FITCH RATES $674MM MASSACHUSETTS GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-16 June 2016: Fitch Ratings has assigned an 'AA+' rating to approximately $674 million in Commonwealth of Massachusetts general obligation (GO) bonds, consisting of:

--$250,000,000 GO bonds, consolidated loan of 2016, series F (green bonds)(federally taxable);
--$423,510,000 GO refunding bonds, 2016 series B.

The 2016 series F green bonds are scheduled to sell via negotiated sale on June 28, 2016. The 2016 series B refunding bonds are scheduled to sell via negotiated sale on June 29, 2016.

The Rating Outlook is Stable.

SECURITY
The bonds 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.

KEY RATING DRIVERS

Massachusetts' 'AA+' Issuer Default Rating 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. The Stable Outlook 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, a marked improvement from historical experience and the performance of other states in the region. Its economic fundamentals include significant strength in health care, technology and education, leaving it well positioned for solid gains going forward. Measured by per capita personal income, Massachusetts measures second-highest in the nation.

Revenue Framework: 'aaa' factor assessment
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' factor assessment
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' factor assessment
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' factor assessment
The Commonwealth has exceptional fiscal resilience, with 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 personal income taxes and judgment and settlement receipts support the Commonwealth's fiscal flexibility.

RATING SENSITIVITIES
The rating is sensitive to shifts in fundamental credit characteristics including Massachusetts' consistent commitment to strong financial management practices.

CREDIT PROFILE

Massachusetts has a fundamentally strong economy with solid growth prospects. A dynamic, service-oriented economy includes numerous institutions of higher education and health care that lend stability, in addition to supporting development and innovation in other areas. At 128% of the U.S. average, per capita personal income is the second highest of the states. Educational attainment is very high, and population growth has approximated that of the U.S. during this decade, a shift from historical experience of slow population gains. Despite this shift, the Commonwealth's population profile remains older than the U.S. average, consistent with other states in the region.

Economic performance has been highly sensitive to national trends. In the most recent recession economic performance was significantly better than the national experience, in contrast to 2002-2004 when Massachusetts suffered among the steepest employment drops in the country. Employment losses in the most recent recession were slightly less severe than those of the U.S. (down 6% in Massachusetts versus 6.3% for the U.S.), and employment since then has risen slightly more than the U.S. (up 11.3% in Massachusetts versus 10.9% for the U.S.).

For much of the expansion, employment gains in Massachusetts have approximated the national trend, while unemployment rates have remained consistently below the nation's. Growth in key services continues to be significant, with professional and business services and education and health experiencing above-average gains. Personal income has continued to grow at levels matching or exceeding the national average.

Revenue Framework
General fund resources derive primarily from PIT, sales tax and corporate income tax. The former two are particularly important, with an estimated 57% of general fund revenues from PIT and another 24% from sales tax in fiscal 2016. The PIT is levied at a flat rate based on type of income, with a 5.1% rate currently applicable to most categories. Under current law the Commonwealth has been gradually lowering the PIT rate to 5%, from a previous level of 5.3%, in 0.05% increments based on a statutory mechanism incorporating Boston-area inflation and baseline revenue growth. Revenues have been economically sensitive, particularly PIT receipts from capital gains as well as receipts from judgments and settlements.

Solid economic fundamentals and a revenue system that captures economic growth are the basis for a revenue profile that is likely to grow at or above the national average over time, in Fitch's view.

The Commonwealth has no significant legal limitations on its ability to raise revenues. A statutory tax revenue growth limit based on average wage and salary growth is present but has not hindered the Commonwealth's ability to manage its revenue resources. The initiative environment has been active periodically, and certain revenues have been affected by past initiative petitions, notably property taxes. Importantly, the legislature retains the ability to make changes to successful initiative petitions.

Expenditure Framework

Massachusetts' expenditure profile is very broad, driven by an expansive scope of services. Medicaid and other social services are the largest single spending commitment in the general fund at about half of total spending; rising needs including those emerging from implementation of the Affordable Care Act have pressured total spending in recent years. Education is also a significant commitment, with extensive funding of local schools and a broad higher education network. The Commonwealth's education commitment extends to covering the pension liabilities of local teachers. Consistent with practices in many smaller states, the Commonwealth is responsible for delivering or funding many services routinely funded at local levels in other states.

As with most states, spending in the absence of policy actions is expected to be in line with, to marginally above, expected revenue growth, driven by social services, particularly Medicaid. The state retains considerable ability to cut spending. Statute allows for swift response in the event of forecast revenue underperformance, including the governor's ability to unilaterally cut allotments under Section 9C.

Long-Term Liability Burden

Debt and pension liabilities are high for a state but represent only a moderate burden on resources. On a combined basis, the burden of net tax-supported debt and unfunded pension liability for employees and teachers equaled 18.9% of personal income, well above the 5.8% median for U.S. states as of Fitch's 2015 state pension update report.

The Commonwealth's net tax-supported debt equals a comparatively high 9.1% of personal income as of Apr. 30, 2016, including sales tax-backed obligations of the Massachusetts Bay Transportation Authority and the Massachusetts School Building Authority and annual contract assistance commitments that support the Massachusetts Department of Transportation. GO debt continues to represent the majority of outstanding debt. The comparatively high direct debt level is partially explained by the Commonwealth's above-average role in funding local government capital needs, relative to most other states. Fitch expects direct debt to remain high for a U.S. state but still manageable.

As of Jan. 1, 2015, the latest valuation date, the systems covering state employees and teachers (except in the City of Boston) were funded at 67.5% and 54.3%, respectively. Using Fitch's more conservative 7% return assumption would result in lower funded ratios of 62.3% and 50.1%. Some pension reforms have been undertaken, including shifting to more conservative assumptions while maintaining a statutorily closed amortization target for achieving full funding in 2040. A 2014 agreement accelerated the schedule for full pension prefunding by increasing contributions 10% per year through fiscal 2017 and 7% in subsequent years. Full prefunding is projected for fiscal 2036 based on current assumptions.

Operating Performance

Fitch believes the Commonwealth retains significant flexibility to address cyclical downturns and operating under-performance and has repeatedly demonstrated its commitment to maintaining a solid financial position. Mechanisms for maintaining balance include the governor's requirement to reduce allotments or identify alternative balancing measures in the event of a mid-year forecast deficiency, under Section 9C of Commonwealth general statute.

The Commonwealth has established mechanisms to cap the impact of volatile capital gains-related PIT receipts and judgment and settlement payments on the general fund, with excesses devoted to the stabilization fund (the Commonwealth's rainy day fund) or to retirement liabilities. Since fiscal 2011, capital gains have been budgeted in the general fund at $1 billion maximum, rising annually based on U.S. GDP growth; as of fiscal 2016 the figure is $1.087 billion. Judgments and settlements are budgeted in the general fund based on a five-year rolling benchmark, currently at $267 million.

In the last recession the Commonwealth relied on allotment cuts, federal stimulus and draws on the stabilization fund, although the Commonwealth did not fully deplete the fund, the balance of which fell to $670 million in fiscal 2010 from a high of $2.34 billion in fiscal 2007.

The Commonwealth has continued to demonstrate ample flexibility both in the form of the rebuilt stabilization fund as well as its ability to cut expenses in response to unforeseen weakness. Similar to many states, the Commonwealth has faced budgetary challenges at several points in the current expansion, including the impact of shifting federal tax law and unexpected demands for Medicaid triggered in part by federal health reform. Although these factors have weighed on progress in rebuilding stabilization fund balances to prerecession levels, the existing balances remain solid and considerable flexibility remains.

With initial recovery, the stabilization fund balance rose to $1.65 billion by fiscal 2012, driven by capital gains and judgment and settlement receipts in excess of their respective caps. Unexpected Medicaid needs and underperformance on PIT receipts resulted in draws and partial suspensions of planned stabilization fund deposits. The stabilization fund balance remains a still adequate $1.26 billion estimated at fiscal 2016 year-end, equal to 4.9% of fiscal 2016 tax revenues. An additional partial suspension of planned deposits was part of the governor's executive budget for fiscal 2017, although $206 million would still be deposited.

Recent Operating Performance Steady

The fiscal 2016 tax revenue forecast, based on the January 2015 consensus and subsequent budgeted adjustments, assumed tax revenues of $25.6 billion, 2.7% higher than actual fiscal 2015 collections. The forecast estimated almost $1.4 billion in capital gains, higher than the $1.087 billion capital gains threshold. Rather than transferring the resulting $300 million in excess collections to the stabilization fund, the budget retained the excess for current-year spending needs. The budget incorporated the expected PIT rate reduction to 5.1%, from 5.15%, effective Jan. 1, 2016.

As of the January 2016 consensus forecast, fiscal 2016 tax revenues were estimated at $25.8 billion, 3.3% higher than fiscal 2015 actual tax revenues. Budgeted expenditures and other uses in fiscal 2016, currently estimated at nearly $40.7 billion, are 6.9% higher than the prior year, a growth rate above the 6.2% reported for fiscal 2015. The majority of fiscal 2016 expenditure increases are directed to Medicaid and health and human services needs even as the Commonwealth continues to focus on slowing the Medicaid spending growth that surged in early 2014 with health care expansion.

Consistent with recent years, the Commonwealth has faced tax revenue underperformance in fiscal 2016 since budget adoption. A forecast deficiency of $320 million was identified in early January due to slower non-tax revenue collections and unexpected spending needs. The Commonwealth implemented Section 9C actions including non-tax revenue actions and allotment cuts.

Despite these actions, tax revenue underperformance continues to be a challenge in fiscal 2016. Year-to-date through May, tax revenue collections are growing 1.9% from the previous year, but are $311 million below the forecast benchmark, driven by PIT collections. The Commonwealth's experience with PIT collections in fiscal 2016 is consistent with those of multiple states with significant PIT collections, including from capital gains. The Commonwealth has disclosed that total fiscal 2016 tax revenue is currently expected to be $320 million to $370 million below expectations.

Based on the Commonwealth's January 2016 consensus forecast, fiscal 2017 revenues of nearly $26.9 billion were expected to be 4.3% higher than the revised fiscal 2016 forecast; the fiscal 2017 figure assumed an additional 0.05% drop in the PIT rate, to 5.05%. Given recently lower tax revenue collections in fiscal 2016, estimated fiscal 2017 tax revenues are now expected to be $450 million to $750 million below the forecast benchmark. Additionally, the Commonwealth has disclosed that the $206 million proposed deposit of excess capital gains to the stabilization fund, noted earlier, may be reduced. Deliberations on the budget for fiscal 2017 continue in the state's legislature.

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Additional information is available at 'www.fitchratings.com'.

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

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478