

CREDIT OPINION

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Update

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Vermont Public Power Supply Authority

Moody's maintains Baa2 on Vermont Public Power Supply Authority's Lamoille County Settlement Notes; outlook stable

Summary Rating Rationale

Moody's Investors Service maintains the Baa2 rating on Vermont Public Power Supply Authority's (VPPSA) 10-year \$8.7 million private placement Lamoille County Settlement Notes. The outlook is stable.

The Baa2 rating reflects VT Transco's predictable cash flow profile that is anchored by revenue earned from the Vermont distribution utilities under the open access transmission tariff (OATT) and the 1991 Transmission Agreement. The rating considers the essential service that VT Transco provides, the limited operating risk associated with transmission businesses since there is no volume risk, and VT Transco's favorable relationship with regulators and the Vermont distribution utilities.

The rating is tempered by potential scenarios where the Vermont Electric Power Company (VELCO) Board of Directors could petition FERC to reduce the equity rate of return on the Class A and Class B equity units, the weak contractual provisions for collecting from VPPSA members any deficiency in the equity distributions to cover debt service on the note, the lack of dedicated liquidity to support annual debt service repayment, and the lack of a timing cushion between the note repayment and the expected receipt of proceeds from the equity units' sale. The rating further incorporates Moody's view that the notes are structurally subordinate to VT Transco's own debt, particularly since the notes' annual debt service is paid from VT Transco equity distributions.

Credit Strengths

- » Predictable cash flow from ISO-NE OATT and Vermont distribution utilities
- » No volume risk as member contracts are full recovery plus a regulated return on equity
- » Class A and Class B equity unit rates of return are defined in the transmission agreement between VT Transco and the Vermont distribution utilities

Credit Challenges

- » Non-amortizing debt
- » No dedicated reserve funds or other liquidity to offset potential cash flow timing mismatches

- » Equity unit distributions used to cover annual debt service are structurally subordinate to VT Transco's debt
- » Weak contractual provisions between VPPSA and its Lamoille County members, on whose behalf these equity units were purchased, in case equity unit distributions are insufficient to cover annual debt service

Rating Outlook

The stable outlook reflects Moody's view that VT Transco's cash flow profile will support equity unit distributions that will sufficiently cover annual interest costs.

Factors that Could Lead to an Upgrade

- » The rating is well positioned at the current level and is unlikely to be upgraded.

Factors that Could Lead to a Downgrade

- » Weakening of VT Transco's credit quality or if equity unit distributions fall to below 1.5 times annual interest coverage.

Key Indicators

Exhibit 1

Exhibit 2

VT Transco LLC	2011	2012	2013	2014	2015
Adjusted Interest Coverage Ratio	5.6x	5.1x	5.9x	6.4x	7.0x
Net Debt / Fixed Assets	39.1%	45.1%	42.9%	39.4%	37.6%
FFO / Net Debt	27.7%	20.9%	26.5%	29.2%	30.8%
RCF / Net Debt	12.2%	8.6%	12.3%	13.4%	12.3%

Source: Moody's Investors Service

Recent Developments

Recent developments are incorporated in the Detailed Rating Rationale.

Detailed Rating Considerations

REVENUE GENERATING BASE

The subject \$8.7 million note was obtained by VPPSA on behalf of four VPPSA members (the Villages of Morrisville, Johnson, and Hyde Park, and the Town of Hardwick; collectively the "Lamoille County System (LCS) members") in order to finance a portion of the terms of the FERC-approved Uncontested Settlement Agreement related to increased construction costs of VT Transco's 115 kV Lamoille County Project.

The settlement stipulates how the LCS members pay their share of the costs associated with the project for the first 10 years of commercial operation. As part of the settlement, the LCS members will 1) pay VT Transco a \$1.529 million fixed annual payment for a 10 year period, and 2) make an investment in VT Transco equity for a 10 year period by purchasing 874,650 of VT Transco equity units. VPPSA purchased the equity units on behalf of the LCS members, and financed the purchase with the subject \$8.7 million 10-year, taxable, 6.25% fixed interest rate, non-amortizing note that matures in November 2019. VPPSA owns both the investment and the debt on behalf of the LCS members.

The interest costs on the note are paid by distributions received from the equity units that were purchased with the note proceeds by VPPSA. VPPSA purchased a total of 384,846 Class A units at \$10 par and 489,804 Class B units at \$10 par. Class A equity units pay an 11.5% annual return while Class B equity units pay a 13.3% annual return, resulting in a weighted average return on these equity units

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of 12.5%. VPPSA receives the distribution from VT Transco on a quarterly basis and VPPSA pays the interest payments on the note with those funds on a quarterly basis.

Assuming no changes, the 12.5% weighted average equity rate of return, is sufficient to cover the annual 6.25% interest rate on the note by 2.0 times. The VELCO Board of Directors (see below), has the ability to petition FERC to have the equity rate of return be reduced; however the board has not taken that decision after previous deliberations. Additionally, with the current spread between the weighted average equity rate of return and the interest rate on the note, it would take a fairly substantial cut in the equity distribution rates for the interest coverage to decline to 1.0 times.

Per an Equity Agreement signed between VPPSA and its individual members, if there is any deficiency between the equity unit distributions and interest costs, then VPPSA shall have the right to collect any such deficiency from the members. However, Moody's considers this language in the Equity Agreement that refers to how shortfalls will be covered to be very weak. If equity returns are insufficient to cover debt service, there is the potential for a funding shortfall if VPPSA is unable to collect the deficiency from its membership in time. The situation is further exacerbated since there are no liquidity or reserve funds dedicated specifically to the note to cover any potential shortfalls. Mitigating this weakness is a provision in the Note Purchase Agreement which stipulates full recourse to VPPSA for payment of interest.

At note maturity, the entire principal will be repaid in full from the proceeds of the sale of the equity units back to VT Transco. Per the Settlement Agreement, after the first 10 years of operation, the LCS members are obligated to sell the equity units at par, and VT Transco is obligated to repurchase the equity units at par. If VT Transco had a funding need at that time, the equity units could be sold to other member utilities, otherwise VT Transco is required to provide the ultimate backstop to repurchase the equity units. Since the note maturity date and the equity unit repurchase date fall on the same day (November 30, 2019), there is no material timing buffer for the receipt and subsequent payment of cash. It is our understanding, that in light of this circumstance, VT Transco has effectively planned and budgeted for the upcoming \$8.7 million equity unit repurchase, including the potential for VT Transco to wire money to the note holder directly.

FINANCIAL OPERATIONS AND POSITION

VT Transco has a predictable cash flow profile with low operating risk. The company's revenue structure is multi-tiered, with the largest percentage of revenue (approximately 80%) earned from the ISO-NE under the ISO-NE OATT for regional transmission service. ISO-NE utilizes the VT Transco transmission system and seven other major transmission systems in New England to provide regional network services, and charges and collects transmission revenues from all the New England utilities, and then pays each transmission owner its pro-rata share of total transmission revenue on a monthly basis.

VT Transco's second revenue tier is the revenue earned from amounts billed to local Vermont distribution utilities under the 1991 Transmission Agreement for local transmission service. The amount billed on a monthly basis is both the specified Class A and Class B equity rates of return and the distribution utilities' pro-rata share (based on actual usage) of VT Transco's total costs that were not recovered through other sources, primarily the ISO-NE tariff. Thus, the first revenue tier is an offset in calculating the customer billings for the second revenue tier, which self-adjusts monthly. Thus, through the combination of the first and second revenue tiers, VT Transco will always collect its full revenue requirement, including the amount needed to pay the distributions on its Class A and Class B equity certificates. Overall, VT Transco's financial position is characterized by its predictable cash flow profile and conservative capital structure.

LIQUIDITY

VT Transco had approximately \$246,000 in unrestricted cash at year-end 2015, which is supplemented by periodic equity infusions and a line of credit of \$70 million (\$41.9 million available at year-end 2015) with Keybank National Association (A3, stable) that extends through December 22, 2017. VT Transco's limited cash is reflective of a common practice of transmission companies' utilizing debt and equity for capital expenditures. While the bank line represents a source of external liquidity, Moody's notes that the existence of a material adverse effect clause is a credit negative as it could prevent access to the bank line for any draws.

DEBT AND OTHER LIABILITIES

The authority has one note outstanding for the Lamoille project, which is the subject \$8.746 million note. It is a 10-year note dated November 30, 2009, with a maturity of the full principal on November 30, 2019 at fixed rate of 6.25%. Note proceeds were used to purchase the VT Transco LLC equity units.

DEBT STRUCTURE

The note is non-amortizing, with final maturity of entire principal on November 30, 2019.

DEBT-RELATED DERIVATIVES

None

PENSIONS AND OPEB

The financial impact of unfunded and OPEB obligations of this issuer are minor and thus not currently a major factor in our assessment of its credit profile.

MANAGEMENT AND GOVERNANCE

VT Transco has no employees. It is managed by VELCO (Vermont Electric Power Company, Inc.) and the 2 entities operate as a single functional unit. VELCO's Board of Directors include the following 13 members:

- CEO/General Manager of Green Mountain Power
- CEO/General Manager of Burlington Electric Department
- CEO/General Manager of Vermont Electric Cooperative
- CEO/General Manager of Vermont Public Power Supply Authority
- CEO/ President of VELCO
- 2 directors appointed by the public power owners of VT Transco
- 3 additional directors appointed by Green Mountain Power
- 3 directors appointed by the Vermont Low Income Trust for Electricity

Legal Security

The \$8,746,000 note is collateralized by a security pledge agreement of 8,746,000 VT TRANSCO, LLC equity units (384,846 of Lamoille County Project (LCP) Class A and 489,804 of Lamoille County Project (LCP) Class B) and the assignment of rights to all distribution income from ownership of the investment. Annual interest costs are paid from the annual equity distributions and repayment of principal at maturity will be paid from the proceeds from the sale of the units back to VT Transco, which has provided the ultimate backstop to repurchase the equity units for par at maturity.

Use of Proceeds

Not Applicable

Obligor Profile

VT Transco LLC is a limited liability company formed in June 2006 by VELCO and 17 VT distribution utilities, including municipalities, electric cooperatives, and IOUs. The Company owns the State of Vermont's high-voltage electric transmission system (115 kV and above), which is operated by VELCO under contract. The Company is subject to regulation by the Federal Energy Regulatory Commission (FERC) and provides service under applicable FERC tariffs to all electric distribution utilities in Vermont, 2 small distribution utilities in New Hampshire and loads throughout New England via ISO-NE.

Methodology

The principal methodology used in this rating was Regulated Electric and Gas Networks published in November 2014. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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