STANDARD & POOR'S
RATINGS SERVICES

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Massachusetts; General Obligation

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Massachusetts; General Obligation

Credit Profile		
US$400.0 mil GO cons loan of 2012 ser C due 10/01/2042		
Long Term Rating	AA+/Stable	New
Massachusetts GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating to Massachusetts' $400 million general obligation (GO) bonds, consolidated loan of 2012, series C. In addition, Standard & Poor's affirmed its 'AA+' rating on existing parity debt. The outlook is stable.

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 any 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 (OPEB) liabilities are offsetting considerations to the current rating. While we view its total postretirement liabilities as relatively high, we believe Massachusetts has been actively managing these liabilities with a focus on cost control and reform in recent years.

Massachusetts' economy has experienced steady recovery, outpacing national and regional trends by most measures. The unemployment rate was 6.3% in August, which is up slightly from 6.0% in June. In recent months, the unemployment rate has been almost 2% below the national average, and 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., and behind Connecticut.

Economic recovery has translated to strong financial performance in the past two fiscal years. There has been a policy focus on increasing the BSF and improving structural budget alignment, which enhances overall financial flexibility in our view. The BSF is projected to be slightly lower at fiscal year-end 2013, but the $1.3 billion is 3.7% of budgeted revenues and has almost doubled since fiscal 2010. The formal schedule for budget revisions and track record of timely adjustments have also contributed to overall budget stability over time.

By most measures, Massachusetts' debt burden remains high compared with that of other states. The commonwealth has about $18.3 billion of GO debt outstanding. It 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 an affordable 6.7% of expenditures in fiscal 2012. The capital investment plan through 2016 is lower than the previous plan but remains sizable at $17.4 billion. Planned debt issuance, ranging from $1.9 billion in fiscal 2012 to up to $2.25 billion in fiscal 2016, is within the parameters of the debt affordability policy; debt service is below 8% of budgeted revenues. The most recent actuarial valuation of the combined pension indicates improved funded ratios through Jan. 1, 2011. The funded ratio improved to 71.1% from 67.0% on Jan. 1, 2010. The unfunded actuarial liability is $18.6 billion, down from $20.0 billion in 2010. The improved funded ratio was largely due to higher assets reflecting investment performance. The funded ratio remains below average relative to funded ratios for other U.S. states. An updated report that was released for the Massachusetts State Employees Retirement System (MSERS) shows a fairly significant decline in the funded ratio for that plan as of Jan. 1, 2012, of 73.8% compared with 81.0% in 2011. The commonwealth attributes the decline to prior year investment performance. The MSERS report includes a recommendation to lower the investment return assumption to 8.00% from 8.25%. We expect that recent pension reform efforts could lower liabilities over time. Massachusetts also has a $16.6 billion unfunded actuarial OPEB liability, which we consider sizable. The commonwealth has 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 is a credit positive.

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 stemming from the Budget Control Act of 2011 and, once these are identified, will evaluate their effect on the state's finances and officials' response to any funding or policy changes.

Government Framework

State finance law requires that the governor submit a balanced budget and the House and Senate each produce a balanced budget. The final general appropriation act must also be balanced. If a revenue shortfall is identified, the governor is required by section 9C of Chapter 29 to reduce agency appropriations or recommend a transfer from the BSF. Massachusetts has autonomy to raise taxes and has adjusted its tax structure over time. Medicaid accounts for about one-third of total spending while direct local aid for about 15% of spending. Funding levels for major program areas have been adjusted as needed. Massachusetts voters have approved revenue growth limitations but these have not negatively affected operations or limited flexibility in our view. More significant measures to reduce or eliminate major tax sources have been on the ballot but not approved. We note that the state legislature could amend various measures before they take effect. The commonwealth is authorized to issue GO debt, special obligation debt, and federal grant anticipation notes. There is a statutory limit on debt outstanding and a statutory limitation on debt service appropriations set at 10%. These limitations have not impaired flexibility to manage capital and infrastructure requirements. There is not a statutory priority for funding debt but we understand that the comptroller and other state officials have developed procedures to prioritize payments and debt service is given the highest priority among various payment obligations. Funding for education and municipal assistance is provided. While municipal assistance payments have been reduced over time, funding reductions for education have been limited.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.5' to the commonwealth's governmental framework.

Budget Performance

Massachusetts' revenue base is diverse, in our view, with income tax (56% of total), sales tax (23%), and corporate tax (9%) comprising the primary tax revenues based on fiscal 2012 estimates. Spending is heavily weighted toward Medicaid, which accounts for about one-third of total spending, while other health and human service spending accounts for another 15% of budgeted expenditures. Local aid is the other significant program area representing about 16% of total spending. Debt and postemployment costs are what we consider a significant 12.6% of spending but have been steady over time. While Massachusetts experienced revenue decline throughout the Great Recession, it made adjustments frequently and included many structural solutions as part of the overall budget balance strategy. In addition to revenue enhancement, we view the expenditure reductions and cost-control measures over the past several years as significant given what we see as high service levels in areas that are usually less flexible such as Medicaid.

Fiscal 2013

The enacted budget for fiscal 2013 was approved by the governor on July 8, 2012, with an interim budget in place to start the year. We believe the consensus tax revenue estimate of $21.95 billion is reasonable and aligned with the current pace of economic growth (4.5%). Collections for July and August were slightly below estimate and last year's collections, but these are not significant revenue collection months. The forecast will be officially reviewed in October based on updated economic information and year-to-date results. We believe the risks to the fiscal 2013 forecast are related to broader macro-economic performance and any federal fiscal consolidation. There were no broad-based adjustments to tax sources with only a few minor changes relating to a delayed implementation of a planned tax exemption, enhanced tax enforcement, and a sales tax holiday. Following these adjustments, revenues for the enacted fiscal 2013 budget are $22 billion. Capital gains are expected to be $1.1 billion, which will require a $100 billion diversion to BSF based on current law. There is a planned withdrawal of $350 million from the BSF and the statutorily required transfer is suspended for fiscal 2013. The balance in the BSF is estimated at $1.3 billion at year-end, which still provides significant flexibility in our view. Spending in the enacted budget is 3.9% above fiscal 2012. Medicaid is the most significant component of the budget and continues to drive spending growth but caseloads have moderated and cost control continues in this area. Spending for Medicaid is budgeted at $11 billion, which represents 5.3% growth over 2012, slightly below the average growth rate of 6.1% from fiscal years 2007-2012. Caseload growth is projected to moderate to 2.8% from a recession peak of 4.9% in fiscal 2010. The waiver from the federal government that covers the Medicaid program was extended through 2014, which provides certainty. Federal health care reform does not represent significant near-term budget risk, in our view, given that coverage provided in Massachusetts exceeds federal requirements and a framework is in place for providing insurance coverage. Health care cost control continues to be the focus for Massachusetts and legislation in 2012 places cost growth caps on health care providers, enhances oversight and supervision, and aims to move providers and payers away from fee-for-service payments. Local assistance increases to $5.12 billion, or 3.9% above fiscal 2012 funding.

Fiscal 2012 Year-End Performance

Revenue performance in fiscal 2012 was strong in our view, with growth of 2.9% recorded, and positive performance for each of the commonwealth's major revenue sources. Revenues were revised up slightly in October and actual revenues still exceeded the revised forecast. Fiscal 2012 ended with a $124.8 million deficit due to the appropriation of prior-year fund balance. Although the enacted fiscal 2012 budget included a withdrawal of the BSF, instead there was a deposit of $160 million due to the receipt of one-time tax settlements. The year-end BSF is estimated to be $1.5 billion.

Fiscal 2011

On a generally accepted accounting principles basis, the commonwealth ended fiscal 2011 with a robust general fund surplus after transfers of $1.2 billion. The unassigned general fund balance was what we consider strong at $1.3 billion or 4.3% of expenditures and transfers. In addition, the committed fund balance was $1.4 billion and represents the stabilization fund, which increased by $709 million from fiscal 2010. This positive performance was due to federal stimulus funds, stronger-than-forecasted revenues, and various structural adjustments to revenues and expenditures. The sales tax rate was increased to 6.25% from 5.00%, other revenue enhancement measures were implemented, and a range of spending reductions occurred in most program areas. The state has historically maintained a negative unrestricted net asset position that increased to $23.1 billion in fiscal 2011, compared with negative $13.3 billion in fiscal 2009. The sharp increase reflects the comprehensive reform to the transportation system in fiscal 2010. The Massachusetts Department of Transportation (MassDOT) was created and several departments and authorities were merged as part of this structural change. All of the transportation assets have been transferred to MassDOT while the commonwealth is responsible for the debt obligations. This negative position has historically reflected debt issuance by the commonwealth to fund assets that are owned by other political subdivisions. This includes debt issued for various transportation and school construction projects. General fund results on a budgetary basis showed a slight deficit of $113.6 million that was offset by a reduction in the budget stabilization reserve.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.5' to Massachusetts' budget performance.

Economy

Economic recovery is underway at a steady pace and job growth has been more robust relative to most other states and the U.S. Unemployment rates have declined at a steady pace due to positive employment trends. The rate for 2011 was 7.4% compared with 8.9% for the U.S. and the rate continues to decline at a relatively rapid pace. The state has always had high income levels but has made gains in this area as well. Per capita personal income stood at $53,621 in 2011, about 129% of the nation, compared with 125% of the nation in 2010; Massachusetts is now ranked second behind Connecticut. Population has expanded over time at a modest pace with 2011 reaching 6.6 million compared to 6.4 million in 2000. Growth has outpaced the region since 2007 but continues to lag the nation.

The economy has diversified over time and education and health services now make up the primary employment sectors, accounting for 21% of total employment in 2011 according to the commonwealth. This is followed by trade and transport (17%) and professional business services (15%). Cyclical sectors, such as manufacturing and construction, represent only 8% and 3% of employment, respectively. The increasing role of services in the economy reflects growth in research laboratories, computer software, management consulting, other business services, and health care. Higher education anchors, a high level of federal research funding, and venture capital give the commonwealth a leading edge in emerging industries, such as biotechnology, software, communications equipment, and surgical instruments. In addition, its defense-related industries continue to perform well. Massachusetts ranks eighth out of the 50 states by value of federal defense and research contract awards.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.8' to Massachusetts' economy.

Financial Management

Budget management framework

Once the budget is approved, the Secretary of Administration and Finance (A&F) is required to prepare quarterly updates of both revenues and expenditures and submit them to the legislature. If projected revenues are expected to be insufficient to meet appropriations, the deficiency is certified by A&F and, pursuant to statute (section 9C of Chapter 29), the governor is required to reduce allotments or submit proposals to raise additional revenues or to make appropriations from the stabilization fund to restore balance. Budget adjustments have historically been implemented regularly and on a timely basis. Deficits are not carried forward into future fiscal years. Massachusetts is an initiative state. While there have been voter initiatives that limit the overall growth in state tax revenue and a limit on the amount of bonds outstanding and debt service appropriations, these have not substantially altered Massachusetts' ability to manage its budget or fund debt service. While more recent ballot initiatives to reduce or eliminate major tax sources of the state were not approved, the legislature can amend an initiative. The commonwealth provides a relatively high level of service. Adjustments have been made to programs but reductions to areas such as education have been limited.

Financial Management Assessment: 'Strong'

Standard & Poor's maintains a "strong" financial management assessment (FMA) score for Massachusetts. In our framework, an FMA of strong 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.

Highlights include the following:

- Massachusetts uses internal resources and outside economic forecasting firms to develop a consensus revenue forecast. It has regularly done monthly revenue estimates and quarterly budget reviews. Legislation approved in 2008 requires that revenue reports be submitted semi-monthly to the legislature.
- Five-year financial forecasting has been implemented. We understand that it will be updated annually and integrated into the budget process.
- A five-year capital investment plan (CIP; administrative intent, not binding) is in place that coordinates every facet of debt issuance. Included in the CIP is a detailed debt affordability analysis that is also updated each year.
- There are statutory limits on debt issuance. For direct debt, there is a limit allowing the issue of up to 105% of the previous year's limit ($16.4 billion compared with $14.7 billion outstanding based on the office of administration and finance estimates). There is also a limit on annual debt service of 10% of the then-current year's budget appropriation. In addition to the aforementioned statutory requirement, the governor's office adheres to an administrative bond cap (debt service capped at 8% of budgeted revenues), which sets the annual limit on debt issuance. The commonwealth targets a 4% net present value savings for refundings. The treasurer's office maintains a swap policy that is comprehensive in our view.
- Massachusetts has a statutorily established BSF that prescribes a mechanism for funding, as well as funding levels. Statute requires the deposit of 100% of consolidated net surplus in any given year into the rainy-day/stabilization fund. The statute also provides that the stabilization fund's maximum amount cannot exceed 15% of the current year's revenues. The commonwealth must use any excess above that for tax reduction. A change was made in 2010 to direct capital gain revenues in excess of $1 billion to the fund (less a distribution to postemployment benefits). Legislation approved in 2012, indexes the capital gains amount to inflation. The statute also directs 5% of the excess to the state retiree benefits trust fund and the pension liability fund. We believe this measure has the benefit of enhancing the fund while decreasing budget reliance on this cyclical revenue source.
- The commonwealth has detailed and frequently reviewed investment policies managed through the office of the treasurer. Quarterly cash flow projections are prepared and submitted to the legislature.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.0' to Massachusetts' financial management.

Debt And Liabilities

By most measures, Massachusetts' debt burden remains high relative to other states. The commonwealth has about $18.3 billion of GO debt prior to this issuance; it has a range of other debt obligations outstanding including those supported by the statewide gas tax, sales tax, contract assistance debt, and debt subject to annual appropriation. Total tax-supported debt is about $31 billion. This includes debt of other entities--Massachusetts School Building Authority and Massachusetts Bay Transportation Authority--that is secured by statewide sales tax revenues. While the debt obligations are separately secured, they fund state infrastructure and are paid from state taxes. The commonwealth's higher debt levels are due in part to its funding of education capital projects as well as other infrastructure funding, which is done at the local level in other states.

Massachusetts' debt per capita ($4,695), debt relative to personal income (9.3%), and debt to gross state product (8.8%) have always been high relative to other states. Debt service on GO bonds and contract assistance obligations was an affordable 6.7% of budgeted expenditures in fiscal 2012. The commonwealth's CIP through 2016 totals $17.4 billion, with $10.1 billion of debt projected. This plan adheres to a debt affordability model and an annual bond cap but represents what we consider a significant amount of additional debt. Massachusetts forecasts debt service to be below 8% of revenues through 2016 based on its current forecast of revenues. Transportation accounts for about 52% of total program requirements.

The Public Employee Retirement Administration Commission released its actuarial valuation of the total pension obligation as of Jan. 1, 2011. The unfunded actuarial accrued liability decreased this year to $18 billion compared with $20 billion the previous year. The funded ratio through Jan. 1, 2011, improved modestly in our view to 71.4% from 67.0% and the annual required contributions were funded. The amortization period for amortizing the unfunded liability to zero was extended as part of the fiscal 2012 budget by 15 years--to 2040 from 2025--which will lower current pension costs. Along with this extension, other reform measures were implemented, which the commonwealth projects will lower liabilities. Specifically, there are a range of reforms for newly hired employees including increasing the retirement age, limiting certain benefits, and making other adjustments that the administration projects will save the commonwealth $3 billion and local governments $2 billion. The administration also forecasts that a higher retirement age would reduce retiree health costs by $1 billion for the commonwealth and $1 billion for local governments. Standard & Poor's believes that Massachusetts' active management of these future cost pressures is important from a credit standpoint.

The commonwealth's accrued OPEB liability as of October 2011 is $16.6 billion, assuming no prefunding. The State Retiree Benefits Trust Fund was created and received a one-time transfer of resources. The fiscal 2011 audit indicates $310 million of assets. The appropriation for fiscal 2011 was $557 million compared with the annual required contribution of $1.3 billion. While this liability is significant in our view, we believe that Massachusetts has begun to manage this liability as evidenced by the trust fund and other measures. A special commission was created and released a report in July 2008 that recommended the commonwealth develop a strategy to fund the liability. Supplemental budget legislation was passed in 2009 that increased the health care contributions to 20% from 15% for state employees whose retirement is effective on or after Feb. 1, 2010, which should add additional resources to fund future liabilities. A law passed in 2010 requires that 5% of capital gains revenue over $1 billion each year would be transferred to the State Retiree Benefits Trust Fund and be used to address the OPEB liability. As part of the fiscal 2012 budget, the Tobacco Master Settlement Agreement funds will be dedicated to the trust fund on a phased-in basis. Starting in fiscal 2013, 10% would be allocated to the fund and an additional 10% would be allocated each year until 2022.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '3.0' to Massachusetts' debt and liability profile.

Related Criteria And Research

USPF Criteria: State Ratings Methodology, Jan. 3, 2011

Ratings Detail (As Of September 21, 2012)		
Massachusetts go 1998B		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts GO rfdg bnds var rate dem bnds ser C dtd 02/20/2001 due 01/01/2021		
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
Massachusetts GO VRDBs 2006B		
Long Term Rating	AA+/A-1/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
Massachusetts GO Rfd		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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