STANDARD & POOR'S RATINGS SERVICES
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RatingsDirect®

Massachusetts; General Obligation

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Massachusetts; General Obligation

Credit Profile		
US$250.0 mil GO bonds, cons loan (Massdirect Notes) ser 2014 1-10 due 08/01/2024		
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' $250 general obligation (GO) bonds consolidated loan of 2014 (MassDirect Notes), series 1-10.

In addition, Standard & Poor's affirmed its 'AA+' rating, and stable outlook, on the commonwealth's existing parity debt.

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 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;
- Healthy budget stabilization fund (BSF) balance, which has been key to managing 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 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.

This bond issue is part of the commonwealth's overall debt and capital investment plan and is subject to the administrative limits on bond issuance but this new direct note program will be issued primarily to retail investors. We understand this program will include monthly rolling sales to retail investors through August of 2014 under the current plan. We are assigning a rating to the total program authorization, which are expected to be fixed-rate GO bonds with a final maturity in 2024. Under the current plan, the commonwealth expects to sell bonds to an underwriter on a negotiated basis and the bonds will then be offered to retail investors on an electronic trading platform. The bonds are expected to sell on a daily basis for two weeks of each month (one week in July and August) with different maturities. The commonwealth expects the program to broaden its investor base and enhance pricing transparency.

Total GO debt outstanding at Dec. 31, 2013, 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, and contract assistance debt. By most measures, Massachusetts' debt burden remains high compared with that of other states. The variable-rate portfolio has been in the area of 20% and 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 $4,792 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 debt affordability policy and bond cap; debt service is below 8% of budgeted revenues. While a debt affordability analysis had been done within the department of administration and finance, 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 and providing an estimate of debt authorization for the year.

Massachusetts' economy has experienced steady recovery, outpacing national and regional trends by most measures. While the pace had been uneven at the end of 2013, the current estimate from the commonwealth is that the unemployment rate declined in January to 6.8% and has been in line with U.S. levels in recent months. 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 2012; 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 manage long-term debt and liabilities should allow for favorable structural alignment of the budget in the future. The BSF provides significant flexibility to manage future fiscal challenges over the two-year outlook horizon, in our view, and the commitment to funding the reserve is positive from a credit standpoint.

Financial And Budget Update

The commonwealth continues its strong budgetary performance. Revenue is expanding at a healthy pace and reserves remain strong, in our view, despite some planned reduction in fiscal 2014 and for fiscal 2015 based on Governor Deval Patrick's proposed budget.

Through February, tax collections were $1.1 billion above fiscal 2013 levels over the same period and $288 million above the revised year-to-date forecast. The forecast was revised in January 2014 with revenues forecast to increase to $23.2 billion from $22.8 billion, a 1.8% increase above the original estimate and 4.9% above fiscal 2013 collections.

Revenue performance compared with 2013 has been robust in a range of areas with significant positive variance in personal income tax withholding collections ($323 million or 4.8%), corporate and business tax collections ($314 million or 33.5%), and sales and use tax collections ($205 million or 5.9%). We believe this positive performance relative to last year and above the revised forecast highlights the strength of the state's underlying economy. The BSF at year-end is estimated at $1.4 billion (3.9% of expenditures), down slightly from fiscal 2013 but less of a reduction that originally budgeted.

On Jan. 14, 2014, the commonwealth released its consensus revenue estimate for fiscal 2015. We believe the consensus 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 governor released his budget proposal on Jan. 22. The proposal includes what we view as minor tax/revenue changes that are projected to yield $141 million. As well, the proposal contains a change in the treatment of one-time settlements that would provide $204 million of revenue. The level of nonrecurring resources to balance the budget also declines to $334 compared with $667 million in fiscal 2014, which improves structural alignment in our view. The proposal also projects reducing the use of BSF resources to $175 million although we note the planned drawdown despite relatively healthy economic performance. Prior to the budget release, the governor and legislature agreed on an updated pension funding schedule that represents a $163 million increase from 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. The increased contribution accelerates full funding by four years (now 2036), which we consider a positive.

Total spending under the proposed budget is $38.2 billion (including pensions), 5.1% above fiscal 2014 and is generally aligned with recurring revenue growth. Major areas of spending increase include pensions ($163 million), education ($137 million increase for early education and K-12 funding; $68 million for higher education), and transportation ($141 million). The budget continues implementation of Medicaid expansion under the Affordable Care Act but federal resources and other cost-control initiatives are expected to offset the cost of expansion.

Pension And Other Postemployment Benefit Update

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, 2011, and is 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. The commonwealth 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 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 of recognition of the 2008 investment losses, which were significant 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 are 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, Dec. 17, 2013