

New Issue: MOODY'S ASSIGNS MIG 1 RATING TO \$1.2 BILLION OF MASSACHUSETTS G.O. REVENUE ANTICIPATION NOTES

Global Credit Research - 17 Aug 2010

State
MA

Moody's Rating

ISSUE	RATING
General Obligation Revenue Anticipation Notes, 2010 Series A	MIG 1
Sale Amount \$350,000,000	
Expected Sale Date 08/18/10	
Rating Description General Obligation Revenue Anticipation Notes	
General Obligation Revenue Anticipation Notes, 2010 Series B	MIG 1
Sale Amount \$425,000,000	
Expected Sale Date 08/18/10	
Rating Description General Obligation Revenue Anticipation Notes	
General Obligation Revenue Anticipation Notes, 2010 Series C	MIG 1
Sale Amount \$425,000,000	
Expected Sale Date 08/18/10	
Rating Description General Obligation Revenue Anticipation Notes	

Opinion

NEW YORK, Aug 17, 2010 -- Moody's Investors Service has assigned MIG 1 ratings to the Commonwealth of Massachusetts's \$350 million General Obligation Revenue Anticipation Notes, 2010 Series A, \$425 million 2010 Series B and \$425 million 2010 Series C.

RATINGS RATIONALE

The notes are secured by the commonwealth's general obligation pledge and will be used to bridge the mismatch in timing between revenue collections and expenditures, particularly personal income tax receipts and school aid payments to local governments. The Series A notes mature on April 28, 2011, the Series B notes on May 26, 2011, and the Series C notes on June 23, 2011. The highest short-term rating reflects the credit quality of the Commonwealth of Massachusetts (general obligation rating of Aa1 with a stable outlook) and its full faith and credit pledge to pay noteholders when due; the staggered maturity structure of the notes that provides satisfactory cash margins following each repayment date; and alternative liquidity provided by the commonwealth's budget stabilization fund, subject to legislative appropriation.

Long-term Credit Strengths:

- Effective financial management during economic downturns, particularly a willingness to promptly identify and close budget gaps through both new revenues and expenditure reductions
- Budget reserves that still provide an adequate cushion, although a reduced one, and a statutory mechanism to replenish them going forward
- High wealth and high levels of educational attainment
- The presence of large, highly-rated higher education and health care institutions in the Boston area have lent a degree of economic stability and have mitigated some job losses during recessions

Long-term Credit Challenges:

- Managing expenditure pressures, especially from health care and social services, in a lower revenue environment, although collections have begun to improve
- High unemployment persists, although at lower levels than the nation and employment has begun to grow slowly
- Low pension funding levels, and debt ratios that are among the highest in the nation

STAGGERED NOTE MATURITIES PROVIDE SATISFACTORY CASH MARGINS

The commonwealth expects to issue a total of \$1.2 billion of revenue anticipation notes (RANs) to meet its fiscal 2011 seasonal cash flow needs, which are largely driven by a mismatch between the timing of personal income tax receipts and payments to local governments for school aid. Those payments are made at the end of quarter of the commonwealth's fiscal year in amounts that range from between \$1.1 billion and \$1.2 billion. The notes are general obligation, full faith and credit obligations of the commonwealth. Massachusetts issued a total of \$1.2 billion in RANs for its fiscal 2010 cash needs, and in fiscal 2009 issued \$750 million in addition to using its commercial paper program. The commonwealth currently plans to rely on RANs for cash flow purposes and access its commercial paper capacity for capital projects.

All short-term borrowings are statutorily required to be repaid by the end of the fiscal year. The notes have three separate staggered maturities, an important distinction that, based on current cash flow assumptions, results in stronger cash margins than if the notes were issued with a single maturity at the end of the fiscal year when ending balances are expected to be weaker. The commonwealth's official cash flow forecast was developed in the spring and reflects a short-term borrowing larger than the notes it now plans to sell. Since that forecast was developed, revenues have also performed more strongly than the baseline forecast. Additionally, Massachusetts' fiscal 2011 budget did not include an extension of federal stimulus funds beyond its original December 2010 expiration date. After the budget was enacted, however, the stimulus funds were extended by six months to the end of the current fiscal year, June 30, 2011; the commonwealth expects to receive approximately \$600 million in additional funds from the extension. While not incorporated into its cash flows, the commonwealth's Budget Stabilization Fund provides an important source of alternative liquidity, although accessing it is subject to legislative appropriation. Following a budgeted draw to help balance the current fiscal year, the fund is expected to total \$550 million.

Based on its official cash flow scenario, ending cash balances at each note repayment date are narrow, even when including the Budget Stabilization Fund and the commonwealth's available commercial paper program. While ending cash balances as a percentage of budgetary revenues are 6.7% and 5.5% for the Series A and Series B notes, respectively, it is just 3.5% at the end of the fiscal year following repayment of the Series C RAN. Adjusting for the size of the current offerings and additional federal funds, ending balances are stronger, at 8.5%, 7.8% and 5.9% of total revenues at each note maturity, respectively, including alternate liquidity.

FISCAL 2010 REVENUES RISE FOLLOWING SALES TAX INCREASE

The commonwealth used a variety of measures to close a fiscal 2010 budget gap that totaled approximately \$2.7 billion. The enacted budget included new revenues, additional use of federal stimulus funds, another draw on the stabilization fund and other one-time measures. The sales tax was increased from 5.0% to 6.25% and the exemption for alcoholic beverages was eliminated, changes that resulted in \$743 million of additional sales tax revenue in fiscal 2010. Corporate income taxes increased by \$20 million (1.0% compared to the prior year) while the personal income tax decreased by \$474 million (-4.5%), resulting in a net revenue increase of \$279 million for the fiscal year, slightly ahead of forecast. The stabilization fund also was drawn on again, bringing its fiscal 2010 year-end balance to \$657 million or just more than 2.0% of revenues.

FISCAL 2011 BUDGET REFLECTS ESSENTIALLY FLAT SPENDING

The \$27.6 billion enacted fiscal 2011 budget reflects an expenditure increase of 0.2% over the prior year, levels approximately in line with fiscal 2007 spending. Revenues, including the sales tax increase enacted in fiscal 2010, are forecast to rise by 3.3%. Notably, before enacting the budget the commonwealth eliminated funds expected to be received from a six-month extension of the increase in the Federal Medicaid Assistance Percentage (FMAP), putting Massachusetts in a more favorable position than many states that budgeted the funds. Since then, the six-month extension has passed, although at a lower level than most states expected. Massachusetts will receive additional federal aid that totals more than \$600 million. The enacted budget also included a debt restructuring to provide budgetary relief, tantamount to a deficit financing as it merely repays this year's debt service with bond proceeds and amortizes that cost over the future. Additionally, the budget withdraws an additional \$100 million from the stabilization fund, reducing its balance to \$550 million or 2.9% of forecast fiscal 2011 revenues. Recognizing the value that its reserves played in managing the current downturn and the extent to which they have been drawn down, the commonwealth also has enacted a plan that will deposit any capital gains revenues greater than \$1 billion into the stabilization fund to rebuild it. If passed, a ballot initiative this fall to halve the sales tax and reinstitute certain exemptions would force the commonwealth to make significant mid-year adjustments.

EMPLOYMENT POSTS SMALL GAIN; HIGH WEALTH AND EDUCATIONAL LEVELS CHARACTERIZE THE STATE

Massachusetts posted a small 0.5% gain in employment in June, the second consecutive month of jobs growth following 19 months of declines; nationally, jobs decreased by 0.2% for the month. The 2009 annual job loss in Massachusetts was 3.5%. The commonwealth's unemployment rate remains elevated at 9.0% in June, but still lower than the 9.5% US level. Still, the downturn has been severe: Massachusetts' unemployment rate was as low as 4.4% in 2007. The commonwealth has been aided by continued growth in its large education and health sector, which makes up more than 20% of employment and showed 2.8% job growth in May. Massachusetts' two largest private employers are Brigham and Women's Hospital and Massachusetts General Hospital, both part of the Aa2-rated Partners Healthcare System. Other top employers include Harvard University (Aaa), Massachusetts Institute of Technology (Aaa), and Boston University (A2). The state also has a large financial activities sector, with a significant mutual fund presence.

The state is characterized by high wealth and education levels but with slow population and job growth. Per capita personal income in 2009 was \$49,875, ranking third among the states. According to the Census Bureau, the commonwealth had the highest percentage of residents with bachelor's degrees of any state in 2008, which has helped to attract and develop significant high tech and defense contracting sectors. Despite the highly educated population, however, during the last two recessions Massachusetts lost more jobs than the nation and gained fewer during the expansions that followed. Among the commonwealth's economic challenges are high business and housing costs and slow population growth with negative migration trends. Indeed, high costs have pushed some suburban Boston growth into more affordable New Hampshire.

HEAVY TAX-SUPPORTED DEBT LOAD

The commonwealth has a high debt burden, with more than \$17.2 billion in outstanding general obligation bonds and \$29 billion in total net tax-supported debt. Based on Moody's 2010 state debt medians, the state's debt levels ranked second-highest among the 50 states on both a per-capita basis and as a percentage of personal income, respectively, and is the highest as a percentage of state gross domestic product. Total net tax-supported debt amounted to 9.2% of total personal income in 2009 compared to the 50-state median of 2.5%.

CLOSELY MANAGED VARIABLE RATE DEBT AND SWAPS PORTFOLIO

Approximately 20% of the commonwealth's general obligation debt is variable rate, largely swapped to fixed rates through cost-of-funds swaps, eliminating basis risk. In March the commonwealth refunded nearly \$540 million of liquidity-backed variable rate debt into SIFMA Index Bonds which do not require liquidity support. The SIFMA bonds mature serially through 2014 and are swapped to fixed rates. The commonwealth's variable rate and derivatives portfolio is closely managed and its liquidity facilities and swap agreements contain provisions favorable to the commonwealth and offset its relatively low available cash balances. Liquidity facilities contain a mix of three- and five-year term-out provisions that, considering the strength of Massachusetts' market access should provide ample time to refinance if necessary. Swap counterparties are well-diversified and do not reflect collateral posting requirements on the part of the commonwealth. As of May 30, the mark-to-market value of Massachusetts' swaps was -\$377 million.

For cash flow purposes, Massachusetts has relied on an \$800 million commercial paper (CP) program and revenue anticipation notes (RANs), although in the future the commonwealth intends to use only RANs for cash flow, while using CP for capital purposes. The commonwealth issued \$1.2 billion of RANs in September 2009 that matured at the end of June 2010. The current forecast reflects issuance of a \$1.4 billion RAN this September. The commonwealth ended fiscal 2010 with a cash balance of \$936 million, ahead of the original forecast of \$860 million.

LOW PENSION FUNDING RATIOS; ANNUAL PENSION CONTRIBUTIONS ADD SUBSTANTIAL FIXED COSTS

Annual pension contributions are substantial, and the budget calls for a \$1.4 billion contribution in fiscal 2011. The commonwealth dramatically improved pension funding during the 1990s, rising from 29% in 1990 to 85% in 2000. The most recent actuarial valuation, as of January 1, 2009 revealed the funded ratio had fallen from 79% in 2008 to 63%, following significant investment losses. The governor has proposed pension reforms which are estimated to save \$2 billion over 30 years. Massachusetts' other post employment benefits (OPEB) liability could add substantial budget pressures in the future, as is also likely in most other states. The January 1, 2009 valuation of the plan shows a \$15.3 billion liability, with just \$277 million of assets. No funds have been contributed to the trust fund since 2008. The governor has proposed dedicating a small portion of future excess capital gains tax revenues to the OPEB liability and also has proposed reforms to reduce the liability, including raising the retirement age. At a combined 16%, the commonwealth's actuarially required contributions (ARC) to pensions and post-retirement health care also exceed the median of 11% for U.S. states. While there is some flexibility in the required timing of these contributions and the liabilities are affected by changes in investment values, the level of this combined ARC may limit the commonwealth's financial flexibility going forward.

PRINCIPAL METHODOLOGY AND LAST RATING ACTION

The principal methodology used in rating Massachusetts (Commonwealth of) was Short-Term Cash Flow Notes rating methodology published in May 2007. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

The last rating action with respect to the Commonwealth of Massachusetts was on July 19, 2010 when Aa1 ratings were assigned to its General Obligation Refunding Bonds, 2010 Series B and General Obligation Bonds, Consolidated Loan of 2010, Series C.

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