FitchRatings

FITCH RATES $338MM MISSISSIPPI GO BONDS 'AA+'; OUTLOOK REVISED TO NEGATIVE

Fitch Ratings-New York-05 November 2013: Fitch Ratings assigns an 'AA+' ratings to the following State of Mississippi general obligation (GO) bonds:

--$179 million GO bonds, series 2013A (taxable);
--$159.225 million GO bonds, series 2013B.

The bonds are expected to sell via negotiation the week of Nov. 11, 2013.

In addition, Fitch affirms the 'AA+' rating on the state's $3.99 billion in outstanding GO bonds and the 'AA' rating on $201 million of appropriation-backed bonds issued by the Mississippi Development Bank (Dept. of Corrections).

The Rating Outlook is revised to Negative from Stable.

SECURITY

The bonds are general obligations of the state, with its full faith and credit pledged.

KEY RATING DRIVERS

OUTLOOK REVISION: The revision in the outlook reflects the state's slow fiscal recovery from the recession and continued reliance on one-time resources to cover recurring needs, in the context of a weak demographic profile and weaker pension funding levels.

CONSERVATIVE FINANCIAL MANAGEMENT: Mississippi's financial management is generally conservative and action to maintain balance amid revenue weakness has been prompt. Stringent budget control mechanisms exist and reserve levels are reduced but remain sound. The 98% budgeting policy, which was suspended through the recession, was reinstated beginning in fiscal 2013; however, the fiscal 2014 budget appropriates a portion of the balance.

MANUFACTURING BASED ECONOMY: The state's socio-economic profile is relatively weak, with wealth and educational attainment indicators that significantly lag national levels. The economy continues to diversify and some successful economic development initiatives should bolster employment in the coming years; however, the manufacturing concentration well exceeds national levels.

HIGH LIABILITIES DUE TO PENSION UNDERFUNDING: Mississippi's debt burden is moderate, but above average, and is largely in the form of GO debt. Unfunded pension liabilities, measured as a percent of personal income, are among the highest of the states.

RATING SENSITIVITIES

The rating may be lowered if the state is unable to consistently fund ongoing operations without relying on one-time revenue sources, if there is weakness in the economy that diverges from the national trend, or if funding for pension liabilities weakens.

CREDIT PROFILE

Mississippi's long-term GO rating of 'AA+' reflects the state's history of conservative financial practices and established reserves in the context of a weak socio-economic profile and high long-term liabilities. The Outlook revision to Negative from Stable reflects the state's slow fiscal recovery and the continued use of one-time revenues to support on-going expenditures despite recent revenue recovery.

USE OF RESERVES DESPITE REVENUE RECOVERY

The state did suspend its 98% budgeting policy for fiscal years 2008 through 2012, but returned to this historical practice in the fiscal 2013 budget as the economy and associated revenues improved. The gradual draw-down of the Working Cash Stabilization Fund, which had reached a peak funding level of $362 million in fiscal 2008, allowed the state to manage reductions in tax revenue associated with the recession. Of some concern, however, is the state's continued use of balances in the fund for budget balancing purposes given recent strong revenue performance, which could leave the state more vulnerable to future revenue volatility. Although it deposited $188 million of fiscal 2013 surplus into the fund, the enacted fiscal 2014 budget transfers $109 million of the balance, in part to spending for Medicaid. The balance is estimated to be $109.5 million at the end of fiscal 2014, 2.2% of general fund revenues.

After two years of revenue weakness related to the recession, revenues began to rebound in fiscal 2011 and stronger growth continued in both fiscal 2012 and fiscal 2013. To achieve balance, the fiscal 2013 budget included 5.5% cuts to many agencies and used cash balances in several funds. The funds were partially replenished with surpluses generated by the return to the policy of appropriating only 98% of expected revenues and strong revenue performance. Unaudited general fund revenues are reported to have exceeded forecast, growing an estimated 5.1% year-over-year.

Revenue estimating continues to be conservative, with the forecast for the current fiscal year requiring no growth over final estimated prior-year results. The enacted budget depletes the budget contingency fund, which is funded from one-time revenues including a transfer from the working cash stabilization fund. A significant portion of the spending from the budget contingency fund is to finance $187 million in Medicaid expenses, a slightly lower amount from non-recurring sources than in fiscal 2013. While the state is not participating in the expansion of Medicaid associated with implementation of the Affordable Care Act, Medicaid costs are expected to increase in fiscal 2014.

MANUFACTURING BASED ECONOMY

Mississippi's economic and demographic profile is relatively weak. The employment base, when compared nationally, is overweight in the more volatile manufacturing sector. Wealth levels are very low - per capita income is ranked 50th among the states and the poverty rate is the highest among the states.

The state lost jobs in the recession generally in line with the U.S. experience, with employment down 5.3% between 2007 and 2010 compared to a 5.6% loss for the nation. However, the state lagged the U.S. in the recovery and employment growth, which had resumed at a slow pace in mid-2010, reversed by mid-2011. After this second dip, employment began growing on a year-over-year basis in November 2011 and has recently begun to demonstrate some strength. Non-farm employment increased 1.7% in August 2013 following a strong summer, with growth in June and July of 2.4% and 2.3% respectively, higher than the national average. Construction and business and professional services experienced particularly strong employment growth of 13.1% and 9.2% respectively in August.

The unemployment rate has fallen from its peak of 11% in February 2010, but remains above the U.S. rate at 8.5% in August 2013, compared to 7.3% for the U.S. With the state's investment in economic development projects designed to diversify and expand the economy, continued moderate growth is expected.

ABOVE AVERAGE LIABILITIES

The state's net tax supported debt of approximately $5.3 billion represents a moderate but above average burden on resources at 5.3% of 2012 personal income. Debt is largely GO and amortization is average, with 58% of outstanding GO debt to be retired in 10 years.

Pension funding continues to decline and the state utilizes a funding methodology that employs a fixed contribution and variation of the amortization period for its unfunded accrued liabilities. Despite having raised employer contributions to 15.75% of payroll and employee contributions to 9% of payroll, the funding of the state's Public Employees' Retirement System declined to 57.7% as of June 30, 2013 and its amortization period increased to 32.2 years. The Fitch-adjusted funded ratio is 51.9%. On a combined basis, the burden of net tax-supported debt and adjusted unfunded pension obligations that are attributable to the state equals 19.4% of 2012 personal income, well above the 7% median for U.S. states rated by Fitch, and amongst the weakest of the states. Fitch notes that the demands of debt and pensions on the state's operating budget continue to be manageable.

The current offerings finance various economic development loans and grants, as well as various capital improvements.

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Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria', dated Aug. 14, 2012;
--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 14, 2012.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015