STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Massachusetts; General Obligation

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

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

Table Of Contents

Massachusetts; General Obligation

Credit Profile		
US$450.0 mil GO bnds cons loan of 2014 ser C due 06/01/2044		
Long Term Rating	AA+/Stable	New
Massachusetts GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' rating and stable outlook to Massachusetts' $450 million general obligation (GO) bonds consolidated loan of 2014, series C.

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.

We understand that bond proceeds will be used to finance various capital projects as authorized in the capital spending plan.

Massachusetts has had variable-rate debt as part of its debt profile since 1990. The variable-rate portfolio is about 19% of total debt (4% unhedged), 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. The state treasurer's office, which is responsible for cash management/investing and borrowing for the commonwealth, recently adopted an asset/liability management program (ALM), which is part of its formal debt management policy. The policy is intended to reduce and manage interest rate risk and volatility associated with its cash balances, which have averaged $3.2 billion annually over the past 10 years, and its debt portfolio. We understand that a variable-rate bond issue is planned in July and will be the first in a series of variable-rate issues planned over the next five years to incrementally increase the level of unhedged variable-rate debt in the portfolio. Based on the current plan, the commonwealth expects to fund the remainder of the five-year capital plan with a mix of fixed rate bonds and about $775 million of unhedged variable-rate debt annually in fiscal years 2015-2018. We understand that the program will be monitored regularly and adjusted based on market or interest rate changes and subject to regular stress testing as outlined in the policy. The ALM program will be managed by an ALM committee, which includes members of the debt management staff, cash management staff in the treasurer's office and the Executive Office for Administration and Finance. We note that staff in the treasurer's office has increased in the past several years to handle the diversifying debt profile, disclosure, and outreach.

While we believe that additional variable-rate debt could lower debt service costs and achieve ALM goals for the commonwealth, it could also add risk to the overall debt profile in terms of investor demand and market changes over time. We believe active management of the debt program, regular monitoring, and a flexible policy will be important considerations from a credit standpoint.

Total GO debt outstanding at May 31, 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. 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 May 2014 declined to 5.6%, with continued strong growth in private-sector employment. 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

Massachusetts continues its strong budgetary performance, in our opinion. Revenue is expanding at a relatively healthy pace, and we believe reserves remain strong despite some planned reduction in fiscal years 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. Although revenues were below forecast in March and April, they rebounded in May with revenues $62 million ahead of forecast and total revenues above the revised forecast by $183 million. As with many states, Massachusetts' returns and refunds were affected by federal tax policy changes but the decline in March and April was modest relative to other states. 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 this 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 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. Before 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 8.00% 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 kindergarten to grade 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). The Senate has released its version of the budget, which includes a similar amount of spending and BSF drawdown. The legislative conference committee is expected to reconcile the various budget proposals 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 was 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. Massachusetts 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 an 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 in our view 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 June 24, 2014)		
Massachusetts GO rfdg bnds (SIFMA index bnds) ser 2014A due 02/01/2015		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts GO VRDBs - C		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Massachusetts GO VRDBs 1997B		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Massachusetts GO VRDBs 2000A		
Long Term Rating	AA+/A-1/Stable	Affirmed
Massachusetts GO VRDBs 2000B		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Massachusetts GO VRDBs 2006A		
Long Term Rating	AA+/A-1+/Stable	Affirmed

Ratings Detail (As Of June 24, 2014) (cont.)		
Massachusetts GO bonds, cons loan (Massdirect Notes) ser 2014 1-10 due 08/01/2024		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts GO (wrap of insured) (ASSURED GTY & AMBAC) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (FGIC)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts GO (MBIA) (Assured Gty)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Massachusetts GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.