STANDARD & POOR'S

PUBLIC FINANCE

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Massachusetts

Credit Profile		
US$1.2 bil GO RANs 2009 ser A-C due 04/29/2010 05/27/2010 06/24/2010		
Short Term Rating	SP-1+	New
Massachusetts GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'SP-1+' short-term rating to Massachusetts' revenue anticipation notes (RANs) 2009 series A, B, and C.

The short-term rating reflects what we view as:

- The general creditworthiness of Massachusetts ('AA' general obligation [GO] rating); and
- Strong note debt service coverage.

The notes are general obligations of the commonwealth, secured by the Massachusetts' full faith and credit pledge.

The notes are being issued to meet cash flow requirements for fiscal 2010. The size of the RAN issuance is higher than the fiscal 2009 RAN borrowing of $750 million, even though the commonwealth's beginning cash position is higher and its current projection of the ending cash balance is also higher for fiscal 2010. We believe the increased RAN borrowing will provide enhanced flexibility to manage any potential revenue volatility in the fiscal year and offset the lower stabilization fund balances that have been available in the past to manage cash flow when authorized by the legislature. Currently, there is legislation under consideration that would allow the stabilization balance to be used to manage cash flow during the year without approval of the legislature. In addition to the RANs, the state has a $1 billion commercial paper program to further manage its cash flow. The series A, B, and C notes will mature on April 29, May 27, and June 24, 2010, respectively. Note coverage at each maturity date is strong in our view at 5.9x, 4.8x, and 3.7x, respectively. To meet cash flow requirements, $300 million of commercial paper was issued in August but will be repaid in September according to the state's current cash flow. The current cash flow forecast is based on the enacted budget and current revenue forecast. This RAN issue represents only 3.8% of total budgeted revenue. On Oct. 15, 2009, the secretary of administration and finance is required by statute to certify fiscal 2009 revenues and make adjustments if necessary. The commonwealth has an estimated $766 million in its stabilization fund, which is not included in the cash flows.

The 'AA' GO rating on the commonwealth reflects our view of its:

- Strong and conservative budget management practices, with swift action to restore balance after identifying shortfalls in tax revenues for the current fiscal year;
- Continued healthy reserve levels despite some planned reductions in the current fiscal year, which in our opinion provide flexibility to manage through the current economic climate;
- High wealth and income levels; and
- Deep and diverse economy, which has experienced weakness in the past year in line with national trends.

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 its total postretirement liabilities as relatively high, we believe the state has been actively managing the liabilities.

Massachusetts' financial position through fiscal 2008 was strong in our opinion, with good reserves. The stabilization balance (on a statutory basis) was $2.25 billion in fiscal 2008 (7.1% of budgeted revenues and other sources). This reserve has provided the state with the flexibility to manage the current budget volatility. We view the consistent funding of this reserve as important, given Massachusetts' dependence on personal income (and related capital gains) taxes, which have been cyclical over time.

In line with most other states, Massachusetts adjusted its revenue forecast several times throughout fiscal 2009. Tax collections for fiscal 2009 are estimated to be $18.3 billion, or $2.6 billion (12.5%) below fiscal 2008 levels and well below the original forecast. The commonwealth estimates that a majority of the decline ($1.4 billion-$1.6 billion) was due to personal income tax receipts that fell sharply in the second half of the fiscal year. Sales tax revenues were down $218 million or 5.3% from 2008, and corporate taxes were down $450 million or 18% below 2008. To restore balance, the commonwealth identified $1.3 billion of spending reductions, $236 million of revenue enhancements, federal recovery aid, and a drawdown of the budget stabilization reserve by about $1.4 billion. The original budget had assumed a $401 million drawdown of the rainy-day fund. With the additional use in fiscal 2009, the commonwealth projects the stabilization fund balance to be about $766 million at fiscal year-end 2009, or 2.4% of projected fiscal 2010 revenues. Due to the steady deterioration in revenues through June of 2009, the consensus revenue forecast for fiscal 2010 was revised downward and the enacted budget addressed a sizable budget gap through a mix of revenue enhancement, spending reductions, use of federal stimulus, and other reserve funds. The enacted budget includes about $1 billion of revenue enhancements. The most significant revenue measure increased the state sales tax rate to 6.25% from the current rate of 5.00%. Total spending in the enacted budget is $30.5 billion or negative 0.6% below fiscal 2009 estimated spending. Despite spending reductions in a range of program areas, there is a $372 million appropriation to the state retiree benefit trust fund, which is the third consecutive year of funding for the trust for a total of $1.1 billion. In conjunction with the fiscal 2010 budget and sales tax increase, the commonwealth addressed statewide transportation funding issues with $275 million of the sales tax increased dedicated to transportation. These resources were partially aimed at improving the credit profile of the Massachusetts Turnpike Authority (MTA), which faced significant termination costs associated with swap agreements outstanding (see MTA full analysis published July 27, 2009, on RatingsDirect). About $928 million of the MTA’s subordinated debt will be supported by contract assistance payments of the state.

By most measures, Massachusetts’ debt burden remains high relative to that of other states. The commonwealth has about $16 billion of GO debt. Of this amount, 78% is fixed rate while $3.5 billion (22%) is variable rate, and $3.3 billion of this amount is hedged with interest-rate swaps. Massachusetts has a range of other debt obligations outstanding, including those supported by the statewide sales tax, contract assistance debt, and debt subject to annual appropriation. On a budgetary basis, debt service was 6.8% of expenditures in fiscal 2009. The commonwealth’s capital investment plan through 2013 totals $14.3 billion, with $8.9 billion of bond issuance projected. This plan adheres to a debt affordability model and an annual bond cap but represents a significant increase of authorized unissued debt in our view. We understand that the commonwealth expects to update this in the next month based on revised revenues and changes related to the MTA.

Standard & Poor’s maintains a “strong” Financial Management Assessment (FMA) score for Massachusetts. A strong FMA indicates that practices are strong, well embedded, and likely sustainable. Many of the commonwealth’s management practices related to debt and financial management are embedded in statute.

We view the state’s economy as deep and diverse. Expansion in the higher education, health care, financial, and service sectors has offset declines over time in manufacturing. Demographic trends have been stable in our opinion, with 2008 population estimated at 6.5 million, 2.1% above 2000 levels. Unemployment increased to 8.2% through May 2009, which is well above 2008’s 5.3% but below the national level of 9.4%. Income levels are well above average in our opinion, with personal income 128% above national levels in 2008.

Related Research

- USPF Criteria: “GO Debt,” Oct. 12, 2006
- USPF Criteria: “Short-Term Debt,” June 15, 2007