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## Summary:

# Massachusetts; CP; General Obligation; General Obligation Equivalent Security; Joint Criteria

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### Credit Profile

US\$688.86 mil GO rfdg bnds ser 2015 A due 07/01/2037

*Long Term Rating* AA+/Stable New

US\$250.0 mil GO bnds cons loan ser 2015 C due 07/01/2045

*Long Term Rating* AA+/Stable New

## Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' rating and stable outlook to Massachusetts' \$250 million general obligation (GO) bonds consolidated loan of 2015 series C, and \$688.86 million GO refunding bonds, 2015 series A.

At the same time, Standard & Poor's has affirmed its 'AA+' rating on approximately \$20.8 billion of parity GO debt outstanding, its 'A+' rating on the state's moral obligation debt, and its 'A-1+' rating on GO secured state commercial paper. The outlook is stable on all long-term debt.

We have also separately lowered the short-term liquidity rating on certain series of independent state-related authorities, which hold state GO equivalent long-term ratings, based on the recent change in the short-term rating on the associated liquidity provider, Barclay's Bank.

Factors supporting the 'AA+' GO 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;
- Strong financial, debt, and budget management policies, including annualized formal debt affordability statements, and multiyear capital investment and financial planning;
- Healthy budget stabilization fund (BSF) balance, despite recent small drawdowns. We believe the BSF helps manage budget volatility as it captures "excess" capital gains tax above a trigger level;
- High wealth and income levels; and
- Deep and diverse economy, which continues its steady recovery.

The series 2015C bonds will fund various capital improvements, while series 2015A bond proceeds will be used to refund certain bond issues.

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. Although 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.

Massachusetts' economy has recovered steadily, outpacing national and regional trends by most measures. Real state GDP grew 2.3% in calendar 2014, compared with 2.2% for the nation. The commonwealth's average annual unemployment rate in 2014 was 5.8% compared with 6.2% for the nation. The preliminary state unemployment rate as of April 2015 has fallen to 4.7%, compared with 5.4% 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, 2016, and 2017, although at a slightly slower rate than that of the nation at 1.6%, 1.3%, and 1.3%, respectively, compared with its forecast of 1.9%, 1.4%, and 1.4% 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 2014 per capita personal income ranked second in the U.S. behind Connecticut, at 128% of the U.S. average. IHS Global Insight projects state real wage growth will rank sixth highest in the U.S. during 2015-2019, led by the professional, scientific, and technical services sector.

We view Massachusetts' budget as generally structurally balanced with good reserves, although several midyear budget adjustments were needed in fiscal 2015, primarily prompted by higher-than-budgeted Medicaid expenses and some projected revenue shortfalls.

Since the 2015 mid-fiscal year adjustments, state revenues are up \$389 million above the revised fiscal 2015 revenue forecast as of the end of May 2015, excluding \$193 million in one-time released tax-related settlements and judgments. The state now expects fiscal 2015 to end in statutory balance, although there will be a small drawdown in the BSF.

The commonwealth ended fiscal 2014 on a budgetary basis with an estimated operating funds' balance of \$1.45 billion, including \$1.25 billion in the BSF, or what we see as a still-good 3.9% of operating funds expenditures (primarily the general fund and transportation fund), on a combined basis, or 6.0% of tax revenues. In fiscal 2014, Massachusetts drew down its BSF by \$308 million. It originally enacted a largely balanced fiscal 2015 budget, with only a slight \$30 million drawdown in its BSF; however, it now projects the BSF will be drawn down \$120 million in fiscal 2015 to \$1.13 billion. Massachusetts currently projects ending fiscal 2015 with a total operating funds' budgetary basis balance, including the BSF, of \$1.20 billion, or 3.0% of budgeted operating expenditures and other uses.

The state made several rounds of midyear budget adjustments in fiscal 2015. The midyear budget shortfalls are the result of both revenue shortfalls and higher-than-budgeted expenditures, particularly in Medicaid. In November 2014, outgoing Gov. Deval Patrick identified a projected \$329 million fiscal 2015 deficiency; \$225 million of this was met with midyear adjustments enacted before he left office. In January, the incoming administration of Gov. Charlie Baker estimated an additional mid-fiscal 2015 shortfall of \$768 million due to new spending exposures, after taking into account the midyear budget adjustments already made. The new gap was particularly attributable to \$230 million of additional Medicaid exposure and \$155 million for employee group health insurance, in addition to unexpected snow removal costs. In particular, the state identified what it believes was poor record-keeping when enrolling Medicaid participants, which led to expansion beyond budgeted levels. It has since implemented adjustments that it believes fully close the midyear deficiency. Solutions included redetermination of existing Medicaid participants' eligibility (\$168 million), diversion of excess capital gains taxes to the general fund (\$331 million instead of an originally

budgeted \$131 million diversion) instead of being deposited into the BSF, reversions of appropriated money (\$108 million), and other measures. The combined \$225 million and \$787 million of separate midyear adjustments total about 3% of originally budgeted fiscal 2015 operating funds' expenditures.

Current financial projections for 2015 include an income tax rate reduction, which was triggered under state law Jan. 1, 2015 as the result of baseline revenue growth over 2.5%, for a loss of about \$70 million in fiscal 2015. Another income tax rate trigger reduction to 5.10% from 5.15% is likely to go into effect on Jan. 1, 2016, as a result of inflation-adjusted baseline revenue growth again over the 2.5% trigger level, with an additional \$145 million loss of revenue.

The governor's executive budget proposal for fiscal 2016 is largely structurally balanced in our opinion, increasing spending by 3.0%, compared with the 4.8% consensus tax revenue growth forecast. The executive budget proposal projects only a slight \$7 million increase for the ending BSF balance, after diversion of excess capital gains tax to the general fund that would have otherwise flowed to the BSF. The executive budget proposal assumes current statutory law will trigger the previously mentioned income tax rate reduction in calendar 2016, as well as additional savings from an early retirement incentive program, and slightly increases deposits to an OPEB trust fund. The executive budget anticipates 5.6% growth in MassHealth spending (which is more than a third of the operating budget), while level funding most other expenditures and appropriating small increases to aid for local government, education, and local road funding.

A final fiscal 2016 budget has not yet been adopted, although the state's Senate passed a version of the budget with slightly more spending than proposed by the governor, and the House has passed a version with slightly less spending than proposed by the governor. A House-Senate conference committee is currently working on reconciling the differences. Although a state budget has sometimes been enacted slightly after the July 1 start of a fiscal year, in such cases an interim budget has typically been enacted to provide operating funding until a full budget can be enacted and signed by the governor.

On a generally accepted accounting principles basis, Massachusetts ended fiscal 2014 (the most recent audited year) with an available assigned and unassigned general fund balance of \$1.59 billion, plus a BSF balance of \$1.25 billion, for a combined balance that we view as strong at 9% of general fund expenditures, down slightly from 11% the year before.

We calculate total GO debt outstanding at fiscal year-end June 30, 2014, at \$20.1 billion, and total tax-supported debt at about \$34.5 billion, including debt issued by state authorities and supported by the statewide sales tax and authority debt supported by state contract assistance payments. The state reports it had \$20.8 billion of GO debt outstanding as of May 31, 2015. By most measures, we believe Massachusetts' debt burden remains high compared with that of other states. Debt per capita was high, in our view, at \$5,121 at fiscal year-end 2014 and 8.7% 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. Massachusetts' 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 a 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. An updated capital plan is expected to be released July 1. 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 \$28.8 billion as of fiscal year-end 2014, or \$4,276 per capita, were high, although the state continues to fully fund its actuarial annual required contribution. In our opinion, Massachusetts' unfunded OPEB is also moderately high at \$15.2 billion as of Jan. 1, 2014, net of \$511.2 million of actuarial assets in an OPEB trust fund. The state intends to make future payments to the OPEB trust fund with 5% of excess capital gains taxes distributed to the BSF (\$2 million in fiscal 2014), and a portion of tobacco settlement money that increase 10% increments each year. In fiscal 2015, 30% of tobacco settlement money, or approximately \$74 million, is expected to be contributed to the OPEB trust fund, and \$85 million next year. The mid-2015 budget gap-closing measures implemented or proposed by both the previous and current governors do not include any reduction in budgeted OPEB pre-funding from tobacco settlement money.

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's GO debt, please refer to our full analysis published April 16, 2015, on RatingsDirect.)

## Outlook

The stable outlook reflects our expectation that Massachusetts will continue to manage its budget proactively so as to preserve near-structural budget balance and preserve the size of its large BSF. We believe the BSF provides significant flexibility to manage future fiscal challenges over our two-year outlook horizon. Despite small declines in the BSF in 2014 and 2015, we believe the BSF balance will remain sizable and the governor's budget proposal for fiscal 2016 does not include any further draw down (though certain capital gains tax receipts that would otherwise flow into the BSF would be diverted to the general fund). The current administration has indicated a desire to add to the BSF in subsequent years if the economic expansion continues. However, if there were a sharp decline in reserves, or debt and liabilities were to increase sharply, this could pressure the rating. The large level of long-term liabilities, which we do not see as changing significantly in the near future, currently constrains 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
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007
- USPF Criteria: Moral Obligation Bonds, June 27, 2006
- Criteria: Methodology And Assumptions: Approach To Evaluating Letter Of Credit-Supported Debt, Feb. 20, 2015

- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- USPF Criteria: Standby Bond Purchase Agreement Automatic Termination Events, April 11, 2008
- Criteria: Joint Support Criteria Update, April 22, 2009
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Methodology Applied To Bank Branch-Supported Transactions, Oct. 14, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

U.S. State And Local Government Credit Conditions Forecast, April 2, 2015

Ratings Detail (As Of June 15, 2015)		
Massachusetts GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts cons loan 2014 (Massdirect Nts) ser 10-15 due 12/01/2024		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts cons loan 2015 (Massdirect Nts) ser 1-10 due 07/01/2025		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts direct purchase GO rfdg bnds (VRDB) ser 2001B due 01/01/2021		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts CP A		
<i>Short Term Rating</i>	A-1+	Affirmed
Massachusetts CP B		
<i>Short Term Rating</i>	A-1+	Affirmed
Massachusetts GO bnds cons loan ser 2014 F due 11/01/2031		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts GO bnds cons loan (Green Bnds) ser 2014 E due 09/01/2032		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts GO rfdg bnds var rate dem bnds ser B dtd 02/20/2001 rmktd dtd 02/03/2012 due 01/01/2021		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts GO rfdg bnds (SIFMA Index Bnds) ser 2014D due 02/01/2016		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts GO VRDBs - C		
<i>Long Term Rating</i>	AA+/A-1+/Stable	Affirmed
Massachusetts GO VRDBs 1997B		
<i>Long Term Rating</i>	AA+/A-1+/Stable	Affirmed
Massachusetts GO VRDBs 2000A		
<i>Long Term Rating</i>	AA+/A-1/Stable	Affirmed
Massachusetts GO VRDBs 2000B		
<i>Long Term Rating</i>	AA+/A-1/Stable	Affirmed
Massachusetts GO VRDBs 2006A		
<i>Long Term Rating</i>	AA+/A-1+/Stable	Affirmed

<b>Ratings Detail (As Of June 15, 2015) (cont.)</b>		
Massachusetts GO bonds, cons loan (Massdirect Notes) ser 2014 1-10 due 08/01/2024		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts GO (wrap of insured) (ASSURED GTY & AMBAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (wrap of insured) (FGIC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (AGM) (SEC MKT)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (FGIC)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (MBIA) (Assured Gty)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<b>Massachusetts GO</b>		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) transp VRDO ser 2000A-2		
<i>Long Term Rating</i>	AA+/A-1/Stable	Affirmed
Massachusetts Bay Transp Auth (Massachusetts) var rate gen transp sys bnds 2000A-1 & A-2 ser dtd 03/09/2000 RMKTD dtd 09/30/2011 due 03/01/2030		
<i>Long Term Rating</i>	AA+/A-2/Stable	Downgraded, Removed from CreditWatch
Massachusetts Bay Transp Auth (Massachusetts) GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts Bay Transp Auth (Massachusetts) GO (AGM)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<b>Massachusetts Bay Transp Auth transp sys bnds (Massachusetts)</b>		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<b>Massachusetts Bay Transp Auth (Massachusetts)</b>		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
<b>Massachusetts Dept of Transp, Massachusetts</b>		
Massachusetts		
Massachusetts Dept of Transp metro hwy sys bnds (Subordinated) ser 2010 A-4/A due 05/16/2033		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts Dept of Transp (Massachusetts) metro hwy sys rev bnds (subord) VRDO ser 2010A-3		
<i>Long Term Rating</i>	AAA/A-1	Affirmed
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Massachusetts Dept of Transp (Massachusetts) metro hwy sys rev bnds (subord) VRDO ser 2010A-6		
<i>Long Term Rating</i>	AA+/A-1/Stable	Affirmed

<b>Ratings Detail (As Of June 15, 2015) (cont.)</b>		
<i>Unenhanced Rating</i>	NR(SPUR)	Withdrawn
Massachusetts Dept of Transp (Massachusetts) GO VRDO 2010A-1		
<i>Long Term Rating</i>	AA+/A-1+/Stable	Affirmed
Massachusetts Dept of Transp (Massachusetts) GO VRDO 2010A-2 A-7		
<i>Long Term Rating</i>	AA+/A-1/Stable	Affirmed
Massachusetts Dept of Transp (Massachusetts) GO VRDO 2010B		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Massachusetts Dept of Transp (Massachusetts) VRDBs 2010A-7		
<i>Long Term Rating</i>	AA+/A-1+/Stable	Affirmed
<b>Massachusetts Development Finance Agency, Massachusetts</b>		
Massachusetts		
Massachusetts Dev Fin Agy (Massachusetts) GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<b>Univ of Massachusetts Bldg Auth, Massachusetts</b>		
Massachusetts		
University of Massachusetts Bldg Auth (Massachusetts) rfdg rev bnds (Massachusetts) sr ser 2011-2		
<i>Long Term Rating</i>	AA+/A-1+/Stable	Affirmed
University of Massachusetts Bldg Auth (Massachusetts) GO		
<i>Long Term Rating</i>	AA+/A-2/Stable	Downgraded, Removed from CreditWatch
University of Massachusetts Bldg Auth (Massachusetts) GO (MBIA) (National)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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