Moody's Investors Service

New Issue: **MOODY'S ASSIGNS MIG 1 RATING TO MASSACHUSETTS GO REVENUE ANTICIPATION NOTES 2009 SERIES A ($350M), 2009 SERIES B ($425 M), AND 2009 SERIES C ($425 M)**

Global Credit Research - 11 Sep 2009

MOODY'S AFFIRMS Aa2 LONG-TERM GENERAL OBLIGATION BONDS RATING WITH STABLE OUTLOOK

State
MA

Moody's Rating

ISSUE		RATING
Revenue Anticipation Notes Series A		MIG 1
Sale Amount	$350,000,000	
Expected Sale Date	09/15/09	
Rating Description	Revenue Anticipation Notes	
Revenue Anticipation Notes Series B		MIG 1
Sale Amount	$425,000,000	
Expected Sale Date	09/15/09	
Rating Description	Revenue Anticipation Notes	
Revenue Anticipation Notes, Series C		MIG 1
Sale Amount	$425,000,000	
Expected Sale Date	09/15/09	
Rating Description	Revenue Anticipation Notes	

Opinion

NEW YORK, Sep 11, 2009 -- Moody's Investors service has assigned MIG 1 ratings to the Commonwealth of Massachusetts' $350 million General Obligation Revenue Anticipation Notes 2009 Series A, $425 million General Obligation Revenue Anticipation Notes 2009 Series B, and $425 million General Obligation Revenue Anticipation Notes 2009 Series C which the commonwealth plans to sell on September 15. In addition, Moody's has affirmed the Aa2 rating and stable outlook on the commonwealth's general obligation bonds, outstanding in the amount of approximately $16.8 billion.

The notes are secured by a general obligation pledge of Massachusetts and proceeds will be used to meet the commonwealth's cash flow needs during fiscal year 2010. The scheduled maturity dates are April 29, 2010 for the 2009 Series A notes, May 27, 2010 for the 2009 Series B notes, and June 24, 2010 for the 2009 Series C notes. The highest short-term rating reflects the Commonwealth of Massachusetts' (long-term general obligation bond rating of Aa2) full faith and credit pledge to the payment of these notes, satisfactory cash margins following note repayment, and the alternative liquidity afforded the notes by the commonwealth's budget stabilization fund. Cash flow projections are based on the adopted fiscal 2010 budget.

Long term credit strengths are:

*Effective management through period of fiscal strain during prior recession (2001-2002) and thus far in current recession

*Willingness to raise sales tax to increase recurring revenues

*Strong reserve levels going into current recession; rapid replenishment of reserves following draws during previous recession.

*Healthy revenue growth in recent years due to solid personal income tax gains that offset more modest sales tax performance.

Long term credit challenges are:

*Significant use of one-time budget solutions to close fiscal 2009 budget and enact fiscal 2010 budget reduce financial flexibility in the event of deeper and/or longer recession

*Rising healthcare costs related to Medicaid, pensions, healthcare reform as well as OPEB add to budget pressures.

*Commonwealth's employment levels were already below 2001 peak levels going into current period of economic declines

*Debt ratios are among highest in the nation and likely to rise if commonwealth lends credit support to transportation related entities under newly established Massachusetts Department of Transportation

SATISFACTORY CASH MARGINS; GENERAL OBLIGATION PLEDGE

Massachusetts plans to issue a total of $1.2 billion in general obligation revenue anticipation notes (RANs) to meet seasonal cash flow needs in fiscal year 2010 driven largely by quarterly aid payments totaling approximately $1 billion to localities, which are due to be made before the end of September, December, March, and June. While the amount is a significant increase over last year's cash flow borrowing, it is intended to cover all of the commonwealth's cash flow needs for the fiscal year. In fiscal 2009, the commonwealth issued $750 million in RANs and also accessed its commercial paper program for liquidity needs. The commonwealth will continue to maintain a general obligation commercial paper program consisting of five $200 million lines of credit for additional liquidity support. Last month, the commonwealth placed $300 million in commercial paper to cover cash flow needs. That amount will be repaid with proceeds of the revenue anticipation notes and cash flows do not include further use of the commercial paper program for the remainder of the fiscal year. As a result, planned total short-term borrowing for cash flow purposes is less than fiscal year 2009 although the commercial paper program remains available as needed for liquidity. All short-term borrowings must be repaid by the end of the fiscal year (June 30).

Massachusetts' non-segregated operating cash margins are projected to be satisfactory at the end of the fiscal year following repayment of the three series of revenue anticipation notes. At approximately $1.16 billion, the projected ending cash balance provides a good margin of protection. The projected ending cash balance is substantially higher than the fiscal 2009 year end cash balance of $805 million in part due to the receipt of federal stimulus funds that are incorporated in the cash flows. On July 1, the commonwealth received a payment of $412 million that had originally been expected in fiscal 2009. The ending cash balance for fiscal 2009 was slightly higher than the original forecast of $785 million and the 2009 revenue notes were repaid on the scheduled maturity date.

The fiscal 2010 cash flows incorporate the budgeted draw of $199 million on the commonwealth's Budget Stabilization Fund (BSF), leaving a projected yearend balance of $571 million. While considerably lower than the balance of $2.2 billion at the end of fiscal year 2008, the amount provides the commonwealth with additional financial flexibility although any unbudgeted draw is subject to appropriation. The BSF is a highly liquid segregated component of the Massachusetts Municipal Depository Trust, the commonwealth's cash and short-term bond fund. The commonwealth made substantial draws on the BSF following the 2001 recession but more than rebuilt the fund with subsequent budget surpluses that followed until the current recession.

CASH FLOWS REFLECT ENACTED FY2010 BUDGET THAT CLOSED SIZEABLE $5 BILLION GAP; SALES TAX RATE INCREASE ADDS TO RECURRING REVENUES

Tax revenues have been hurt by the economic downturn in the commonwealth, as they have been in nearly every other state. Moody's assigned a negative outlook to the U.S. state sector in February 2008 and affirmed that outlook in February 2009. Due to the rapid deterioration in tax revenue performance, the commonwealth took the unusual step of preparing a special consensus forecast in May, outside the normal January and October consensus forecast process. As a result of the lower tax revenue forecast, Massachusetts faced a substantial budget shortfall of $5 billion for fiscal 2010, up from $3.5 billion earlier in the year. The gap reflected a significant falloff in the revenue forecast to a level that could not support current service expenses. The state also addressed a shortfall of nearly $1 billion at the end of fiscal 2009, stemming largely from significant personal income tax underperformance that emerged in the last quarter of the fiscal year.

The cumulative budget gap for fiscal 2009 was at least $3.6 billion which represented a sizeable 15% of total operating revenues, excluding federal aid. The commonwealth took actions, largely on the spending side, to close a $1.4 billion gap a year ago. The gap-closing plan also incorporated $100 million in savings from a pension funding deferral, a budget balancing action the commonwealth has resorted to in the past, as well as one-time money from a $200 million transfer from the BSF. Actions to close the remaining gap by the end of fiscal year 2009 relied heavily on one-time measures. These included additional draws on the BSF for a total of $1.39 billion for the year as well as approximately $1.3 billion in federal stimulus funds. Combined, one-time solutions account for about 62% of the fiscal 2009 gap-closing plan. According to the latest estimates, the commonwealth expects to end fiscal 2009 with approximately $766 million in the BSF, down significantly from $2.1 billion the prior year.

The enacted fiscal 2010 budget closed a budget gap of approximately $5 billion, $1.5 billion more than the gap that was estimated at the time of the governor's proposed plan early in calendar year 2009. The larger shortfall reflected the significant revenue falloff that the commonwealth experienced in the last quarter of fiscal 2009. The revised tax revenue forecast for fiscal 2010 was 1.5% below the fiscal 2009 revised amount. However, a substantial sales tax increase (from 5% to 6.25%) was approved, thereby adding $759 million to the tax revenue estimate for fiscal 2010. Of this amount, $275 million is dedicated to transportation. The total estimate of net new taxes is approximately $1 billion reflecting the higher sales tax rate, the elimination of certain sales tax exemptions, a new tax on direct broadcast satellite service, tax law changes, and the addition of auditors. As a result, total tax revenues are projected at $18,879 million, 3.4% above the revised fiscal 2009 tax revenue forecast of $18,259 million.

Additional budget solutions for fiscal 2010 include federal stimulus funds and the use of approximately $200 million in BSF reserves. Following the 2001 recession, the commonwealth's BSF declined 59% from a peak of $1.7 billion at the end of fiscal 2001 to $641 million at fiscal year end 2003. After three consecutive years of draws, the balance in the BSF is currently projected at $571 million for fiscal year-end 2010, about 75% lower than the $2.3 billion pre-recession peak at the end of fiscal 2007. At approximately 3% of forecast tax revenues, this level of reserve provides some financial flexibility in the event of further revenue deterioration if the economic recovery is delayed.

PLAN APPROVED TO REPLACE MASSACHUSETTS TURNPIKE AUTHORITY

The commonwealth recently approved a plan to create a new transportation organization, the Massachusetts Department of Transportation (MassDOT). Effective November 1, 2009, MassDOT will oversee four divisions including: the highway systems, transit, aeronautics, and the registry of motor vehicles. The new reporting structure is expected to result in greater efficiencies and increased transparency. Details will be worked out over the coming months. The reorganization may add to the commonwealth's already sizeable debt burden.

DEEPER AND MORE PROLONGED ECONOMIC WEAKNESS LEADING TO REVENUE DETERIORATION WOULD EXACERBATE CHALLENGES

With the national economy now in a major recession, Massachusetts is not alone in facing sharply lower revenue forecasts. However, because Massachusetts is a high-wealth state, fluctuations in personal incomes have a substantial impact on tax receipts. Personal income tax collections make up about 40% of the commonwealth's operating resources. Even with the evident tax revenue recovery in recent years, it took the commonwealth five years for personal income tax receipts to surpass the peak levels of fiscal 2001, underscoring the magnitude of the last recession's impact on financial operations. Downward pressure on revenues was particularly harsh in fiscal 2002, when total tax receipts fell nearly 15%, driven by a 20% drop in personal income tax receipts primarily related to capital gains affected by the stock market decline.

If the economic downturn is more severe or prolonged, the commonwealth's revenue estimates may need to be revised downward even further. As in many states, Massachusetts saw a sharp drop in tax revenues in April. The housing downturn began earlier in Massachusetts than in other parts of the country, with negative effects showing up in weak sales tax performance due to reduced draws on home equity as housing values fell. As in other high-wealth states, Massachusetts remains vulnerable to potential stock market fluctuations that could further erode the capital gains portion of its personal income tax results.

ECONOMY IN RECESSION AND HOUSING MARKET WEAKNESS CONTINUES

Massachusetts was among the states hardest hit by the 2001 recession in terms of jobs lost on a percentage basis. At the end of 2008, total non-farm employment was still down from the prior peak by approximately 54,000 jobs, based on annual averages for each year. Job losses have accelerated since the beginning of calendar year 2009 and were down 3.3% year-over-year in July. The commonwealth's unemployment rate of 8.8% in July 2009 remained below the national level of 9.4% the same month. The largest declining sectors in Massachusetts were construction, financial, trade, and manufacturing, which has been shedding jobs since 2000. The educational and health services sector is the only one that has maintained some upward momentum this year although government employment is modestly positive. However, these slim job gains are not enough to offset employment losses in other sectors. In the near term, the commonwealth's economy may be constrained by low housing affordability and negative migration trends. Continuing weakness in the financial markets leading to significant job losses in that sector will likely add strain to the commonwealth's economy.

HEAVY TAX-SUPPORTED DEBT LOAD; DEBT AFFORDABILITY STUDY SHOULD AID CAPITAL PLANNING

The commonwealth has a heavy debt load, with about $16 billion in outstanding general obligation bonds and $29 billion in total net tax-supported debt. The state's debt levels ranked second highest among the 50 states, on a per-capita basis and as a percentage of personal income as reflected in Moody's 2009 State Debt Medians Report. Total net tax-supported debt amounted to 8.9% of total personal income in 2009, over three times the 50-state median of 2.5%. The commonwealth's net tax-supported debt per capita was $4,323, about five times the 50-state median of $865 in 2009. As of December 2008, approximately $4 billion (25%) of the commonwealth's general obligation debt was variable rate, the majority of which is synthetically fixed by cost-of-funds swaps. $2.4 billion of the commonwealth's variable rate demand bonds are supported by standby liquidity facilities, and none of these bonds is insured.

Debt burden increased in recent years in part due to the costs of the central artery/tunnel project and as a result of sizeable issuances for local schools through the Massachusetts School Building Authority (MSBA). The MSBA is authorized to issue up to $10 billion in bonds secured by a dedicated portion (one cent) of the commonwealth's sales tax. Thus far, MSBA has issued almost $4 billion in bonds. With continued issuance for capital needs, the commonwealth's debt ratios are expected to remain among the highest in the country.

Massachusetts is an active participant in interest rate swaps in connection with its general obligation bond issuance, with approximately $3.5 billion synthetically fixed via swap agreements associated with general obligation debt. As of July 31, 2009, the commonwealth's swap agreements had a combined fair market value of negative $345 million, an amount it would owe if the its rating were downgraded below Baa3 and the counterparties opted to terminate the agreements. If a termination event is triggered by a counterparty downgrade or bankruptcy filing, the commonwealth has the option to terminate. The commonwealth has the option of terminating its swaps at any time, and its counterparties do not have such an option. Most of its swaps are conservatively structured on a cost-of-funds basis, which eliminates basis risk.

ANNUAL PENSION CONTRIBUTIONS ADD SUBSTANTIAL FIXED COSTS

Annual pension contributions are substantial, at $1.4 billion for fiscal 2008 and $1.46 billion for fiscal 2009. These amounts satisfy actuarially required pension contributions. The combined pension funded ratio was 79% as of January 2008 and investment losses of 29% were recently reported for 2008. Massachusetts' other post employment benefits (OPEB) liability could add substantial budget pressures in the future, as is also likely in other states. Assuming no pre-funding of costs, Massachusetts' liability is $15.6 billion. Assuming partial pre-funding, the liability declines to about $11.6 billion with an annual required contribution (ARC) of approximately $981 million. The fiscal 2008 budget created an irrevocable trust fund to begin funding the commonwealth's OPEB liability and $400 million was transferred into the fund at the end of the fiscal year. A similar transfer did not occur for the fiscal 2009 budget. The pay-as-you-go amount for OPEB was $355 million in fiscal 2008 and $377 million in fiscal 2009.

MOST RECENT RATING ACTION AND PRINCIPAL METHODOLOGY

The last rating action with respect to the Commonwealth of Massachusetts was on July 20, 2009 when the rating of Aa2 with a stable outlook was assigned to the Woods Hole, Martha's Vineyard and Nantucket

Steamship Authority Bonds 2009 Series A, reflecting the Commonwealth of Massachusetts' pledge to make debt service payments if the funds of the steamship authority are insufficient. The obligation is a general obligation and carries the full faith and credit pledge of the commonwealth.

The principal methodology used in rating these current issues was "Short-Term Cash Flow Notes" which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

Analysts

Nicole Johnson
Analyst
Public Finance Group
Moody's Investors Service

John Ceffalio
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

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

Moody's Investors Service