

RatingsDirect®

Massachusetts; General Obligation

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US\$200.0 mil GO bnds cons loan (Federally Taxable) ser 2014 B due 05/01/2024

Long Term Rating AA+/Stable New

Massachusetts GO

Long Term Rating AA+/Stable Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating, and stable outlook, to Massachusetts' \$200 million general obligation (GO) bonds consolidated loan of 2014. In addition, Standard & Poor's affirmed its 'AA+' rating on the commonwealth's existing parity debt. The outlook is stable.

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.

Total GO debt outstanding at April 30, 2014 was about \$19 billion, and total tax-supported debt is about \$30 billion, including debt issued by state authorities and supported by the statewide sales tax, as well as contract assistance debt. By most measures, Massachusetts' debt burden remains high compared with that of other states. The variable-rate portfolio is 19%, is actively managed by the commonwealth, and is governed by a formal policy. In the past several years, the overall portfolio of variable-rate debt has diversified, and put risk has been significantly reduced in our opinion. Debt per capita is high, in our view, at \$4,792 and 8.6% of personal income. Planned debt issuance for fiscal 2014 was originally \$2.8 billion (GO and special obligation) but has been lowered by \$500 million due to slower-than-projected capital spending. Planned issuance remains within the parameters of the commonwealth's debt affordability policy and bond cap; debt service is below 8% of budgeted revenues. While a debt affordability analysis had been done within the department of administration and finance, legislation was introduced in 2012 that created a capital and debt affordability committee. The 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' economy has experienced steady recovery, outpacing national and regional trends by most measures. The unemployment rate through April 2014 declined to 6%. The rate decline was due in part to a slight reduction in the labor force participation rate, but overall employment and labor force growth for the state is positive relative to last year. The unemployment rate, at 6.9%, in 2013 was below national levels of 7.4%. Employment growth has been strong relative to other states throughout the recovery, and as of 2013, the commonwealth had regained its pre-recession employment peak according to the Bureau of Labor Statistics. 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 other states, with per capita personal income now ranked second in the U.S. behind Connecticut in 2012, 28% above the U.S. average.

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.

Outlook

The stable outlook reflects our expectation that Massachusetts will continue to proactively manage its budget. Management initiatives to formalize long-term financial planning and to manage long-term debt and liabilities should allow for favorable structural alignment of the budget in the future. The BSF provides significant flexibility to manage future fiscal challenges over our two year outlook horizon, in our view. Despite steady economic expansion, the BSF has been reduced through fiscal 2014 and will likely diminish again in fiscal 2015, which could offset future flexibility to manage budget volatility.

Financial And Budget Update

The commonwealth continues its strong budgetary performance. Revenue is expanding at a relatively healthy pace, and reserves remain strong in our view despite some planned reduction in fiscal 2014 and 2015 based on Governor Deval Patrick's proposed budget. The revenue forecast was increased in January to \$23.2 billion from \$22.8 billion, a 1.8% increase above the original estimate and 4.9% above fiscal 2013 collections. Revenues through April are slightly above the revised forecast by \$121 million. Performance had been stronger, but March and April income tax receipts were below forecast. As with many states, returns and refunds have been affected by federal tax policy changes. Despite weaker-than-forecasted performance in recent months, the revenue estimate for fiscal 2014 is unchanged. The BSF at year end is estimated at \$1.4 billion (3.9% of expenditures), down slightly from fiscal 2013 but less of a reduction than originally budgeted.

On Jan. 14, the commonwealth released its consensus revenue estimate for fiscal 2015. We believe the consensus estimate of \$24.3 billion (4.9% above the revised estimate for fiscal 2013) is reasonable and aligned with the current pace of economic growth. After \$3.4 billion of transfers for pension funding, dedicated sales tax revenue, and capital gains that exceed the statutory threshold and would be deposited to the BSF (\$122 million), there would be \$20.8 billion in tax revenue available to fund the fiscal 2015 budget.

The governor released his budget proposal on Jan. 22. The proposal includes tax and revenue changes we view as minor and that are projected to yield \$141 million, as well as a change in the treatment of one-time settlements that would provide \$204 million of revenue. The level of nonrecurring resources to balance the budget also declines to \$334 million compared with \$667 million in fiscal 2013 which improves structural alignment in our view. The use of BSF resources is also projected to decline to \$175 million. Prior to the budget release, an updated pension funding schedule was agreed on by the governor and legislature, representing a \$163 million increase over fiscal 2014 and \$65 million more than would have been contributed under the previous schedule. The schedule is based on the lower investment return assumption of 8% compared with 8.25%. Contribution increases of 10% are planned over the next three fiscal years with 7% increases thereafter until full funding in 2036.

Total spending under the proposed budget is \$38.2 billion (including pensions), 5.1% above fiscal 2014, and is generally aligned with recurring revenue growth. Major areas of spending increase include pensions (\$163 million), education (\$137 million increase for early education and K-12 funding; \$68 million for higher education) and transportation (\$141 million). The budget continues implementation of Medicaid expansion under the Affordable Care Act, but the commonwealth expects federal resources and other cost-control initiatives to offset the cost of expansion.

The Massachusetts House of Representatives approved its version of the fiscal 2015 budget, which recommends a similar level of spending (\$36.3 billion) and a slightly lower withdrawal from the BSF (\$140 million). Following the release of the Senate budget, the legislative conference committee will reconcile the various budget proposals, a process which should conclude by the end of the fiscal year.

Pension And OPEB update

The most recent actuarial valuation of the combined pension indicates weaker funded ratios through Jan. 1, 2013. The aggregate funded ratio declined to 60.6% from 65.1% on Jan. 1, 2011 and far below the 78.6% funded ratio recorded in 2008. The unfunded actuarial liability increased to \$28.3 billion from \$23.6 billion in 2012. The commonwealth attributes the lower funded ratio to recognition of prior-year investment losses and certain adjustments to actuarial assumptions, including mortality rates and investment return assumptions (lowered to 8.00% from 8.25% based on experience study). The funded ratio remains below the average funded ratio for other U.S. states. We expect improvement as this is the final year to recognize the 2008 investment losses, which were significant at 23.9%. Massachusetts also has a \$15.4 billion unfunded actuarial accrued OPEB liability, which we consider sizable, but we note the decline from \$16.3 billion recorded in 2012 as various reform measures are phased in. The commonwealth established a trust fund to begin to accumulate assets toward the liability and is dedicating tobacco settlement revenues to the trust fund (to be phased in over 10 years) to provide a permanent funding source, which we consider a credit positive. The trust had assets of \$406.7 million as of Jan. 1, 2013.

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, April 7, 2014

Ratings Detail (As Of May 15, 2014)		
Massachusetts GO rfdg bnds (SIFMA index bnds) ser 2014A due 02/01/2015		
<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
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 & BHAC) (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
Massachusetts GO		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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