Fitch Ratings

FITCH RATES MASSACHUSETTS' $350MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-18 May 2012: Fitch Ratings assigns an 'AA+' rating to the following Commonwealth of Massachusetts general obligation (GO) bonds:

--$350 million GO bonds consolidated loan of 2012, series B.

The bonds are scheduled to sell through competitive bid on May 22, 2012.

In addition, Fitch affirms the following ratings:

--Approximately $19 billion of outstanding Commonwealth GO and Commonwealth guaranteed bonds at 'AA+'.

The Rating Outlook is Stable.

SECURITY

General obligations of the Commonwealth, to which its full faith and credit are pledged.

KEY RATING DRIVERS

--STRONG AND WEALTHY ECONOMY: Massachusetts has a broad and diverse economy with the second highest personal income per capita in the nation.

--PRUDENT FINANCIAL MANAGEMENT: The Commonwealth has benefited from conservative budgeting and sound financial practices over time. A limitation on the use of capital gains-related tax revenue has reduced the volatility of economically sensitive revenues, and the Commonwealth has shown a commitment to reserve funding. A new initiative to develop a long-term fiscal policy framework is illustrative of the Commonwealth's careful approach to financial management.

--COMPARATIVELY HIGH LIABILITY BURDEN: Massachusetts' debt levels are high for a U.S. state government, and Fitch expects them to remain so. The comparatively high debt levels are partially explained by an above-average role in relation to local levels of government when compared to most other states.
The Commonwealth is responsible for the pension benefits of not only Commonwealth employees but also teachers statewide, and the combined burden of debt and pensions is also well above the median for U.S. states rated by Fitch.

CREDIT PROFILE

Massachusetts' current financial position has stabilized following a period of steep decline in the recession. Strong revenue performance in fiscal 2011, led by 13.5% year-over-year growth in personal income taxes, allowed for an increase in the stabilization fund balance to $1.4 billion, up from $670 million at the end of fiscal 2010. For the current fiscal 2012, the Commonwealth addressed a large budget gap that reflected the phase-out of federal stimulus funds primarily through spending control, particularly in the area of health care. Despite much more modest revenue growth in fiscal 2012, the Commonwealth forecasts reserve levels to be maintained, with additional deposits likely from capital gains-related revenue and one-time judgments and settlement payments. The proposed budgets from the governor and legislature for fiscal 2013, which begins on July 1, again rely on spending control to maintain balance. Proposals include a reserve draw of as much as $400 million, without considering capital gains-related revenue and one-time judgments and settlement payments.

The fiscal 2012 enacted budget assumed relatively modest baseline tax revenue growth over fiscal 2011 (about 1.7%). The revenue forecast was raised from $20.6 billion to $21 billion in October 2011 due to revenue overperformance in the first few months of the year, and now projects year-over-year baseline growth of 3.7%. Through April, actual results are $180 million below the revised forecast. Personal income tax revenues are up 3.6% (baseline) year-to-date compared to the prior fiscal year, while sales and use tax revenues are up 4.9%. The consensus tax revenue forecast of $21.95 billion for fiscal 2013, released in January 2012, assumes baseline tax revenue growth of 5.4%.

Due to the strong fiscal 2011 revenue performance, the state's flat income tax rate automatically dropped from 5.3% to 5.25% effective Jan. 1, 2012. The Commonwealth estimates the impact of the change at only approximately $55 million in fiscal 2012, rising to about $115 million in fiscal 2013. Although legislation was recently passed to license up to three regional resort casinos and one slot facility, much of the revenue is expected to go to local governments and there is no related money assumed in the Commonwealth's fiscal 2012 budget or the proposed budgets for fiscal 2013.

Massachusetts has consistently taken timely action to ensure budget balance in recent downturns while maintaining some level of reserves. This is important given the nature of the Commonwealth's revenue system, which quickly reflects changing economic conditions. With economic deterioration, tax revenue forecasts were reduced significantly over the course of fiscal 2009, from $21.4 billion in the enacted budget to actual results of $18.3 billion, and the year ended down 13% (baseline) compared to fiscal 2008. The budget for fiscal 2010 included a 25% increase in the Commonwealth's sales tax rate (to 6.25%) and other revenue measures totaling about $1 billion. Fiscal 2010 taxes were down 3.4% (baseline) versus fiscal 2009.

In addition to solid ongoing budget management, in recent years the Commonwealth has proactively taken steps to reduce the volatility of its revenue system. The variability and unpredictability of capital gains-related tax revenue has been a key factor in this volatility over time. In response, the fiscal 2011 enacted budget included a new mechanism for budgeting capital gains-related tax revenue that limits the amount of such revenue that can be included in the Commonwealth's budget to $1 billion, with excesses dedicated to reserve funding. A similar change requires one-time judgments and settlement payments in excess of $10 million be deposited in the stabilization fund; $214 million of such revenue has been deposited to date in fiscal 2012, and the Department of Revenue's April tax collections report notes another $200 million in non-recurring business and corporate tax-related payments that will be recognized in May. Along the same lines, the Commonwealth is now developing a long-term fiscal policy framework focused on budget sustainability.

Massachusetts has a fundamentally strong and wealthy economy. At 129% of the U.S. average, the Commonwealth's personal income per capita is the second highest of the states. After experiencing among the steepest employment drops in the country from 2002-2004, the Commonwealth's performance in the recent recession was significantly better than the national experience. Employment losses in 2009 were less severe than those of the U.S. (3.3% versus 4.4%), and Commonwealth employment rose 0.3% in 2010 while the U.S. employment fell 0.7%. Based on U.S. Bureau of Labor Statistics estimates, employment continued to rise in 2011, with year-over-year growth of 0.6% in Massachusetts equaling about half the increase for the nation, and employment was up 0.6% year-over-year in April 2012. Massachusetts' unemployment rate of 6.3% for April 2012 was 78% of the U.S. level.

The Commonwealth's net tax-supported debt equals a comparatively high 9.6% of personal income, including sales tax obligations of the Massachusetts Bay Transportation Authority and the Massachusetts School Building Authority and contract assistance commitments to the Massachusetts Department of Transportation. The comparatively high debt levels are partially explained by the Commonwealth's above-average role in relation to local levels of government when compared to most other states. GO debt continues to represent the majority of outstanding debt. Fitch expects debt to remain high.

The Commonwealth is responsible for the pension benefits of not only Commonwealth employees but also teachers statewide. To avoid a large increase in the annual contribution for pensions in the fiscal 2012 budget, the schedule for amortizing the unfunded liability was extended from 2025 to 2040. The Commonwealth has undertaken some pension reforms and projects manageable growth in pension funding requirements going forward.

On a combined basis, the burden of net tax-supported debt and adjusted unfunded pension obligations equals 17.4% of 2011 personal income, well above the 6.6% median for U.S. states rated by Fitch.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria', dated Aug. 15, 2011;
--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 15, 2011;
--'Improving Comparability of State Liabilities', dated March 28, 2012.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648898
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648897
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