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$200.0 mil GO bnds cons loan ser 2014 D-2 due 09/01/2043		
Long Term Rating	AA+/Stable	New
US$200.0 mil GO bnds cons loan ser 2014 D-1 due 09/01/2043		
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' $400 million general obligation (GO) bonds consolidated loan of 2014, series D (multi-modal bonds), consisting of $200 million subseries D-1 and $200 million subseries D-2.

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 balance the budget;
- 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 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. Both series of bonds are multimodal and will be issued initially in the Securities Industry And Financial Markets Association (SIFMA) mode. The commonwealth has the option to convert the bonds to another interest rate mode (after the first optional redemption date which is March 1, 2016, for series D-1 and March 1, 2017, for series D-2). Any conversion would result in a mandatory tender of the bonds being converted. The bonds have a scheduled mandatory tender date of Sept. 1, 2016 (subseries D-1) and Sept. 1, 2017 (subseries D-1). If the bonds are not successfully remarketed or refunded, the interest on the bonds would increase to 9% based on the current plan of finance. A failed remarketing is not considered an event of default. While in the current mode, the bonds are not subject to tender at the option of bondholders.

This is the first bond issuance for a new management initiative for Massachusetts. 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. This variable rate issue is 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 2015-2019. 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 (A&F). We note that, in the past several years, staff in the treasurer's office has been increased 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.

Massachusetts has had variable-rate debt as part of its debt profile since 1990. The variable-rate portfolio is currently 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.

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 (A&F) 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 (CIP) 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 June 2014 declined to 5.5%, with continued strong growth in private-sector employment. This compares favorably to 6.8% in January. 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 2013, and 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. In our view, the BSF provides significant flexibility to manage future fiscal challenges over our two-year outlook horizon. 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. If there was a sharp decline in reserves or debt and liabilities increased sharply, the rating could be pressured.

Budgetary Performance

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 reduction in fiscal years 2014 and 2015 (planned based on the enacted budget). Year-end revenues for fiscal 2014 are projected to be $23.4 billion, which is slightly ahead of the revised forecast and 5.6% above fiscal 2013. The revenue forecast was increased in January to $23.2 billion from $22.8 billion, a 1.8% increase above the original estimate. As with many states, Massachusetts' returns and refunds were affected by federal tax policy changes but despite some decline related to this the overall revenues performed well. The BSF at year-end is estimated at $1.3 billion (5.4% of general fund tax revenues), down slightly from fiscal 2013 but less of a reduction than originally budgeted. The ending fund balance for fiscal 2014 is estimated at $1.4 billion but this is preliminary and there are supplemental appropriations and other adjustments that may affect this estimate.

On Jan. 14, 2014, 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 fiscal 2015 budget was enacted on June 30, 2014, and signed by the governor on July 11, with an interim budget in place to start the fiscal year. The enacted budget totals $36.5 billion after accounting for $16 million of vetoes. The budget includes tax and revenue changes we view as minor and projected to yield $93 million, as well as a change in the treatment of one-time non-tax judgments and settlements that would provide $240 million of revenue. The level of nonrecurring resources to balance the budget also declines to $423 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 $140 million and this will be only $30 million on a net basis if capital gains are consistent with forecast requiring a $110 million deposit to the BSF pursuant to statute. Before budget release, the governor and legislature agreed on an updated pension funding schedule 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% above fiscal 2014, and is generally aligned with recurring revenue growth. Major areas of spending increase include pensions, education, and transportation. 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.

Economy

Massachusetts' labor market has fared relatively well so far in 2014. According to IHS Global Insight Inc., private-sector payroll gains have averaged 1.7% in the past six months through May. This translates to an overall net gain of 24,400 jobs. Unemployment rates have declined at a steady pace due to positive employment trends and fell to 5.5% as of June 2014 ranking the state 19th nationally. The average annual unemployment rate for 2013 was 7.1%, which was below the 7.4% rate for the U.S. Population has expanded over time at a modest pace and has reached nearly 6.7 million as of 2013. Population growth has outpaced the region since 2007 but continues to lag the nation and we expect this trend to continue.

Massachusetts has always had high income levels. Per capita personal income increased to $56,923 in 2013, which is 128% of the nation and the state has consistently held this level over the past decade. We expect that income will remain well ahead of other states based on the nature of the jobs being created and the pace of expansion. Real state GDP is expected to average 2.9% growth between 2014 and 2019, which will just slightly trail the U.S.

The economy has diversified over time and education and health services now make up the primary employment sectors, accounting for nearly 22% of total employment in 2013 according to the Bureau of Labor Statistics. This is followed by trade and transport (17%) and professional business services (15%). Cyclical sectors, such as manufacturing and construction, represent only 8% and 4% 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. This part of the economy is likely to be inordinately affected by any federal fiscal consolidation in the future.

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

Government Framework

State finance law requires that the governor submit a balanced budget and the House and Senate each produce a balance 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 14% 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 no 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.

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

Financial Management

Budget management framework

Once the budget is approved, the Secretary of 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 BSF to restore balance. Budget adjustments have historically been implemented regularly and on time and deficits are not carried forward into future fiscal years. Massachusetts is a voter 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 performed monthly revenue estimates and quarterly budget reviews. Legislation approved in 2008 requires that revenue reports be submitted semimonthly 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 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. 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 debt management and swap policies that we view as comprehensive. The asset liability management policy was introduced this year as noted above.
- 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 BSF. The statute also provides that the BSF'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. Legislation approved in 2012 indexes the capital gains amount to growth in U.S. gross domestic product. 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. Judgments and settlements in excess of $10 million must also be deposited to the fund.
- 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 score of '1.0' to Massachusetts' financial management.

Debt And Liabilities

Total GO debt outstanding at April 30, 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. The variable-rate portfolio is 19%, 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. Debt per capita is high, in our view, at $4,847 and 8.6% of personal income. Planned debt issuance for fiscal 2014 was $500 million lower than forecast due to slower-than-projected capital spending. The updated CIP and debt affordability policy were updated in July 2014 and planned issuance remains within the parameters of the commonwealth's debt affordability policy and bond cap; debt service is projected to remain below 8% of budgeted revenues through fiscal 2019. While a debt affordability analysis had been done within the office of A&F, 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 CIP and providing an estimate of debt authorization for the year. The CIP for fiscal 2015 through 2019 totals $17.1 billion, with transportation (50%), community investment (10%), and higher education (9%) being the primary areas of investment. A total of $11 billion of debt is planned to support the program, which should translate into a stable debt profile in our view. Bond authorization of $1 billion of special obligation bonds was approved in 2014 to fund expansion of the convention center. Hotel/motel occupancy taxes are expected to support the bonds. This debt is not included in the affordability analysis because the revenues that support debt are not general fund tax sources. We include special tax bonds supported by statewide tax sources in the ratios we use to assess total tax-supported debt. There is no timetable for issuance at this time.

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, 2012, 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 were 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, July 8, 2014

Ratings Detail (As Of July 28, 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

Ratings Detail (As Of July 28, 2014) (cont.)		
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 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.

1349425 | 300001337