

RatingsDirect®

Massachusetts; Note

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Rationale

Standard & Poor's Ratings Services assigned its 'SP-1+' short-term rating to the commonwealth of Massachusetts' \$800 million of general obligation (GO) revenue anticipation notes (RANs), 2013 series A, B, and C.

The short-term rating reflects what we view as the general creditworthiness of Massachusetts ('AA+' GO rating) and strong note debt service coverage at maturity.

The notes are general obligations of the commonwealth, secured by Massachusetts' full faith and credit pledge, and are being issued to meet cash flow requirements for fiscal 2014.

Massachusetts does not use interfund borrowing for cash flow purposes and the sizable balance in its budget stabilization fund (BSF) is not available for general fund cash flow requirements unless authorized by the legislature. The BSF balance at fiscal year-end 2013 was \$1.6 billion but is projected to decline to \$1.4 billion at fiscal year-end 2014. In our view, revenues have experienced strong recovery in the past several years, contributing to healthy budgetary results and an improved BSF. While this is positive from a credit standpoint, the legal prohibition to use the BSF for cash flow contributes to cash flow imbalance through the year despite this ongoing revenue improvement.

The size of the RAN issuance this year is substantially reduced from previous year borrowings. This issue represents a low, in our view, 2.2% of the fiscal 2014 tax revenue estimate, and is also lower than in previous years. In addition to ongoing revenue growth, local aid payments are now distributed monthly rather than quarterly following a statutory change effective in fiscal 2014. The series A, B, and C notes will mature on April 24, May 29, and June 26, respectively. There will be no revenue withholding in advance of note repayment but the staggered maturity schedule provides for extremely strong coverage in our view, at 10.0x, 5.5x, and 7.9x, respectively. The current cash flow forecast is based on the enacted budget and revenue forecast. Cash management is the responsibility of the state treasurer and in our view the commonwealth has robust cash forecasting processes, with detailed reporting and monitoring. The cash forecast is revised regularly to incorporate actual performance and the next revision is scheduled for Nov. 29, 2013. We believe that Massachusetts' current forecast of revenues is reasonable and aligned with current economic performance. Actual revenues for the first two months of the fiscal year are \$252 million or 8.8% above fiscal 2013 and \$139 million above forecast.

Fiscal 2014 Budget Update

On Jan. 14, 2013, the secretary of Administration and Finance and the legislature agreed on the consensus revenue estimate for fiscal 2014. We believe the estimate of \$22.3 billion is reasonable and aligned with the current pace of economic growth. After the required statutory deposit of capital gains tax revenue to the BSF and transfers of dedicated sales tax revenue, \$19.1 billion would be the tax revenue available to fund the fiscal 2014 budget. The enacted budget includes total revenues of \$22.45 billion, which includes minor revenue adjustments. This represents 3.5% growth compared with the current estimate of fiscal 2013 revenues. The revenue forecast will be updated in October.

The budget for fiscal 2014 was enacted on July 1, 2013, and approved by the governor on July 12. A \$4.1 billion interim budget was approved to start the fiscal year. Total spending under the enacted budget is \$34.1 billion, 4.8% above fiscal 2013. This increase is well below what had been included in the governor's budget proposal but is above inflation. The budget implements Medicaid expansion under the Affordable Care Act but federal resources and other cost-control initiatives are expected to offset the cost of expansion. Medicaid spending increases by 12% over fiscal 2012 reflecting this expansion. Local aid increases by 3.5%, and funding for primary and secondary education and higher education also expand under the enacted budget.

The budget relies on \$696 million of nonrecurring resources, which include a \$350 million draw on the BSF, and certain other reversions and transfers. We recognize that the statutory requirement to transfer capital gains in excess of a threshold amount (\$1 billion, indexed for inflation) to the BSF could limit the actual use of the BSF, which was the case in fiscal 2013. The net reduction in the BSF at year-end is modest, in our view, at \$207 million after accounting for deposits.

Transportation reform was authorized by the legislature on July 24, 2013. The fiscal 2014 budget relies on approximately \$439 million in new tax revenues included in the transportation finance legislation and is expected to address deficiencies in mass transit operations and also provide a dedicated source of funding in the future. Of this amount, \$240 million will support transportation, \$177 million will support nontransportation related investments, and \$22 million will fund additional revenue to the Massachusetts School Building Authority. Transportation spending is centered on eliminating the Massachusetts Bay Transportation Authority's \$115 million operating deficit, regional transit authority funding of \$78 million, and other transportation enhancements.

Tax increases include:

- Increasing the motor fuels tax by three cents and indexing it to the rate of inflation (\$95 million);
- Increasing the excise tax on tobacco products (\$144 million);
- Applying the sales tax to computer systems design services and to the modification of prewritten software (\$150 million); and
- Changes to the corporate excise (\$50 million).

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Short-Term Debt, June 15, 2007
- USPF Criteria: Financial Management Assessment, June 27, 2006

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