Rating Update: Moody's revises Burlington, VT's outlook to stable; affirms Baa3 GO on $102.8M of debt

Global Credit Research - 14 Apr 2014

Also affirms Ba1 and Ba2 on $9M of COPs

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

Opinion

NEW YORK, April 14, 2014 --Moody's Investors Service has affirmed the Baa3 rating on the City of Burlington, VT's $102.8 million of outstanding general obligation bonds. Concurrently, Moody's has affirmed the Ba1 rating on $1.9 million of outstanding essential (city multi-purpose) Certificates of Participation (COPs), Series 2000, and a Ba2 rating on $7.1 million non-essential (parking) COPs, Series 1999A and 2005. The outlook on the general obligation debt and COPs has been revised to stable from negative. The bonds are secured by the city's unlimited tax pledge.

SUMMARY RATING RATIONALE

The Baa3 general obligation rating reflects the city's strained financial position given the significant advances to other funds from the General Fund prior to fiscal 2012, including a material use of reserves for the expansion of Burlington Telecom (BT). The rating also incorporates the city's strength as the economic center of Vermont (rated Aaa stable) and a manageable debt burden.

The Ba1 and Ba2 ratings on the COPs reflect the city's general credit profile while incorporating the appropriation risk of the COPs and essentiality of the projects.

The stable outlook reflects the recent stabilization of General Fund operations and management's commitment to addressing the negative unassigned fund balance in the General Fund and non major governmental funds over the near term. The outlook also incorporates the terms of a pending settlement in the BT lawsuit that, if approved by the Vermont Public Service Board (PSB), will significantly limit the General Fund's liability.

STRENGTHS

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

- Manageable debt profile

- Pending settlement with Citibank over telecom enterprise

CHALLENGES

- Addressing negative unassigned fund balance in the General Fund and non major governmental fund

- Finalizing the BT settlement and eventual sale of BT

- Repayment or elimination of advances to other funds from the General Fund

DETAILED CREDIT DISCUSSION

FISCAL 2013 REFLECTS RETURN TO STABILITY IN GENERAL FUND

The city has improved its financial position through the use of deficit financing bond proceeds, conservative budgeting and proactive revenue and expenditure enhancements for nonmajor and enterprise funds. Fiscal 2013 audited financials reflect the first General Fund operating surplus in five years of $793,000 (net of bond proceeds) attributable to conservative budgeting of expenditures. In addition, the city issued $9 million of deficit financing bonds in April which helped to reduce its negative fund balance position and provide sufficient cash flow for operations. The operating surplus and bond proceeds improved the available General Fund balance to negative $928,000 (-1.9% of revenues) from negative $11.4 million (-20.4% of revenues). The unassigned fund balance improved to negative $2.2 million (-4.3% of revenues) from a negative $15.0 million (-26.9% of revenues). The bond proceeds have also eliminated the city's need to rely on short term financing through tax anticipation notes and lines of credit (LOC). In fiscal 2014, the city established a $10 million LOC but is expected to end the year without drawing on the balance. This position is an improvement from fiscal 2011 which ended with a net cash position of negative 12.3% of revenues. Going forward, this change in operations provides greater stability and efficiency for tight control over expenditures.

The fiscal 2013 total General Fund balance of $19.4 million is bolstered by a $20.3 million nonspendable fund balance due to the allocation of $20.1 million of advances to other funds from the General Fund. This is a reduction from $23.9 million in fiscal year 2012. The advances include $16.9 million to BT and $3.2 million water and other nonmajor enterprise funds for capital expenditures. It is unclear how these advances will be repaid over the near term, although the city is developing a plan to address the advances. Some of the capital expenditures include a long-term repayment schedule while the full advance to BT may never be recovered. In addition, the 2013 audit reflects a negative $4.3 million unassigned fund balance in the nonmajor governmental funds which relates, in part, to the advances from the General Fund. The city's ability to manage these advances and develop a plan to address this large amount will continue to be a factor in future rating reviews.

The fiscal 2014 budget increased by 3% and is balanced with a 6% tax levy increase and includes a $500,000 contingency. Year-to-date revenue and expenditures are on budget and management expects to end the year with a slight surplus, which will improve the negative fund balance position. The advances to other funds is expected to remain unchanged. The fiscal 2015 preliminary budget reflects continued tight expenditure control with an increase driven by wages and employee benefits. The budget is expected to be balanced with less than a 5% increase in the tax levy.

PENDING SETTLEMENT TERMS WITH CITIBANK COULD LIMIT GENERAL FUND LIABILITY

In February 2014 the city council approved terms of a settlement agreement with Citibank in the BT lawsuit. The settlement agreement establishes that the city will pay Citibank $10.5 million, versus the original claim of $33.5 million, plus a share of BT's future value. The city expects to fund its payment largely from telecom revenues and various other sources, including: $6 million in bridge financing; approximately $1.5 million from co-defendant law firm or its insurance; $1.3 million from the city; $981,000 BT revenues paid to Citibank (held in escrow by court); $500,000 city insurance carrier paid at settlement closing; and $250,000 BT additional revenue payments paid between now and closing.

At the end of March 2014, the city council approved a commitment letter for the $6 million bridge financing. The financing will be a sale-leaseback transaction whereby all BT assets are purchased and transferred to a special purpose entity owned by the lessor. The city will continue to operate BT under its current certificate of public good, originally provided by the PSB. The lease payments will be subject to appropriation and paid only by net revenues of BT. All revenues will be deposited in a lockbox trust account. The terms also include a four year window for the city to find a purchaser of BT. The intent is for the purchase price to be sufficient to repay the $6 million bridge financing and provide net revenues to be split between the city and Citibank.

The settlement is subject to PSB approval before the execution of any of its terms, including the bridge financing, or the final closing of the settlement. The city has submitted a petition for review and estimates the PSB to provide approval by the end of the third quarter of this year.

If the settlement is approved by the PSB, the General Fund's liability would be limited to the $1.3 million due directly from the city, which management projects to fund from a combination of BT revenues and non-recurring sources. There is still no surety of how the $16.9 million advances from the General Fund will be repaid. One scenario includes at least partial repayment from the city's share of net revenues from the eventual sale of BT.

STRONG HEALTH CARE AND HIGHER EDUCATION INSTITUTIONS ANCHOR STABLE TAX BASE

Burlington's $3.9 billion tax base is expected to remain stable over the near term given the diversity of the city's local economy, its regional importance, and a stabilizing institutional presence. Health care, higher education and public sector employment represents approximately 35% of total jobs, including two of the city's five largest employers, Fletcher Allen Health Care (rated Baa1 positive) and the University of Vermont (rated Aa3 stable), which comprise a combined 8,294 jobs, or 7.2% of the city's workforce. The region's private sector economy is anchored by Vermont's largest single employer, IBM (5,400 jobs - senior unsecured debt rated Aa3 stable). The full value (estimated fair market value) increased by 1.0% in 2013, bringing the five year average annual growth to 2.7%. In addition, assessed value remains stable, with five consecutive years of limited growth averaging 0.9% annually. The city's wealth levels are just below the state and national average with median family income equal to 91.6% and 93.2%, respectively. Also, the city's unemployment rate of 3% (December 2013) remains well below the state (3.8%) and US (6.5%).

GENERAL FUND-SUPPORTED DEBT IS 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 1.8% of full value is expected to remain manageable. Amortization of outstanding principal is below average, with 54.8% retired within ten years. Future debt issuance includes the city's annual issuance of approximately $7 million for annual capital needs plus another $5 to 7 million for TIF district improvement in fiscal 2015. Debt service in fiscal 2013 represented 6.3% of expenditures and the city's debt portfolio is comprised entirely of fixed rate debt with no exposure to derivative agreements.

The city participates in the Burlington Employee Retirement System, a single-employer, defined benefit retirement plan. The city's annual required contribution (ARC) for the plan was $8.2 million in fiscal 2013, or 16.5% 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 108% of its annual Other Post Employment Benefit costs in 2013, representing $363,122. The city's OPEB UAAL as of June 30, 2013 is $3.8 million.

OUTLOOK

The stable outlook reflects the recent stabilization of General Fund operations and management's commitment to addressing the negative unassigned fund balance in the General Fund and non major governmental funds over the near term. The outlook also incorporates the terms of a pending settlement in the BT lawsuit that significantly limits the General Fund's liability.

WHAT WOULD MAKE THE RATING GO UP

- Closing of BT settlement without alteration of current terms

- Trend of General Fund operating surpluses

- Elimination of negative fund balance positions

- Plan to addressing the advances to other funds from the General Fund

WHAT WOULD MAKE THE RATING GO DOWN

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

- Inability to reduce the negative fund balance positions

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

- Inability to make progress towards repayment of the advances to other funds

KEY STATISTICS

2013 Full Valuation: $3.9 billion

2013 Full Value Per Capita: $93,288

Median Family Income as % of US Median: 93.2%

Fiscal 2013 operating fund balance as a % of revenues: -1.9%

5-Year Dollar Change in Fund Balance as % of Revenues (2009-2013): -12.93%

Fiscal 2013 Cash Balance as % of Revenues: 27.7%

5-Year Dollar Change in Cash Balance as % of Revenues (2009-2013): 27.14%

Institutional Framework: "Aa"

5-Year Average Operating Revenues / Operating Expenditures (2009-2013): 0.99x

Net Direct Debt as % of Full Value: 1.8%

Net Direct Debt / Operating Revenues: 1.41x

3-Year Average of Moody's ANPL as % of Full Value: 3.76%

3-Year Average of Moody's ANPL / Operating Revenues: 1.26x

The principal methodology used in the rating of the general obligation bonds was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the rating of the certificates of participation 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.

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