

## Massachusetts; General Obligation; General Obligation Equivalent Security

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### Table Of Contents

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Rationale

Outlook

Fiscal 2011 Budget Proposal

Related Criteria And Research

# Massachusetts; General Obligation; General Obligation Equivalent Security

Credit Profile		
US\$250. mil GO bnds cons loan ser 2010B due 06/01/2011-2020		
<i>Long Term Rating</i>	AA/Stable	New
Massachusetts GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed

## Rationale

Standard & Poor's Ratings Services assigned its a 'AA' long-term rating, and stable outlook, to the commonwealth of Massachusetts' \$250 million general obligation (GO) bonds consolidated loan of series 2010B. At the same time, Standard & Poor's affirmed its 'AA' underlying rating, with a stable outlook, on the parity debt outstanding.

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

- Strong and conservative budget management practices, with swift action to restore balance after identifying revenue shortfalls throughout the recession;
- Continued budget stabilization reserve balances despite 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 that 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 the commonwealth's total postretirement liabilities as relatively high, we believe Massachusetts has been actively managing these liabilities.

The Massachusetts economy continues to experience decline but the pace has slowed. The unemployment rate has been above 9% in 2010, compared with 5.3% in 2008. The rate remains below the national average and the pace of employment decline has slowed while the labor force has been stable. To date, job loss through this recession has been less severe than in the 2001 recession and the recession of early 1990s by what we consider a significant margin. Economic recovery is likely to be slow in our view, but IHS Global Insight Inc. projects that Massachusetts will lead the region in recovery. We believe 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.

In line with most other states, Massachusetts has faced significant budget gaps for fiscals 2009 and 2010 (an \$8 billion cumulative gap) due largely to declining revenues. Revenues were revised four times through fiscal 2009, which significantly lowered the revenue base for fiscal 2010. As required by statute, the Secretary of Administration and Finance announced on Oct. 15, 2009, that it expected a \$600 million revenue deficiency for fiscal 2010. The governor submitted a plan to close the gap that relied heavily on spending reductions and some minor revenue enhancements. In addition to the revenue shortfall, potential spending pressures above budgeted levels in Medicaid

and other program areas were identified. In January of this year, revenues were revised upward by \$181 million to \$18.5 billion based on improved year-to-date collections. This trend appeared to be holding through May with revenues just \$70 million lower than forecast. There continues to be spending deficiencies, which are projected to be \$426 million if not contained. Additional unbudgeted federal reimbursements of \$130 million (\$80 million attributable to fiscal 2010) will partially offset the additional cost exposures. The commonwealth expects its stabilization fund to be \$687 million at year-end fiscal 2010. Cash flow has been stable and an increase in the year-end cash balance of about \$55 million is now projected for fiscal 2010.

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 increase 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 the full analysis on the MTA published July 27, 2009, on RatingsDirect on the Global Credit Portal). About \$928 million of the MTA's subordinated debt is now supported by contract assistance payments of the commonwealth.

By most measures, Massachusetts' debt burden remains high compared with that of other states. The commonwealth has about \$17 billion of GO debt. Of this amount, more than 80% is fixed rate and the remaining \$3.3 billion is variable rate and 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 about 7% of expenditures in fiscal 2009. The capital investment plan through 2014 totals \$17 billion, with \$10.5 billion of bond issuance projected. This plan adheres to annual bond cap (debt service as a percent of budgeted revenue within the 8% limit) that is outlined in Massachusetts' annual debt affordability analysis.

## Outlook

The stable outlook reflects Standard & Poor's view of the commonwealth's proactive approach to managing budget volatility through the recession. Revenue adjustments have been frequent and gap-closing actions have been swift, successfully restoring balance. While diminished, the budget stabilization fund retains a balance that will continue to provide flexibility to manage the current fluid revenue environment. These are important credit factors for Massachusetts given its dependence on personal income (and related capital gains) tax revenues, which are volatile during economic cycles.

## Fiscal 2011 Budget Proposal

The commonwealth's fiscal 2011 budget was introduced in January 2010 and closed a \$2.75 billion budget gap. The House of Representatives and the Senate have each released their budgets and negotiations are underway to finalize the fiscal 2011 budget. Under the governor's proposal, balance was achieved through a mix of minor revenue enhancements, spending reductions, additional use of the budget stabilization reserve and other one-time sources, and a debt restructuring plan, as well as an expectation of additional federal Medicaid assistance payments. Baseline revenue growth is projected to be 3.2%, or \$590 million above fiscal 2010 based on the consensus revenue forecast. While growth is forecast for fiscal 2011, revenues remain far below the \$21.4 billion consensus revenue estimate for fiscal 2009.

There were no broad-based revenue enhancements included in the budget but there were some minor limits proposed on tax exemptions and some departmental revenue increases. The extension of the federal stimulus was projected to yield \$608 million. While this was a risk since it has not yet been authorized at the federal level, the commonwealth mitigated this risk by requiring a re-filing of the budget in June if the additional stimulus funds were not approved. The governor submitted a revision to the legislature on June 8, 2010. Spending reductions are recommended across the state budget with the exception of debt service, certain education aid programs, and unrestricted general government aid. The budget plan assumes a \$160 million payment from the Social Security Administration for certain health care expenditures the commonwealth funds. Spending in the proposed general fund budget is projected to rise by 3% to \$19 billion. Total spending for education is increased by 4.3% while spending for health and human services increases by 4.1%. Local assistance is held stable for fiscal 2011. Net spending reductions of \$670 million are included in the plan. Part of the reduction will include a proposed debt restructuring that would refinance \$200 million of fiscal 2011 amortizing principal and extend the repayment out over the next seven years. While this has not been a budget-balancing strategy for the commonwealth in recent years, it represents a relatively modest portion of the overall debt profile and will be amortized rapidly.

The stabilization fund would have a balance of \$450 million at fiscal year-end 2011 after the proposed use of \$175 million to balance the budget. The budget includes a proposal to reform the way the state budgets for capital gains revenue. Both the House and Senate version of the budget include this provision. This portion of the personal income tax has been volatile for the state over time. To highlight the volatility, capital gains revenue was \$2.2 billion in fiscal 2008 and fell to \$554 million in fiscal 2009, which was more than \$1 billion below estimate. The proposal provides that any capital gains revenues in excess of \$1 billion in a given fiscal year would be transferred to the stabilization fund. The proposal outlines that 5% of that excess would be transferred to the State Retiree Benefits Trust Fund and be used to address the liability for its retirees' health insurance and other nonpension retirement benefits. We believe this would contribute to reduced cyclicity in budget performance and allow for a dedicated source of funding for a significant long-term liability.

## Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

<b>Ratings Detail</b> (As Of June 16, 2010)		
Massachusetts GO cons loan (wrap of insured) (FGIC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Massachusetts GO (wrap of insured) (ASSURED GTY & AMBAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Massachusetts GO (FGIC)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Massachusetts GO (MBIA) (Assured Gty)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Massachusetts GO (MBIA) (National)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Massachusetts GO</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

<b>Ratings Detail (As Of June 16, 2010) (cont.)</b>		
<b>Massachusetts GO RFD</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Massachusetts GO Rfd</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) gen transp ser 1991A		
<i>Long Term Rating</i>	AA/Stable	Affirmed
<b>Massachusetts Bay Transp Auth transp sys bnds (Massachusetts)</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>Massachusetts Bay Transp Auth (Massachusetts)</b>		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>University of Massachusetts Bldg Auth, Massachusetts</b>		
Massachusetts		
University of Massachusetts Bldg Auth (Massachusetts)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
<i>Unenhanced Rating</i>	NR(SPUR)	
University of Massachusetts Bldg Auth (Massachusetts) GO (MBIA) (National)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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