

### Summary:

## Massachusetts; General Obligation

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## Summary:

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Credit Profile		
US\$538.86 mil GO rfdg (SIFMA Index bnds) 2010 ser A due 02/01/2014		
<i>Long Term Rating</i>	AA/Stable	New
Massachusetts GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Massachusetts GO cons loan (wrap of insured) (FGIC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

## Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating, and stable outlook, to the commonwealth of Massachusetts' series 2010 A general obligation (GO) refunding bonds (SIFMA index bonds). Standard & Poor's also affirmed its 'AA' long-term rating, with a stable outlook, on the commonwealth's parity debt outstanding.

The 'AA' GO rating on Massachusetts reflects our view of its:

- 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 the liabilities.

The series 2010 bonds will be issued as Securities Industry And Financial Markets Association (SIFMA) bonds. The SIFMA bonds have a variable-rate coupon, issued with a fixed spread to SIFMA. There is no put risk and there will be staggered fixed maturities over the next four years with the final maturity in 2014 based on the current plan of finance. There is an existing swap in place that is tied to SIFMA so it will be a matched hedge and therefore basis risk will be eliminated.

The commonwealth has formalized a policy and an administrative process that outlines the rollover risk and articulates how the bond program will be managed.

In addition to the fixed maturity date, the bonds are subject to optional redemption six months before maturity, allowing additional time to refinance if necessary. Refinancing options would include the following: the issuance of new SIFMA index bonds, variable- or fixed-rate debt; use of a portion of the commercial paper program; or use of cash or other resources. The commonwealth's goal is to maintain the existing amortization schedule.

The Massachusetts economy continues to experience decline but the pace has slowed. The unemployment rate was 9.1% through December 2009 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 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 appears to be holding through February. There continues to be spending deficiencies, which are projected to be \$426 million if not contained. The commonwealth expects its stabilization fund to be \$609 million at year-end fiscal 2010.

Massachusetts' budget for fiscal 2011 was introduced in January and closed a \$2.75 billion budget gap. 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. The extension of the federal stimulus for Medicaid is projected to yield \$608 million. While this is a risk because it has not yet been authorized, the commonwealth has partially mitigated this risk by requiring that the budget be resubmitted by June 1 if the additional stimulus funds are not approved. Some of the other nonrecurring items require action at the federal level or approval at the state level that could also represent some risk. Baseline revenue growth is projected to be 3.2% based on the consensus revenue forecast. Spending in the proposed general fund budget is projected to increase by 3% to \$19 billion. Local assistance is held stable for fiscal 2011. A debt restructuring has also been proposed 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 what we consider 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.

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). 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 \$16.8 billion of GO debt. Of this amount, about 80% is fixed rate and the remaining \$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 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.

## Related Research

USPF Criteria: GO Debt, Oct. 12, 2006

<b>Ratings Detail</b> (As Of March 4, 2010)		
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>University of Massachusetts Bldg Auth, Massachusetts</b>		
Massachusetts		
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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