

New Issue: MOODY'S ASSIGNS Aa1 RATING TO \$457 MILLION OF MASSACHUSETTS GENERAL OBLIGATION BONDS

Global Credit Research - 16 Sep 2011

\$18.5 BILLION OF G.O. DEBT OUTSTANDING OUTLOOK IS STABLE

State
MA

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Consolidated Loan of 2011, Series D	Aa1
Sale Amount	\$475,000,000
Expected Sale Date	09/30/11
Rating Description	General Obligation

Opinion

NEW YORK, Sep 16, 2011 -- Moody's Investors Service has assigned a Aa1 rating to the Commonwealth of Massachusetts' \$475 million General Obligation Bonds, Consolidated Loan of 2011, Series D. Proceeds of the bonds, which are scheduled to price on September 21 and have a 17-year final maturity, will be used to finance portions of the commonwealth's capital plan.

SUMMARY RATING RATIONALE

The rating reflects the commonwealth's strong financial management practices and its demonstrated willingness to balance its budget when necessary through spending cuts, revenue increases and use of reserves; a large education and health care sector that generates high wages and that has helped to mitigate job losses in the current downturn; debt levels that are among the highest in the nation; and relatively low pension funding levels. The outlook is stable.

Credit Strengths:

- Strong financial management during economic downturns, particularly a willingness to promptly identify and close budget gaps through expenditure reductions, revenue increases and prudent use of reserves
- Budget reserves that provide an adequate cushion to another downturn and the commonwealth's demonstrated commitment to rebuild them to stronger levels, including through new 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 has lent a degree of economic stability and have mitigated some job losses during recessions

Credit Challenges:

- Managing expenditure pressures, especially from health care and social services, in a lower revenue environment and amid ongoing economic uncertainty
- Relatively low pension funding levels, and debt ratios that are among the highest in the nation
- Managing the challenges from federal downsizing during the next several years, which could have a heavy impact on the commonwealth's important healthcare sector

DETAILED CREDIT DISCUSSION

COMMONWEALTH ENDS FISCAL 2011 IN STRONG FINANCIAL POSITION

Massachusetts ended fiscal 2011 with tax collections up 10.6% (nearly \$2 billion) compared to the prior year, and 3.6% greater than forecast. Personal income taxes, which account for 56% of general fund revenue in the high wealth state were especially strong, increasing by 14.5%, growth driven by strong nonwithholding collections. Sales taxes (24% of the total) increased by 6.4% compared to fiscal 2010, and corporate income taxes (11% of the total) were up by 5.1%. All other collections (9% of the total) were up by 5.6%.

The commonwealth ended the year with a budgetary basis \$460 million general fund surplus, mostly as the result of the strong nonwithholding collections. While the fiscal 2011 enacted budget included a \$100 million draw on the commonwealth's Budget Stabilization Fund and the use of \$95 million carried forward from fiscal 2010, amid higher revenue collections and the extension of federal stimulus funds, legislation enacted in October eliminated both. Further, in addition to a statutorily-required transfer into the stabilization fund of \$100 million based on half of 1% of fiscal 2011 tax collections, the governor has proposed a discretionary transfer of an additional \$300 million. If the additional transfers are enacted, the stabilization fund will total just more than \$1 billion, or 5.2% of the fiscal 2012 revenue forecast of \$20.6 billion. By comparison, entering the downturn in fiscal 2007 the fund totaled \$2.3 billion. Massachusetts' efforts to rebuild its reserves are a credit positive development that represents its understanding of the important role a strong reserve position played in its management of the downturn.

FISCAL 2012 BUDGET REFLECTS SPENDING REDUCTION AND REDUCES RELIANCE ON ONE-TIME RESOURCES

The \$30.6 billion fiscal 2012 budget reduces total state spending by approximately \$666 million, or 2.1%. It works toward a greater structural balance by reducing the commonwealth's use of one-time resources, which now only reflect 1.5% of the total budget compared to 6.0% in fiscal 2011. The budget includes a \$185 million draw from the Budget Stabilization Fund, although as in fiscal 2011 that could be reduced or eliminated later depending on the strength of revenue collections. Assuming that the planned draw occurs (and that the legislature enacts the proposed additional deposits), the stabilization fund would total 4.3% of estimated fiscal 2012 revenue. In addition to the portion of annual tax revenue the stabilization fund receives, going forward any capital gains collections greater than \$1 billion will also be deposited into it. However, while a proposed pension reform measure will provide the commonwealth with long-term savings, the 15-year extension of the schedule to eliminate its unfunded liability provides \$800 million in savings in fiscal 2012, also a non-recurring action to provide budgetary relief. Fiscal 2012 revenue is estimated to increase by 0.5% on an actual basis. The commonwealth updates its consensus revenue forecast four times a year, a strong practice which allows it to quickly make mid-year budget adjustments when required.

PENSION REFORM HAS LONG TERM BENEFITS FOR THE STATE

A pension reform measure that was recently passed by the Massachusetts senate will provide long-term benefits to the state, if enacted. Based on an updated actuarial valuation released on October 1, 2010, Massachusetts' pension funded ratio had improved to 67.5% from 62.7% in 2009, although that is still relatively low. Among its changes, the plan extends the funding schedule from 2025 to 2040, which reduces the fiscal 2012 contribution from \$2.2 billion to \$1.4 billion (although that is still larger than then fiscal 2011 amount). The negative impact of pushing out the period to fully fund the retirement obligations is partially offset by increasing the retirement age to 67 for most state employees; eliminating early retirement subsidies; increasing the period for calculating retirement from an average of three years to five years; and eliminating double-dipping. The measure also prohibits the commonwealth from making less than the annual payment required by the new schedule if investment returns exceed expectations: greater-than-expected gains would be used to shorten the schedule. It further dedicates future tobacco settlement monies to the commonwealth's other post-employment benefits (OPEB) trust fund, starting in phases in fiscal 2013. The combined ratio of Massachusetts' pension and OPEB actuarially required contributions (ARC) to revenue is 16%, slightly higher than average. Left unchecked, those costs could limit the commonwealth's fiscal flexibility going forward, but the new plan should help to mitigate them.

EMPLOYMENT CONTINUES SLOW IMPROVEMENT; HIGH WEALTH AND EDUCATIONAL LEVELS CHARACTERIZE THE STATE

Jobs in Massachusetts began to grow again four months before the nation as a whole, and have increased on a year-over-year basis in each of the past 16 months. For both Massachusetts and the U.S., the growth has been slow although it accelerated in Massachusetts in recent months. Employment in Massachusetts increased by 1.5% in August compared to a year earlier, while for the U.S. it increased by just less than 1.0%. Similarly, Massachusetts' unemployment rate has been lower than the national average, and was 7.4% in August compared to 9.1% for the U.S.

The commonwealth continues to be aided by its large education and health sector, which makes up more than 20% of employment. The state also has a large financial activities sector, with a significant mutual fund presence. While the important healthcare sector is partly behind Massachusetts's above-average employment and income performance, future federal downsizing could impact healthcare and have a significant impact in Massachusetts. The state is characterized by high wealth and education levels but with slow population and job growth over the longer run. Per capita personal income in 2010 was \$51,552, ranking second 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 \$18.5 billion in outstanding general obligation bonds and \$29 billion in total net tax-supported debt. Debt levels have been driven upwards by the commonwealth's issuance of bonds to finance projects that in other states would be paid for at the local level. 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. It has reduced its exposure to external liquidity facility risk through the issuance of SIFMA index bonds, although the need to roll or take out maturities of those bonds creates some market access and liquidity risks. 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 June 30, the mark-to-market value of Massachusetts' general obligation swaps was -\$369 million. The commonwealth also maintains a \$400 million commercial paper program.

For cash flow purposes, in fiscal 2011 the commonwealth issued \$1.2 billion of revenue anticipation notes (RANs). It expects to issue \$800 million of fiscal 2012 RANs in November of this year, based on a recently release cash flow.

Outlook

The outlook for Massachusetts is stable, reflecting rebuilding of reserves, improving revenues and efforts to regain structural budget balance. The outlook also reflects our expectation that the commonwealth will continue to take proactive measures to close budget gaps if they emerge and continue its trend of strong financial management. Going forward, heavy reliance on one-time budget solutions, tighter cash margins, unexpectedly severe economic deterioration, or a large increase in tax-supported debt could be credit challenges.

What would make the rating change - UP

- Rapid rebuilding of reserves and establishment of stronger constraints on their use
- Established trend of structural budget balance
- Reduced debt ratios relative to Moody's 50-state median

What would make the rating change - DOWN

- Protracted structural budget imbalance driven by deeper and/or prolonged economic downturn
- Depletion of Budget Stabilization Fund to inadequate levels
- Increased leveraging of the commonwealth's resources to pay debt service or further erosion in funding ratios
- Narrowed cash flow that strains the commonwealth's liquidity

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Moody's State Rating Methodology published in November 2004. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moody.com.

Information sources used to prepare the rating are the following: parties involved in the ratings, public information, and confidential and proprietary Moody's Analytics information.

Moody's considers the quality of information available on the rated entity, obligation or credit satisfactory for the purposes of issuing a rating.

Moody's adopts all necessary measures so that the information it uses in assigning a rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see Moody's Rating Symbols and Definitions on the Rating Process page on www.moody.com for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on www.moody.com for the last rating action and the rating history.

The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moody.com for further information.

Please see www.moody.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Analysts

Nicholas Samuels
Analyst
Public Finance Group
Moody's Investors Service

Nicole Johnson
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

© 2011 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ARE MOODY'S INVESTORS SERVICE, INC.'S ("MIS") CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Any publication into Australia of this document is by MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001.

Notwithstanding the foregoing, credit ratings assigned on and after October 1, 2010 by Moody's Japan K.K. ("MJKK") are MJKK's current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, "MIS" in the foregoing statements shall be deemed to be replaced with "MJKK". MJKK is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly owned by Moody's Overseas Holdings Inc.,

a wholly-owned subsidiary of MCO.

This credit rating is an opinion as to the creditworthiness or a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.