

Rating Update: Moody's Investors Service Upgrades Burlington, Vermont Electric Revenue Bonds to Baa1 from Baa2; Outlook Stable

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Upgrade Recognizes Financial Position Improvement

BURLINGTON (CITY OF) VT ELECTRIC ENTERPRISE
Electric Distribution
VT

NEW YORK, November 09, 2015 --Moody's Investors Service has upgraded the rating on the outstanding \$29.03 million Burlington, Vermont Electric System Revenue Bonds to Baa1 from Baa2. The outlook is stable. Burlington also has \$46.8 million General Obligation bonds issued for electric utility purposes (Baa2; positive). The city issues approximately \$3 million General Obligation bonds annually for electric purposes. The pledge of payment is after the payment of debt service on the electric system revenue bonds.

SUMMARY RATING RATIONALE

The rating upgrade takes into consideration the improved financial record of Burlington Electric Department (BED) ; competitive rates; the shift to a more diverse power supply mix; and the strengthening local economy.

BED serves the City of Burlington, Vermont (Baa2 positive) which has a diverse local economy; stability is provided by the institutional presence of a major university and medical center; and the city serves as a commercial center for a large geographic area. The rating also considers BED's reliable and competitive power supply which is less subject to market volatility and is significantly renewable; the utility's improving financial record including expected strengthening forecasted metrics; and supportive rate regulation. While the BED is subject to the state public service board regulation, new rates may be collected 45 days after the filing with the state. The regulatory board must consider bond covenants and sufficiency of revenues to support voted bonded authorizations. The rate setting record has been supportive and timely with full recovery of requested costs recovered since 2004. The utility has a conservative General Fund transfer policy.

A positive factor in the rating is the proactive stance of management in its strategic planning regarding the evolving power industry. A focus on efficiency programs; renewable energy supply and positioning the utility organization through improved operations factor into our view about BED. Retail rates are also competitive. While the McNeil Generation Station, a wood burning electric generation facility represents 43.9% of FY 2015 BED energy, the carbon neutral-renewable energy source is well-maintained and has had a sound operating record. Vermont is also exempt from the federal EPA Clean Power Plan (CPP) so compliance issues are not a factor.

BED's financial record has been improving with a focus on stronger financial metrics with adjusted debt service coverage trending towards 1.50 times and forecasted coverage in the same range. The adjusted coverage includes payment of General Obligation bond debt service. Combined electric revenue bond and General Obligation bond debt service is level. FY 2015 financial results include adjusted debt service coverage of 1.71 times and days liquidity on hand of 94 days. BED's elimination of a material adverse clause from its line of credit also was a positive factor. BED expects an erosion of net income in FY 2018 due to several factors but management is taking reasonable mitigation measures to resolve. In addition, BED has had a sound record of rate adjustments when appropriate. No additional rate adjustments are currently expected in next two fiscal years.

OUTLOOK

The stable outlook reflects the improving trend of BED's financial position that is reflected in the utility's financial forecasts showing continued improvement in financial metrics.

STRENGTHS

*More diverse and cleaner mix of power supply resources than previously utilized mitigating industry challenges such as market price disruptions and carbon regulation. Vermont is exempt from CPP.

- *Sound financial management with forward-looking financial polices to maintain sound financial metrics
- *Burlington has a diverse economy with colleges, a major hospital and the city is the economic center of region.
- *Experienced management focused on industry transition including ensuring utility fixed cost recovery through rate structure changes
- *Strong reliability indicators for distribution system

CHALLENGES

- *Like most municipal electric utilities transition to more distributive generation including roof top solar represents new challenges
- *McNeil wood fueled generation facility has dominant role but has had strong operating record and adequate fuel supply
- *No base rate increase since 2009
- *While regulated on rate-setting by the state board, the rate setting record reflects full cost recovery and the ability to increase rates within 45 days after filing with the state with later true-up.

WHAT COULD CHANGE THE RATING UP

- *The rating could be upgraded once BED registered a longer trend of both debt service coverage and adjusted days liquidity
- *Continued and sustained improvement in the City of Burlington general financial record

WHAT COULD CHANGE THE RATING DOWN

- *Deterioration in financial record of the city and utility
- *Unsupportive regulatory board regarding cost recovery and the maintenance of sound utility financial metrics

RECENT DEVELOPMENTS

- *The city's Burlington Telecom (BT) legal issues and enterprise risks are now in past and city is managing the enterprise well. BED was not impacted.
- *Elimination of the material adverse clause in the utility's line of credit was a positive factor

DETAILED RATING RATIONALE

Revenue Generating Base

The utility serves the City of Burlington, Vermont, the state's largest city and economic center. BED has a monopoly in the service area. BED is regulated by the state public service board but it is not like an investor-owned utility oversight. The board has to take into consideration bond covenants and newly filed rates may be collected 45 days after filing with the state subject to later true-up. No historic record of lag or inadequate recovery. University of Vermont and regional medical center represent more than 20% of the customer base revenues. It is unlikely the university or medical center would relocate, lessening the concentration risk as a consideration.

BED rates are competitive in all customer classes with residential rates being substantially below state average.

Burlington, Vermont is the economic center for the state; has had an expanding local economy with several redevelopment and smart development projects; customer base is stable but demand has shrunk due to extensive energy efficiency program.

BED's power supply mix is substantially renewable energy through both owned and purchased energy resources. McNeil Plant, a wood-burning generation facility, represented 43.9% of power supply sources, operated well in FY 2015 with a 63.6% capacity factor.

GOVERNANCE AND MANAGEMENT

The utility is governed by the Mayor and 12-member city council. The mayor is elected every three years and each member of the city council have two year terms. The current mayor was recently re-elected. The mayor and city council appoint 5 representatives to serve 3 year terms on the advisory Board of the Electric Commissioners. Most operating decisions are made by the BED and there is a degree of separation from the city such as an independent auditor; limited General Fund transfers in the form of PILOTS; a line of credit independent from the city.

Ultimately rate filings must be approved by the Mayor and City Council. Following local approval, the Vermont Public Service Board (PSB) reviews the rates, the quality of services, and financial management of the utility.

Financial Operations and Position

BED has had an improving financial record with adjusted debt service coverage trending higher in the 1.5x range between 2013-2015. BED operating efficiencies, average weather, and renewable energy credit sales have been positive factors in the financial trend. Forecasts reflect adjusted debt service coverage improving in 2016-2018 but several factors may lead to a net income deficit in 2018. BED has identified several mitigation measures to correct. Those mitigation measures include pre-authorization of renewable energy credit sales; standard offer exemption and promoting solar development behind the meter. Assumptions include no rate adjustments; average weather conditions and impacts on sales from energy efficiency programs.

Liquidity

BED days liquidity on hand has been improving with FY 2015 liquidity days on hand at 94. The three year average 2013-2015 was 66 days. BED has a \$5 million line-of-credit also available.

Debt Structure and Capital Improvement Plan

BED has a conservative debt structure with fixed rate debt, voted authorization to issue bonds which Vermont Public Service Board has to incorporate in rate-setting, and level debt service. The debt service on the General Obligation bonds issued by the City of Burlington is paid after the payment of debt service on the electric system revenue bonds.

BED expects to spend about \$10 million annually between 2016-2018 on capital improvements, which includes new transmission investments. BED projects a new electric revenue bond issuance in 2017 (\$7.5 million) and 2018 (\$6 million) and about \$3 million annually through city General Obligation financings.

Debt-Related Derivatives

None

Pension and OPEB

BED is covered by the City of Burlington pension 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.

Methodology Scorecard Factors: US Public Power Electric Utilities: Burlington Electric

As indicated below, the grid indicated rating for Burlington Electric is A3. The rating assigned to the outstanding electric revenue bonds is Baa1. The difference between the grid-indicated rating of A3 and the rating of Baa1 primarily reflects the financial metrics have not yet registered fully in the A category on a three-year basis and the City of Burlington remains at Baa2-positive due to a history of governance issues.

The grid is a reference tool that can be used to approximate credit profiles in the public power electric utility sector in most cases. However, the grid is a summary that does not include every rating consideration. Please see the

US Public Power Electric Utilities with Generation Ownership Exposure Methodology for more information about the limitations inherent to grids.

Current Rating: Baa1

1. Cost Recovery Framework (25% weight)- (A)
2. Willingness to Recover Costs and Maintain Sound Financial Metrics- (25% weight) (Baa)
3. Management of Generation Risk-(10% weight) (A)
4. Rate Competitiveness- (10% weight) (A) (-2.3%)
5. Financial Strength:
 - Sub factor a) Adjusted Days Liquidity on Hand-(10% weight) (66 days)
 - Sub factor b) Debt Ratio-(10% weight) (55.5%)
 - Sub factor c) Fixed Obligation Charge Coverage (10% weight) (1.52x)

Notching Factor: None

Grid Indicated rating : A3

Key Facts

City of Burlington GO rating: Baa2 positive

Three-year average days liquidity, 2013-2015: 66 days

Median for top 30 City Utilities That Own Generation 2014 - 239 days

Three-year average adjusted debt service coverage, 2013-2015: 1.52 times

Median for top 30 City Utilities That Own Generation 2014 - 1.95

OBLIGOR PROFILE

The utility serves the City of Burlington, Vermont, the state's largest city and economic center. BED is a department of the city government and has a monopoly in service area. BED is regulated by state public service board but is not like an investor-owned utility oversight.

LEGAL SECURITY

The bonds are secured by the net revenues of the electric system. There is a 1.25 times rate covenant and the debt service reserve requirement is equal to maximum annual debt service on the senior revenue bonds.

The department also has approximately \$43 million of general obligation (GO) bonds that are expected to be repaid from electric department operating revenues. The rate covenant on the consolidated debt outstanding is 1.00 times. Per the General Bond Resolution, the claim on the revenues of the department by the revenue bondholders is prior to any claim of the GO bondholders.

USE OF PROCEEDS

N/A

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PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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