RatingsDirect®

Summary:

Massachusetts; General Obligation

Primary Credit Analyst:
David G Hitchcock, New York (1) 212-438-2022; david.hitchcock@standardandpoors.com

Secondary Contact:
Robin L Prunty, New York (1) 212-438-2081; robin.prunty@standardandpoors.com

Table Of Contents

Summary:

Massachusetts; General Obligation

Credit Profile		
US$360.0 mil cons loan 2015 (Massdirect Nts) ser 1-10 due 07/01/2025		
Long Term Rating	AA+/Stable	New
US$150.0 mil cons loan 2014 (Massdirect Nts) ser 10-15 due 12/01/2024		
Long Term Rating	AA+/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' rating and stable outlook to Massachusetts' $150 million general obligation (GO) bonds consolidated loan of 2014 (MassDirect Notes), series 10-15, and $360 million GO bonds consolidated loan of 2015 (MassDirect Notes), series 1-10.

Factors supporting the 'AA+' rating include what we view as Massachusetts':

- Strong budget performance, with timely monitoring of revenues and expenditures and swift action when needed to make adjustments, with a focus on structural solutions to budget balance;
- Ongoing progress in improving financial, debt, and budget management, including formalized policies relating to debt affordability, as well as multiyear capital investment and financial planning, which are key improvements from a credit standpoint;
- Healthy budget stabilization fund (BSF) balance, which has been key to managing budget volatility;
- High wealth and income levels; and
- Deep and diverse economy, which continues to experience steady economic recovery.

Standard & Poor's believes the commonwealth's high debt burden and significant unfunded pension and other postemployment benefit (OPEB) liabilities are offsetting considerations to the current rating. While we view Massachusetts' total postretirement liabilities as relatively high, we believe the commonwealth has been actively managing these liabilities with a focus on cost control and reform in recent years.

The MassDirect Note program is part of the commonwealth's overall debt and capital investment plan and is subject to the administrative limits on bond issuance, but will be issued primarily to retail investors. We understand this program will include monthly rolling sales to retail investors through June 2015 under the current plan. We are assigning a rating to the total program authorization, which is expected to be fixed-rate GO bonds with a final maturity in 2025. Under the current MassDirect program, the commonwealth expects to sell bonds to an underwriter on a negotiated basis and the bonds will then be offered to retail investors on an electronic trading platform. The bonds are expected to sell on a daily basis two weeks of each month (one week in January and February) with different maturities that are expected to be within 10 years. The commonwealth expects the program to broaden its investor base and enhance pricing transparency. We understand that proceeds will be used to finance various capital projects as authorized in the state's capital spending plan.

Massachusetts' economy has experienced steady recovery, outpacing national and regional trends by most measures. The state's average annual unemployment rate in 2013 was 7.1% compared with 7.4% for the nation. The preliminary state unemployment rate as of August 2014 has fallen to 5.8%, compared with 6.1% for the nation, the result of continued strong growth in private-sector employment. Employment growth has been strong relative to other states and the commonwealth regained its pre-recession employment peak in 2013 according to the Bureau of Labor Statistics. IHS Global Insight Inc. forecasts continued state employment growth in 2015 and 2016, although slightly slower than the nation at 1.6% and 1.2%, respectively, compared with its forecast of 1.9% in 2015 and 1.6% in 2016 for the U.S.. In our view, Massachusetts' economic fundamentals and key anchors, which are centered on higher education, technology, and health care, should contribute to continued expansion. Income growth has also been strong relative to that of other states, with per capita personal income now ranked second in the U.S. behind Connecticut in 2013, 28% above the U.S. average.

We view the state's budget as generally structurally balanced with good reserves. The state ended fiscal 2014 on a budgetary basis with an estimated operating funds' balance of $1.4 billion, including $1.2 billion in the BSF, or what we see on a combined basis as a good 3.9% of operating funds expenditures (primarily the general fund and transportation fund), or 6.0% of tax revenues. Fiscal 2014 tax revenues rose approximately 5.6% in fiscal 2013; the state is budgeting for about 4.5% tax revenue growth in fiscal 2015. The first two months of fiscal 2015 show continued moderate revenue growth, although they represent relatively small tax collection months and might have benefitted from some acceleration of withholding tax payments from September into August. The state projects fiscal 2015 will end with what we view as a still-good operating funds' balance of $1.2 billion, including a $30 million BSF drawdown, for what we view as a still-good combined 3.1% of operating funds expenditures, or 5.1% of projected tax revenue. Preliminary indications are that another reduction in the income tax rate to 5.15% from 5.20% could occur in January 2015, based on current revenue growth that is above Massachusetts' 2.5% trigger set in law for a reduction, assuming current growth trends continue for the next three months. This would lead to a loss of about $70 million in tax revenue; however, it would be offset by the higher revenue growth that triggered the rate reduction.

Two voter initiatives on the November ballot could affect state revenues. One would repeal inflation indexing of motor vehicle excise taxes, while another would repeal certain casino authorizing legislation and eliminate $73 million of related budgeted revenues in fiscal 2015. We do not believe either referendum would significantly affect credit quality in the near term, as the potential loss of excise taxes would come only from future inflation adjustments beginning Jan. 1, 2015, while the loss of casino-generated fees would be relatively small compared to the total budget.

On a generally accepted accounting principles basis, Massachusetts ended fiscal 2013 (the most recent audited year) with an available assigned and unassigned general fund balance of $1.68 billion, plus a BSF balance of $1.56 billion, for a combined balance that we view as a strong 11% of general fund expenditures.

Total GO debt outstanding was about $19 billion at Aug. 31, 2014, while we calculate total tax-supported debt at about $31 billion, including debt issued by state authorities and supported by the statewide sales tax, as well as contract assistance debt. By most measures, we believe Massachusetts' debt burden remains high compared with that of other states. Debt per capita is high, in our view, at $4,847 at fiscal year-end 2013 and 8.5% of personal income. Planned debt issuance remains within the parameters of the commonwealth's debt affordability policy and bond cap. A capital and debt affordability committee includes seven voting members and eight nonvoting members from the legislature and is charged with formally reviewing the capital investment plan and providing an estimate of debt authorization for the year. The state's capital plan released June 30, 2014, calls for $2.125 billion of GO borrowing in fiscal 2015 (not including $237.6 million of GO self-financed project bonds), out of total borrowing of $3.39 billion. The five-year plan covering fiscal years 2015-2019 anticipates issuance of $11.125 billion of GO bonds that are subject to the state bond cap. We view current debt service of about 8% of general governmental revenues as moderately high. Other long-term liabilities are also large, in our opinion. We believe unfunded pension liabilities of $28.3 billion are high at $4,265 per capita, while unfunded OPEB is also moderately high at $15.9 billion; however, the state has started to put aside extra money in an OPEB trust fund that could reach about $197 million at fiscal year-end 2015, and the 2015 budget dedicates an extra $163 million to accelerate the funding of the state's pension liability.

Based on the analytic factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a composite score of '1.8' to Massachusetts.

(For more information on the state of Massachusetts, please refer to our most recent full analysis published on July 28, 2014, on RatingsDirect.)

Outlook

The stable outlook reflects our expectation that Massachusetts will continue to manage its budget proactively. Management initiatives to formalize long-term financial planning and to manage long-term debt and liabilities should allow for favorable budget structural alignment in the future. We believe the BSF provides significant flexibility to manage future fiscal challenges over our two-year outlook horizon. Despite steady economic expansion, the BSF was reduced $309 million in fiscal 2014 and may diminish slightly by about $30 million in fiscal 2015, which could offset future flexibility to manage budget volatility. If there were a sharp decline in reserves, or debt and liabilities were to increase sharply, the rating could be pressured. The level of long-term liabilities is currently constraining upside rating potential.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 15, 2014

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.