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Summary:
Massachusetts; General Obligation

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Table Of Contents

Summary:

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Credit Profile		
US$230.54 mil GO rfdg (Sifma Index Bnds) ser 2013 A due 02/01/2017		
Long Term Rating	AA+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating, and stable outlook, to Massachusetts' $230.54 million series 2013A general obligation (GO) refunding bonds (Securities Industry And Financial Markets Association [SIFMA] index bonds).

Factors supporting the 'AA+' rating include what we view as the commonwealth's:

- 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;
- Commitment to increasing budget stabilization fund (BSF) balances, which provide flexibility to manage budget volatility;
- High wealth and income levels; and
- Deep and diverse economy, that continues to experience steady economic recovery.

Standard & Poor's believes the commonwealth's high debt burden and significant unfunded pension and other postemployment benefit 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.

The series 2013 refunding bonds will be issued as SIFMA bonds. The refunding was originally scheduled in December 2012 but was postponed until January of this year. The SIFMA bonds have a floating-rate coupon, and will bear interest at the SIFMA rate plus or minus a certain spread determined weekly. There is no put risk and there will be staggered fixed maturities over three years with the final maturity in 2017 based on the current plan of finance. There is an existing swap in place that is tied to SIFMA so it will be a matched hedge and, therefore, basis risk will be eliminated.

The commonwealth has formalized a policy and an administrative process that outlines the rollover risk for variable-rate debt and articulates how the bond program will be managed.

Refinancing options would include the following: the issuance of new SIFMA index bonds, or variable- or fixed-rate debt; use of a portion of the commercial paper program; or use of cash or other resources. The commonwealth's goal is to maintain the amortization schedule of the original series 2005 bond issue. The bonds will be subject to redemption by Massachusetts six months before the maturity date.

About $3.5 billion (19%) of the $18.6 billion in GO debt outstanding is variable rate. All but $626 million of this amount is hedged. The variable rate portfolio 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.

Massachusetts' economy has experienced steady recovery, outpacing national and regional trends by most measures but the pace has slowed in recent months. The unemployment rate has increased slightly to 6.6% through November of 2012 after falling to 6.0% in June 2012 but still remains well below the U.S. rate of 7.8%. Employment growth has been strong relative to other states throughout the recovery. In our view, the commonwealth's economic fundamentals and key anchors, which are centered on higher education, technology, and health care, should contribute to positive economic growth prospects over time. Income growth has also been strong relative to other states with per capita personal income now ranked second in the U.S. behind Connecticut.

Financial And Budget Update

Although there has been a sustained economic and revenue recovery underway, recent growth trends have slowed and revenues have performed below forecast for much of fiscal 2013. On Dec. 4, 2012, the secretary for administration and finance (A&F) identified a tax revenue shortfall of $540 million for the year. The governor filed legislation with proposed solutions to address the shortfall including the following:

- $225 million in spending reductions across executive branch agencies;
- $20 million in personnel savings;
- $25 million in non-executive branch agencies;
- 1% across the board reductions in unrestricted local aid; and
- $200 million from the budget stabilization fund (BSF). This is in addition to the $350 million already included in the budget.

The enhanced level of the BSF following significant deposits through fiscal 2012 provides Massachusetts with significant flexibility, in our opinion, to manage midyear budget adjustments. The solutions to close the gap continue a policy focus on improving structural budget alignment, which is positive in our view given the ongoing economic and federal funding uncertainty. The BSF is now projected to be slightly lower at fiscal year-end 2013, but the $1.3 billion projected balance is 3.6% of budgeted revenues and transfers and has almost doubled since fiscal 2010 ($700 million balance). This is after accounting for one-time tax settlement funds in excess of $10 million that must be deposited. We also believe that the formal schedule for budget revisions and track record of timely adjustments have also contributed to overall budget stability over time. Although there had been no official change to the revenue forecast on Oct. 15, 2012, A&F had announced spending and hiring controls, and contingency plans were put in place to prepare for a potential downward revenue adjustment. These actions early in the fiscal year should minimize implementation risk associated with the current gap-closing proposal. Revenues through December 2012 were relatively strong compared with forecast, with a $133 million positive variance. Personal income tax receipts and corporate and business tax collections were above estimate while sales tax collections were $14 million below estimate. About $95 million of the variance is attributable to one-time settlements. We understand that there is no change to the forecast based on the December revenue results and implementation of the gap-closing plan will continue. The commonwealth will release its consensus tax revenue forecast for fiscal 2014 as well as an update of current year tax revenues on Jan. 15, 2013. (For additional information on the Commonwealth of Massachusetts, see the report released Dec. 3, 2012, and full analysis on Sept. 21, 2012, on RatingsDirect on the Global Credit Portal.)

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. We do not expect to change the rating in the two-year outlook period. While budget resources remain constrained, recent management initiatives to formalize long-term financial planning and manage long-term debt and liabilities should improve structural budget performance over time. The BSF also provides flexibility to manage future fiscal challenges in our view. Standard & Poor's will continue to monitor the federal fiscal consolidation efforts and, once these are identified, will evaluate their effect on the state's finances and officials' response to any funding or policy changes.

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Related Criteria And Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 9, 2012
- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.