

FITCH RATES MASSACHUSETTS' GO REVENUE NOTES 'F1+'; OUTLOOK STABLE

Fitch Ratings-New York-15 August 2018: Fitch Ratings has assigned 'F1+' short-term ratings to \$1.5 billion in Commonwealth of Massachusetts general obligation (GO) revenue anticipation notes, consisting of:

- \$500,000,000 2018 series A;
- \$500,000,000 2018 series B;
- \$500,000,000 2018 series C.

The RANs will be offered by competitive sale on or about Aug. 23, 2018.

SECURITY

The notes are general obligations of the Commonwealth, to which its full faith and credit are pledged. A statutory state tax revenue growth limit does not exclude principal and interest on debt obligations from the limit.

ANALYTICAL CONCLUSION

The 'F1+' short-term rating on \$1.5 billion in GO revenue anticipation notes is based on Massachusetts' 'AA+' Issuer Default Rating (IDR), which reflects its considerable economic resources, strong budget controls and a record of careful financial management. The Commonwealth carries a long-term liability burden that is well above average for a U.S. state but remains a moderate burden on resources. A Stable Outlook on the IDR reflects the expectation that the Commonwealth will continue to act as needed to ensure budget balance and maintain an adequate budgeted reserve position.

Economic Resource Base

The Commonwealth has a broad and diverse economy. Employment growth is solid, education levels are high, and population growth has approximated that of the U.S. this decade. The Commonwealth's economic fundamentals include significant strength in the health care, technology and education sectors, leaving it well positioned for solid gains going forward. Measured by per capita personal income, Massachusetts is the second wealthiest state in the nation.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Tax revenues, while diverse, are dominated by personal income taxes (PIT), which are sensitive to economic conditions, particularly those related to capital gains. Baseline growth prospects for taxes are strong, driven by the Commonwealth's solid economic fundamentals.

Expenditure Framework: 'aaa'

Consistent with most states, the natural pace of spending growth is expected to marginally exceed expected revenue growth over time, requiring ongoing cost control. The Commonwealth has ample ability to reduce spending throughout the economic cycle.

Long-Term Liability Burden: 'aa'

Liability levels in Massachusetts, while high for a U.S. state, are a moderate burden on resources. The Commonwealth's above average liability position is partly the result of state funding for needs that are more commonly funded at the local level.

Operating Performance: 'aaa'

The Commonwealth has exceptional fiscal resilience, with strong gap-closing capacity stemming from a practice of building solid reserve balances and making revenue and spending changes as needed in response to changing circumstances. Conservative budgeting, ongoing economic and revenue monitoring, and mechanisms to protect the general fund from economically sensitive PIT and judgment and settlement receipts support the Commonwealth's fiscal flexibility.

RATING SENSITIVITIES

The rating is sensitive to changes in Massachusetts' 'AA+' IDR, to which it is linked.

The IDR is sensitive to Massachusetts' consistent commitment to strong financial management practices, including preserving budgetary flexibility and actively managing its relatively high long-term liability position

CREDIT PROFILE

Massachusetts routinely issues RANs to cover intra-year cash flow needs. The \$1.5 billion in series 2018 RANs being issued for fiscal 2019 liquidity is equal to amounts issued in the last two fiscal years. Although not currently expected, the Commonwealth also periodically issues commercial paper notes to support intra-year cash flow needs. Forecast coverage for the 2018 series RANs is strong at about 5.5x for the series A maturity in April 2019, 3.9x for the series B maturity in May 2019, and 5x for the series C maturity in June 2018. The current official cash flow forecast projects a fiscal 2019 non-segregated operating cash ending balance of nearly \$2.1 billion, down from the \$3.6 billion beginning balance as of July 1, 2018.

Recent cash flow trends have been favorable, with tax collections ahead of earlier forecasts. The ending cash balance in fiscal 2018 was over \$3.6 billion, compared to forecast expectations of \$2 billion when the Commonwealth issued cash flow notes a year ago, for fiscal 2018 cash flow needs. Stronger cash flows were related in part to timing-related increases to tax collections driven by federal tax law changes.

The Commonwealth's stabilization fund is a segregated fund, and thus Fitch does not include it in the coverage figures for cash flow notes. However, the stabilization fund can be drawn on via legislative appropriation fairly expeditiously, and, as such, it provides substantial additional cushion. The stabilization fund balance was nearly \$1.8 billion at June 30, 2018, following the deposit of a net \$463 million from capital gains tax collections in excess of the Commonwealth's \$1.169 billion statutory threshold for fiscal 2018. The budget for fiscal 2019 forecasts a deposit of \$368 million, which would bring the balance to approximately \$2.2 billion.

Massachusetts' 'AA+' IDR reflects its solid credit attributes. The Commonwealth's dynamic, service-oriented economy, anchored by numerous institutions of higher education and health care, has solid growth prospects despite remaining sensitive to national trends. Net tax-supported debt and pension liabilities are high for a state but represent only a moderate burden on resources; high debt levels are partly explained by the Commonwealth's role in funding local capital needs. Sources of fiscal flexibility include the balance in the stabilization fund, noted above. Moreover, in the event of a mid-year forecast deficiency, the governor is required to reduce allotments or identify other balancing measures. Operating performance is enhanced further by mechanisms to cap the impact of volatile capital gains-related PIT receipts and judgment and settlement payments on the general fund.

For additional information on the Commonwealth of Massachusetts, please see Fitch's press release, "Fitch Rates Massachusetts' GO Bonds 'AA+'; Outlook Stable", dated Aug. 9, 2018, at www.fitchratings.com.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

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Additional information is available on www.fitchratings.com

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

<https://www.fitchratings.com/site/re/10024656>

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