S&P Global Ratings

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## Summary:

# Massachusetts; General Obligation

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| US$275.0 mil GO bnds cons loan of 2024 ser I due 12/01/2054 | | |
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## Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating on the Commonwealth of Massachusetts' approximately $800 million of 2024 general obligation (GO) bonds consolidated loans, consisting of series G, series H, and series I.
- The outlook is stable.

### Security

Massachusetts' full faith and credit are pledged to the GO bonds.

The proceeds for the 2004 bonds will finance or reimburse the costs of various capital expenditures included in the commonwealth's capital investment plan.

### Credit overview

Our rating on Massachusetts reflects its strong economic metrics, with very high per capita income levels compared to the nation, partly the result of the strong presence of high-technology companies in the Boston metropolitan statistical area (MSA). The rating further reflects some historical cyclicality in financial results due to volatile revenue sources, although recent strong growth in tax collections and federal aid have led to large operating surpluses and reserves. The rating also reflects the commonwealth's high debt, pension, and other postemployment benefit (OPEB) liabilities, with a history of funding less than full annual actuarial recommendations to its pension and OPEB funds.

We believe that Massachusetts' economy, with a substantial high-technology sector presence in the Boston MSA, has been a bright spot, with a substantial proportion of highly skilled workers with strong income levels supporting the commonwealth's revenue growth and strong finances. Strong tax growth is expected to boost the commonwealth's budget stabilization fund (BSF) balance, which receives both excess general fund revenue as well as capital gains tax above an annual benchmark, along with certain other lesser revenue sources. Strong revenue growth, combined with extra federal aid and strong budgetary management practices, helped the commonwealth end its last three fiscal years in an extremely strong financial position, with the highest level of reserves in its history. The BSF was $8.04 billion, or 12.8% of operating revenues and other sources as of fiscal year-end June 30, 2023. The trend of adding to its reserves continued in fiscal 2024, with the year ending with a BSF balance of $8.38 billion, or a strong 12.9% of budgeted operating revenues and other source. The state plans another deposit into the BSF, ending fiscal 2025 at about $8.5 billion.

Nevertheless, the commonwealth still faces headwinds as very strong revenue performance in previous fiscal years transitions to more subdued revenue estimates across states. Although national recessionary pressures have waned to a more tepid slowdown in growth, when combined with the commonwealth's long-term liabilities that remain among the highest in the nation, and with a history of underfunding of its pensions, this could lead to budgetary pressures as revenue growth softens and tests the commonwealth's commitment to strong BSF levels in the long term. S&P Global Market Intelligence forecasts that real gross state product (GSP) will experience slower growth than the nation overall through 2027, at 7.1%, compared with the nation's real GDP growth of 7.8%.

S&P Global Ratings' baseline forecasts an expansion of the national economy by about 2% in the next two years. Inflation is likely to be above the 2% target for longer than previously assumed, given that the probability of a disruption to the Fed's easing bias has risen. Employment and national output will continue to cool for the balance of the year and into 2025. With the expectation of higher interest rates (as the Fed reacts to higher inflation expectations) and retaliation from trading partners, global financial markets would likely become more risk averse. Meanwhile, erosion of purchasing power from inflation would likely offset the economic benefit of proposed tax cuts, potentially resulting in a net drag on output and job creation and could weigh on the overall macroeconomic outlook. For additional information see, "Economic Outlook U.S. Q1 2025: Steady Growth, Significant Policy Uncertainty," published Nov. 26, 2024, on RatingsDirect.

The governor approved two supplemental appropriations for fiscal 2024 for its emergency shelter program and associated services. Preliminary expenditure and uses exceed revenue by about $891 million, or 1.4% of expenditures before adjusting for nonrecurring appropriations. However, the deficits are being funded using prior-year surplus revenue and federal appropriations that were previously set aside. The commonwealth does not anticipate any tax rebates paid for fiscal 2024, as revenue is not expected to exceed the allowable limit as defined by Chapter 62F Massachusetts General Laws based on the fiscal 2024 revenue results.

The governor approved the fiscal 2025 budget in July 2024, providing for approximately $57.8 billion in authorized spending, which is about 3.1% higher than enacted fiscal 2024 spending. Massachusetts' enacted fiscal 2025 budget includes gross spending of $62.6 billion and a BSF balance projected at about $8.5 billion at the end of fiscal 2025. The budget is based on a consensus revenue estimate of $41.5 billion, including the $1.3 billion estimate of revenue from the 4% surtax on personal income above $1 million, and yields a structural budget balance after adjusting for nonrecurring uses from previously appropriated funds. The enacted budget also allows $375 million in capital gains tax revenue above the threshold to be diverted from the BSF to be used for budgeted expenditures, if necessary.

Despite the commonwealth's strong finances and economy, financial risks remain. We believe Massachusetts has an above-average dependence on cyclical capital gains tax revenue, which benefits from a strong stock market but could significantly recede in a national economic contraction, thereby pressuring the state's commitment to its financial goals. The state has also had large recent increases in Medicaid enrollment, a potential budgetary concern with the expiration of higher Medicaid reimbursements rates implemented by the federal government during the pandemic. Other long-term pressures for the commonwealth include its high debt levels and moderately high pension and OPEBs liabilities, compared with similarly rated states, which could increase over time. At fiscal year-end 2023, the last audited fiscal year, we calculate the commonwealth had net total tax-backed debt per capita of $5,954 and 7% of personal income, including tax-supported revenue debt.

Massachusetts has underfunded its actuarially required annual pension contribution over the years. Pension contributions are statutorily determined based on a funding schedule set every three years, and the state has made contributions in accordance with its schedule set in 2023. The latest schedule targets a fully funded retirement system by 2036 by increasing annual contributions by 9.63% per year through 2028, a steep increase that we believe defers current pension pressure to future years. Contribution increases are scheduled at a slower rate of 4% afterward through 2036. The commonwealth has contributed less than its actuarial annually recommended contribution since 2011, funding an estimated 95% (including supplemental contributions) of its annual actuarial recommendation in fiscal 2023, which could escalate pension costs in the future and introduce additional pressures to future budgets.

For more information, see our full report on the commonwealth published Sept. 16, 2024.

Factors supporting the 'AA+' GO rating include what we view as Massachusetts':

- Deep and diverse economy and income levels among the highest in the nation, with per capita income at 128% of the nation in 2023;
- History of timely monitoring of revenue and expenditures, and swift action when needed to make adjustments;
- Well-balanced institutional framework that supports predictability, structural balance, and autonomy of raising revenue;
- Strong financial, debt, and budget management policies, including annualized formal debt affordability statements and multiyear capital investment planning;
- Steady financial performance and historically high BSF reserves, equal to about 12.8% of expenditures and position Massachusetts well to manage future fiscal pressures; and
- High debt, pension, and OPEB liabilities which could escalate future costs.

### Environmental, social, and governance

We consider Massachusetts' physical risks moderately negative in our credit rating analysis because of the commonwealth's coastal exposure to rising sea levels, with about two-thirds of its population in the Boston MSA and substantial property value in the combined Boston and Cape Cod area, exposing the state to significant economic disruption following a high-impact event. However, the commonwealth has been addressing environmental risks since 2004 through its Climate Protection Plan, which is regularly updated to meet the needs of the commonwealth and has historically maintained a stable management and policy framework to respond to developing risks. We view social and governance risks as neutral in our credit rating analysis.

## Outlook

The stable outlook reflects our view that Massachusetts' underlying economy and currently very strong reserves support its rating, despite its economically sensitive revenue and the potential for a nationwide economic slowdown.

## Downside scenario

We could lower our rating if we believe Massachusetts will fail to make necessary budget adjustments to maintain structural balance or maintain strong reserves if its revenue weakens. Other factors that could lead to a downgrade include significant increases in debt or other fixed costs, or a significant decline in pension-funded levels due to the commonwealth falling significantly behind required pension funding contribution levels.

## Upside scenario

If Massachusetts significantly reduces its pension and debt obligation while demonstrating continued commitment to strong budgetary policies and pension funding discipline, especially during periods of economic contraction, we could raise our rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.