Moody's
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS MIG 1 RATINGS TO $1.2 BILLION OF MASSACHUSETTS GENERAL OBLIGATION REVENUE ANTICIPATION NOTES

Global Credit Research - 09 Nov 2011

STATE HAS $18.5 BILLION OF LONG-TERM G.O. DEBT OUTSTANDING

MASSACHUSETTS (COMMONWEALTH OF)
State Governments (including Puerto Rico and US Territories)
MA

Moody's Rating

ISSUE		RATING
General Obligation Revenue Anticipation Notes, 2011 Series A		MIG 1
Sale Amount	$600,000,000	
Expected Sale Date	11/17/11	
Rating Description	Note: Bond Anticipation	
General Obligation Revenue Anticipation Notes, 2011 Series B		MIG 1
Sale Amount	$600,000,000	
Expected Sale Date	11/17/11	
Rating Description	Note: Bond Anticipation	

Moody's Outlook N/A

Opinion

NEW YORK, November 09, 2011 --Moody's Investors Service has assigned MIG 1 ratings to the Commonwealth of Massachusetts' $600 million General Obligation Revenue Anticipation Notes 2011 Series A and $600 million 2011 Series B. Proceeds of the notes, expected to be offered on November 17, will be used to bridge seasonal imbalances in the state's revenues and expenditures.

SUMMARY RATINGS RATIONALE

The notes are secured by the commonwealth's general obligation pledge and will be used to bridge the mismatch in timing between revenue collections and expenditures, particularly personal income tax receipts and school aid payments to local governments. The Series A notes mature on April 28, 2012 and the Series B notes on May 31, 2011. The highest short-term rating reflects the credit quality of the Commonwealth of Massachusetts (general obligation rating of Aa1 with a stable outlook) and its full faith and credit pledge to pay noteholders when due; the staggered maturity structure of the notes that provides satisfactory cash margins following each repayment date; and alternative liquidity that could be provided by the commonwealth's budget stabilization fund, subject to legislative appropriation.

STRENGTHS

-- Strong financial management during economic downturns, particularly a willingness to promptly identify and close budget gaps through expenditure reductions, revenue increases and prudent use of reserves

-- Budget reserves that provide an adequate cushion to another downturn and the commonwealth's demonstrated commitment to rebuild them to stronger levels, including through new statutory mechanism to replenish them going forward

-- High wealth and high levels of educational attainment

-- The presence of large, highly-rated higher education and health care institutions in the Boston area has lent a degree of economic stability and have mitigated some job losses during recessions

CHALLENGES

-- Managing expenditure pressures, especially from health care and social services, in a lower revenue environment and amid ongoing economic uncertainty

-- Relatively low pension funding levels, and debt ratios that are among the highest in the nation

-- Managing the challenges from federal downsizing during the next several years, which could have a heavy impact on the commonwealth's important healthcare sector

STAGGERED NOTE MATURITIES PROVIDE SATISFACTORY CASH MARGINS

The commonwealth expects to issue a total of $1.2 billion of revenue anticipation notes (RANs) to meet its fiscal 2011 seasonal cash flow needs, which are largely driven by a mismatch between the timing of personal income tax receipts and payments to local governments for school aid: at the end of each quarter of the commonwealth's fiscal year (September, December, March and June) a $1.2 billion payment is made. The notes are general obligation, full faith and credit obligations of the commonwealth. Massachusetts has issued RANs each year since fiscal 2009, including $750 million that year and $1.2 billion in each of fiscal years 2010 and 2011. The use of RANs reflects the commonwealth's shift away from using bank-supported commercial paper for cash flow management.

The commonwealth's official cash flow forecast is from August, when it planned to issue an $800 million RAN. In our analysis we have adjusted the cash flow to reflect several more recent developments. Based on required and discretionary transfers that have since been made to its Budget Stabilization Fund that were larger than original forecasts, Massachusetts near-term cash imbalance also is larger. The need for the larger short-term borrowing is offset by the credit positive impact of rebuilding the reserve fund more quickly as a cushion in an uncertain economic environment. The commonwealth made approximately $350 million of statutorily required transfers into the fund at the end of fiscal 2011 and in a supplement budget measure in October appropriated an additional $350 million. Based on those deposits, the fund totals nearly $1.4 billion, or 6.6% of forecasted fiscal 2012 tax revenue.

All of the commonwealth's short-term borrowings are statutorily required to be repaid by the end of the fiscal year. The two staggered maturities of the notes and their repayment one full month before the end of the fiscal year is an important structural feature that provides strong cash margins for each separate series of notes than if they were issued with a single maturity. The Budget Stabilization Fund is not included in the cash flow, although because the RANs are general obligations we consider it a possible source of alternative liquidity, subject to legislative appropriation.

Based on our analysis, ending cash balances at each note maturity provide noteholders with sufficient cushion. At the April maturity of Series A, the ending cash balance is 8.8% of tax revenue and 6.0% of total revenue. For Series B, the ending cash balance is only 4.2% of tax revenue, reflecting lower expected tax collections in May, but is 12.2% of total revenue.

COMMONWEALTH ENDS FISCAL 2011 IN STRONG FINANCIAL POSITION

Massachusetts ended fiscal 2011 with tax collections up 10.6% (nearly $2 billion) compared to the prior year, and 3.6% greater than forecast. Personal income taxes, which account for 56% of general fund revenue in the high wealth state were especially strong, increasing by 14.5%, growth driven by strong nonwithholding collections. Sales taxes (24% of the total) increased by 6.4% compared to fiscal 2010, and corporate income taxes (11% of the total) were up by 5.1%. All other collections (9% of the total) were up by 5.6%. The commonwealth ended the year with a budgetary basis $460 million general fund surplus, mostly as the result of the strong nonwithholding collections.

FISCAL 2012 BUDGET REFLECTS SPENDING REDUCTION AND REDUCES RELIANCE ON ONE-TIME RESOURCES; REVENUE FORECAST REVISED UPWARDS

The $30.6 billion fiscal 2012 budget reduces total state spending by approximately $666 million, or 2.1%. It works toward a greater structural balance by reducing the commonwealth's use of one-time resources, which now only reflect 1.5% of the total budget compared to 6.0% in fiscal 2011. Including a supplemental measure passed last month, the budget includes a $200 million draw from the Budget Stabilization Fund, although as in fiscal 2011 that could be reduced or eliminated later depending on the strength of revenue collections; in 2012 the budget would suspend the transfer into the fund equal to 0.5% of tax revenue. Assuming that the planned draw occurs, the stabilization fund would total 5.6% of estimated fiscal 2012 revenue.

Last month, the fiscal 2012 consensus revenue forecast was revised upwards substantially. While collections had been estimated to increase by only 0.5%, the new forecast calls for 2.4% growth. Actual collections year-to-date through October are 6.6% greater than the prior fiscal year, and while we expect economic uncertainty to continue, the forecast is still reasonable. The commonwealth updates its consensus revenue forecast four times a year, a strong practice which allows it to quickly make mid-year budget adjustments if necessary.

FAVORABLE EMPLOYMENT SITUATION CONTINUES

The jobs situation in Massachusetts continues to outperform the nation. Unemployment in the state in September was 7.3% while it was 9.1% nationally. Total nonfarm employment growth was 1.5% compared to one year earlier in Massachusetts, while it was 1.2% for the U.S. The commonwealth continues to be aided by its large education and health sector, which makes up more than 20% of employment. The state also has a large financial activities sector, with a significant mutual fund presence. While the important healthcare sector is partly behind Massachusetts's above-average employment and income performance, future federal downsizing could impact healthcare and have a significant impact in Massachusetts. The state is characterized by high wealth and education levels but with slow population and job growth over the longer run. Per capita personal income in 2010 was $51,552, ranking second among the states. According to the Census Bureau, the commonwealth had the highest percentage of residents with bachelor's degrees of any state in 2008, which has helped to attract and develop significant high tech and defense contracting sectors. Despite the highly educated population, however, during the last two recessions Massachusetts lost more jobs than the nation and gained fewer during the expansions that followed. Among the commonwealth's economic challenges are high business and housing costs and slow population growth with negative migration trends. Indeed, high costs have pushed some suburban Boston growth into more affordable New Hampshire.

HEAVY TAX-SUPPORTED DEBT LOAD; HIGH PENSION COSTS ALTHOUGH REFORMS WILL PROVIDE LONG-TERM BENEFITS

The commonwealth has a high debt burden, with $18.5 billion in outstanding general obligation bonds and $29 billion in total net tax-supported debt. Debt levels have been driven upwards by the commonwealth's issuance of bonds to finance projects that in other states would be paid for at the local level. Based on Moody's 2010 state debt medians, the state's debt levels ranked second-highest among the 50 states on both a per-capita basis and as a percentage of personal income, respectively, and is the highest as a percentage of state gross domestic product. Total net tax-supported debt amounted to 9.2% of total personal income in 2009 compared to the 50-state median of 2.5%.

A pension reform measure working through the Massachusetts legislature would provide long-term benefits to the state, if enacted. Based on an updated actuarial valuation released on January 1, 2011, Massachusetts' pension funded ratio had improved to 71.1% from 67.5% in 2010. Among its changes, the plan extends the funding schedule from 2025 to 2040, which reduces the fiscal 2012 contribution from $2.2 billion to $1.4 billion (although that is still larger than then fiscal 2011 amount). The negative impact of pushing out the period to fully fund the retirement obligations is partially offset by increasing the retirement age for most state employees; eliminating early retirement subsidies; increasing the period for calculating retirement from an average of three years to five years; and eliminating double-dipping. The measure also prohibits the commonwealth from making less than the annual payment required by the new schedule if investment returns exceed expectations: greater-than-expected gains would be used to shorten the schedule. It further dedicates future tobacco settlement monies to the commonwealth's other post-employment benefits (OPEB) trust fund, starting in phases in fiscal 2013. The combined ratio of Massachusetts' pension and OPEB actuarially required contributions (ARC) to revenue is 16%, slightly higher than average. Left unchecked, those costs could limit the commonwealth's fiscal flexibility going forward, but the new plan should help to mitigate them.

CLOSELY MANAGED VARIABLE RATE DEBT AND SWAPS PORTFOLIO

Approximately 20% of the commonwealth's general obligation debt is variable rate, largely swapped to fixed rates through cost-of-funds swaps, eliminating basis risk. It has reduced its exposure to external liquidity facility risk through the issuance of SIFMA index bonds, although the need to roll or take out maturities of those bonds creates some market access and liquidity risks. The commonwealth's variable rate and derivatives portfolio is closely managed and its liquidity facilities and swap agreements contain provisions favorable to the commonwealth and offset its relatively low available cash balances. Liquidity facilities contain a mix of three- and five-year term-out provisions that, considering the strength of Massachusetts' market access should provide ample time to refinance if necessary. Swap counterparties are well-diversified and do not reflect collateral posting requirements on the part of the commonwealth. As of June 30, the mark-to-market value of Massachusetts' general obligation swaps was -$369 million.

WHAT COULD MAKE THE SHORT TERM RATING GO DOWN

-- Material weakening in the state's cash flow margins beyond current estimates

The principal methodology used in this rating was Short-Term Cash Flow Notes published in May 2007. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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