service issued for school purposes and paid by the school department) comprised 6.6% of 2018 expenditures.

DEBT-RELATED DERIVATIVES

Burlington has no interest rate swaps or derivative agreements

PENSIONS AND OPEB

The liabilities associated with the retirement system continue to increase, but remain affordable on an annual basis. The city participates in the Burlington Employee Retirement System, a single-employer, defined benefit retirement plan. Annually, the city funds its contractually required contribution (CRC). In 2018 its cost was \$6.2 million, representing a manageable pension expense of 7.7% of GASB 34 expenses or 10% of general fund expenses and consuming approximately the same percentage of revenues as in fiscal 2016. While not a concern presently the city dropped slightly below our tread water indicator over the past two years.

The city's Moody's adjusted net pension liability, based on a 3.61% discount rate, was \$153 million and its three year average was \$137 million up from \$109 million in 2016. This equates to a moderate 2.2x operating revenues. This is inclusive of the pension burden across all governmental and enterprise funds. It does not include the pensions of teachers which are an obligation of the state. In comparison, the city reported a net pension liability, based on a discount rate of 7.63% of \$59.1 million. Moody's adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city contributed \$385 towards its annual OPEB cost in fiscal 2018 based on a June 30, 2018 measurement date, representing less than 1% of expenditures. The total unfunded liability is \$5 million as of June 30, 2018. The city does not administer its plan through an OPEN trust.

Total fixed costs for fiscal 2018 are elevated and include debt service, required pension contributions and retiree healthcare payments, representing \$13.6 million, or 21.4% of operating expenditures.

Management and Governance

The current management and governance team has a strong record of conservative budget management and proactive policies that have benefitted the city financially, evidenced by the resolution of the Burlington Telecom litigation and building of a strong reserve position which has grown to \$16.8 million from negative \$11.4 million in fiscal 2012.

The city of Burlington has a strong mayor-council form of government. The current mayor is serving his third term and has been in office since 2012. The City Council consists of 12 members.

Vermont Cities have an Institutional Framework score of Aa, which is high. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Property taxes, Vermont Cities' major revenue source, are not subject to a cap. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, Vermont has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

Burlington (City of) VT

Rating Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$4,608,608	Aa
Full Value Per Capita	\$109,108	Aa
Median Family Income (% of US Median)	109.3%	Aa
Notching Factors: ^[2]		
Institutional Presence		Up
Regional Economic Center		Up
Other Analyst Adjustment to Economy/Taxbase Factor: Challenging housing and limited capacity for economic expansion		Down
Finances (30%)		
Fund Balance as a % of Revenues	27.3%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	33.0%	Aaa
Cash Balance as a % of Revenues	27.3%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	3.7%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	Aa
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.3%	A
Net Direct Debt / Operating Revenues (x)	1.7x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	3.0%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	2.2x	A
	Scorecard-Indicated Outcome	Aa2
	Assigned Rating	Aa3

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated December 16,

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2019 publication

Sources: US Census Bureau, Moody's Investors Service, issuer financial statements

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