Moody's Investors Service

New Issue: MOODY'S ASSIGNS Aaa RATING AND STABLE OUTLOOK TO $124.6 MILLION STATE OF MISSOURI GENERAL OBLIGATION REFUNDING BONDS, SERIES A 2010

Global Credit Research - 30 Jun 2010

RATINGS AFFIRMED ON $529 MILLION OF OUTSTANDING G.O. DEBT, AND ON STATE'S OUTSTANDING LEASE DEBT; OUTLOOK IS STABLE

State
MO

Moody's Rating

ISSUE	RATING
General Obligation Refunding Bonds Series A 2010	Aaa

Sale Amount	$124,600,000
Expected Sale Date	07/07/10
Rating Description	General Obligation

Opinion

NEW YORK, Jun 30, 2010 -- Moody's Investors Service has assigned a Aaa rating to the State of Missouri's $124.6 million General Obligation Refunding Bonds, Series A 2010. Concurrently, Moody's has affirmed the state's Aaa rating, affecting $529 million of outstanding general obligation debt, post-refunding. Moody's has also affirmed the Aa1 ratings on $627 million of outstanding appropriation-backed debt issued through the Missouri Board of Public Buildings and the Missouri Development Finance Board; and the Aa2 ratings on $88 million of appropriation-backed debt issued through the St. Louis Regional Convention and Sports Complex Authority, and $85.5 million of outstanding Certificates of Participation. The rating outlook is stable. The rating reflects Missouri's history of excellent financial performance, strong fiscal management controls, and moderate debt burden. Proceeds of the bonds, scheduled to sell on July 7, will refund $116 million of outstanding general obligation debt for net present value savings estimated at 8% of refunded principal, providing $39 million and $4 million of budgetary relief in fiscal years 2011 and 2012, respectively, and shorten the overall maturity structure of the bonds by 10 years.

Credit Strengths:

-- Constitution provides strong executive powers to respond to revenue shortfalls, including the ability to reduce spending to below appropriated levels

-- Budget reserve fund provides state with short-term liquidity without need for external borrowing

-- Conservative fiscal policies have led to healthy GAAP fund balances despite recent reductions; and moderate debt ratios

Credit Challenges:

-- Hancock Amendment limits the state's ability to increase revenues and requires taxpayer rebates when revenue growth exceeds personal income growth

-- Vulnerability to job losses in the manufacturing sector which could impede the state's economic recovery

HIGHEST CREDIT RATING SUPPORTED BY HISTORY OF STRONG FINANCIAL RESULTS

Missouri's highest-quality credit rating is based on a history of financial discipline demonstrated by the state's consistently high available fund balances (unreserved, undesignated fund balance plus reserve funds) as a percentage of operating revenue. Among Aaa-rated states, Missouri's five-year average growth in available fund balance is among the highest. Such strong financial performance is particularly remarkable because it occurred during a period that includes some of the most severe fiscal stress experienced by states, and demonstrates Missouri's determination to maintain a strong credit profile.

FISCAL 2009 FINANCES REMAIN ROBUST, DESPITE REVENUE SHORTFALL; MODEST USE OF RESERVE FUND IN 2010

The state ended fiscal 2009 with a GAAP-basis operating funds (General Fund and Public Education Fund) unreserved, undesignated fund balance (UUFB) of $1.0 billion, and a Budget Reserve Fund balance of $560 million. Those amounts reflect a healthy available balance: combined, the UUFB and budget reserve are nearly 17% of operating revenue, essentially the level recorded in fiscal 2006, despite revenue weakness related to the economic recession. On a budgetary basis, officials project a fiscal 2010 ending balance in the Budget Reserve Fund equal to approximately $527 million.

FISCAL 2010 REVENUES FALL SHORT OF FORECAST

Fiscal 2010 continued to challenge the state, as the economic recession drove significant revenue weakness. While the enacted budget required 4.2% revenue growth over fiscal 2009 actual receipts to support appropriations, actual revenues are projected to reflect a 9.6% decline. Based on the March 2010 estimate, personal income tax collections-which represent roughly 65% of Missouri's general revenue collections - declined by 10.6% compared to fiscal 2009. Sales taxes, the second largest revenue source, comprising 25.6% of revenues, decreased by 4.6% from the prior year. Additionally, corporate income and franchise taxes, which can be difficult to estimate, decreased by 19.5%. As revenue performance deteriorated over the course of the year, the governor implemented spending restrictions totaling over $900 million, and utilized $1.3 billion of federal stabilization funds.

FISCAL 2011 REVENUES REVISED DOWNWARDS; REDUCED SPENDING IN MOST AREAS

The fiscal 2011 consensus forecast, devised last December in advance of the governor's budget proposal, assumed 3.6% revenue growth over fiscal 2010 receipts projected a the time. This estimate has been revised downwards, with the current forecast calling for modest 2.2% growth, reflecting moderate increases in individual income taxes and corporate income and franchise tax collections of 3.7% and 7.5%, respectively; sales taxes also are expected to remain weak, with a slight increase of less than 1% projected. Notably, these estimates fall short of fiscal 2006 actual collections, reflecting the severity of the revenue decline. The enacted budget, which declined by $500 million from fiscal 2010 spending levels reflecting decreases in all areas other than K-12 education, utilizes $859 million of federal stimulus funds and does not assume extension of enhanced federal Medicaid (FMAP) funding. The current refunding will provide an estimated $39 million of budgetary relief in fiscal 2011. Given a projected $100 million un-programmed carry-forward balance from fiscal 2010 to offset unforeseen needs, the requirement that 3% of appropriations be placed in the Governor's Reserve and expectation of normal lapsed appropriations, officials anticipate balanced operations for the year.

Preliminary discussions are underway regarding additional offsets to the expiration of federal stimulus funds as of fiscal 2012. Expenditure savings related to a review of state tax credits, Medicaid cost containment, pension reform, restructuring of employee health benefits, departmental consolidation are under consideration, as well as system upgrades expected to improve revenue collection rates.

ECONOMIC RECOVERY EXPECTED TO KEEP PACE WITH NATION

Missouri's unemployment rate, which exceeded the nation's for the five year period ending in 2008, mirrored the 9.3% national unemployment rate in 2009, and has remained at or below the national level for 11 of the past 12 months. Most recently, unemployment as of May 2010 stood at 9.4%, below the 9.9% US unemployment rate for that month. Missouri's non-farm employment decreased by 0.2% in 2008, followed by a 3.6% decline in 2009; compared with declines of 0.6% and 4.3%, respectively, for the nation.

Missouri continues to lose manufacturing jobs, like most if its Midwestern peers, and has a high concentration of auto-related employment, although the state has been more successful at diversifying its economic base. While manufacturing represented 14.6% of Missouri's non-farm employment in 2000, it had fallen to 10.4% as of 2008. Similarly, other sectors have grown in importance to the state's economic base: professional and business services and financial activities are 18.2% of total non-farm employment, education and health services are 14.1%, and retail trade comprises 11.2% of Missouri employment. Indeed, while Missouri's largest manufacturing employers include the Big Three domestic auto manufacturers, the state also is home to firms such as A.G. Edwards & Sons, Inc., AT&T and several large health systems.

Personal income in Missouri decreased by 1.4% in 2009, compared with a nationwide decline of 1.7%. On a per-capita basis, Missouri's personal income ranks 30th among states and is 91% of the U.S. level. Population growth mirrors that for the US, averaging 0.8% annually over the past five years. Notably, Missouri is one of the few Midwestern states with a recent trend of positive net migration during the same five-year period, in part reflecting the diversification of the state's economic base.

STATE'S LOW DEBT LEVELS A STRONG POINT

Missouri's judicious approach to debt reflects both the state's tradition of conservative financial management and constitutional limits on debt issuance. The state's debt ratios consistently are well below the 50-state medians, although they have risen in recent years following increased issuance by the Missouri Highways and Transportation Commission of bonds backed by motor fuels and motor vehicle sales taxes. The state has chosen to fund a greater share of projects on a pay-as-you-go basis rather than issue debt, and further approaches capital budgeting conservatively: when debt is used, the state fully appropriates for a project's cost in the year debt is issued and carries the unspent amounts of that appropriation forward into future years until fully paid down.

On a per capita basis, Missouri's $780 of net tax-supported debt ranks 31st compared to the median level of $936. Net tax-supported debt as a percentage of personal income is 2.2% in Missouri compared to the U.S. median of 2.5%, ranking 33rd.

RETIREMENT SYSTEMS ARE FUNDED ADEQUATELY, PRELIMINARY OPEB VALUATION REFLECTS MODERATE LIABILITY

Pension and retiree health care benefit obligations are not captured in the state debt medians numbers. The state's primary public retirement system, the Missouri State Employees' Retirement System (MOSERS), had an overall funded ratio of about 83% as of June 30, 2009. The state's unfunded liability for other post-employment benefits (OPEB) is estimated at $1.6 billion as of June 30, 2009, which would require an annual required contribution (ARC) of $125 million or about 1.3% of revenue. In fiscal 2009, the state funded $31.6 million toward the ARC.

EXECUTIVE CONTROL OVER APPROPRIATED FUNDS IS CENTRAL TO STATE'S STRONG FISCAL MANAGEMENT

Missouri's historically conservative financial practices reflect in part the executive's ability to control allotment of appropriated funds during the course of the fiscal year. This power is a particularly strong one that provides the state with an agile means to react to budget shortfalls. Forty percent of appropriations are allotted in the fiscal year's first quarter, with 20% allotted in each succeeding quarter, providing the state with a controlled pattern of expenditure within available revenues. If actual collections fall below the budgeted revenue estimates, the governor may limit expenditures to amounts below the appropriated amounts. The governor also has line-item veto authority, except over appropriations for public debt and public education.

Outlook

The outlook for the State of Missouri's general obligation bonds is stable, reflecting the state's history of sizeable available balances, strong financial management practices, and moderate debt ratios.

What could change the rating - DOWN

-- Inability to address potential declines in existing tax revenue or spending pressure, under inflexible mandates of the state's Hancock amendment.

-- Increased pressure from education, Medicaid or other large category of state spending that strains budgets.

-- Economic weakening that affects state revenue collections

PRINCIPAL METHODOLOGY AND LAST RATING ACTION

The principal methodology used in assigning the rating was Moody's "State Rating Methodology," published in November 2004 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

The last rating action with respect to the State of Missouri was on October 23, 2007 when a Aaa rating with a stable outlook was assigned to $50 million of Water Pollution Control General Obligation Bonds, Series A 2007.

Analysts

Lisa Cole
Analyst
Public Finance Group
Moody's Investors Service

Nicholas Samuels
Backup Analyst
Public Finance Group
Moody's Investors Service

Edith Behr
Senior Credit Officer
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653