

FITCH RATES MASSACHUSETTS SUB GANS 'AA+'; AFFIRMS OUTSTANDING SR & SUB LIEN GANS AT 'AA+'

Fitch Ratings-New York-29 October 2013: Fitch Ratings assigns an 'AA+' rating to approximately \$287.9 million of Commonwealth of Massachusetts (the Commonwealth) subordinate lien Federal Highway Grant Anticipation Notes (GANs), 2013 series A. The GANs are expected to price the week of Nov. 4, with closing scheduled for the week of Nov. 11.

Fitch also affirms the 'AA+' rating on the commonwealth's \$100 million of outstanding subordinate lien GANs, series 2010A, and approximately \$349.1 million of senior lien revenue refunding GANs, series 2003A and 2010A. The senior lien is closed, with a final maturity in June of 2015.

The Rating Outlook is Stable for both liens.

The 2013 series A bonds are the second issuance of subordinate lien GANs to fund the Commonwealth's Accelerated Bridge Program (ABP). Following the upcoming sale, issuances to date will total approximately \$388 million out of a total \$1.1 billion in authorization to complete the program.

Federal reimbursement revenues from the Highway Trust Fund (HTF) and a subordinate lien on Commonwealth Transportation Fund (CTF) revenues secure both the senior and subordinate lien GANs. The primary applicable Fitch criteria for the above ratings is "Leveraging Federal Transportation Grants: Rating Criteria for GARVEE Bonds," with the credit provided by the CTF revenues evaluated under the U.S. State Government Tax-Supported Rating Criteria.

Currently, the highest-rated Fitch standalone GARVEE bonds - those for which HTF revenues are the only pledged revenue source - are rated 'A+', reflecting primarily Fitch's view of the strength of the federal program currently authorizing outlays to state Depts of Transportation from the HTF. Therefore, the 'AA+' rating on the commonwealth's senior and subordinate lien GANs reflects Fitch's view of the strong enhancement provided by the revenues from the CTF.

KEY RATING DRIVERS

Pledge of Commonwealth Revenues and Strong Structural Protections Mitigate Federal Concern: Although federal highway reimbursement revenues received by the Commonwealth are expected to cover debt service on both series of GANs, both liens also benefit from additional pledges of revenues deposited in the CTF, providing strong debt service coverage to a potentially declining long-term federal revenue stream. In addition, the GANs' Trust Agreement establishes funds and accounts that govern the collection of federal highway reimbursements and fund debt service up to one year in advance.

Strong Debt Service Coverage: Projected debt service coverage is strong. Though the CTF pledges for the GANs are subordinate to payment of CTF bond debt service, the high 4x maximum annual debt service (MADS) additional bonds test (ABT) on senior CTF bonds protects against overleveraging.

CTF Revenues Offer Limited Growth Potential: The pledged CTF revenues have shown relative stability over time, and the Commonwealth has shown the willingness and ability to raise revenues. However, Fitch believes the revenue stream has limited growth potential absent Commonwealth action to increase rates.

Uncertainty of the Federal Program: In Fitch's view, the federal program, once formula driven and funded on a multiyear basis, has now morphed into a program where future policy is less certain.

Funding levels are less predictable, and more frequent action is needed from Congress to extend authorization and on general fund transfers that will likely need to be continued indefinitely barring an increase in the federal gas-tax or a significant reduction in spending.

CTF Pledges Require Commonwealth Appropriation: Use of CTF revenues for GANs debt service requires Commonwealth appropriation. However, should an appropriation not be provided, monies are frozen until debt service has been funded, which Fitch believes effectively eliminates the risk of non-appropriation.

RATING SENSITIVITIES

Debt Service Coverage: The rating is sensitive to the performance of pledged revenues and the resulting strength of debt service coverage. Given uncertainty related to the federal program, coverage provided by the net CTF pledge is key.

Limited Leveraging of CTF Revenues: Additional leveraging of CTF revenues, beyond the current 4x ABT on senior CTF bonds, that weaken the back-up pledge would likely pressure the ratings. The Commonwealth's current plans would maintain coverage at much higher levels.

SECURITY

The senior GANs are secured by a senior lien on all federal highway reimbursements received by the Commonwealth. The notes are also secured by a subordinate lien on up to \$0.10 per gallon of the Commonwealth's Chapter 64A gas tax receipts in the event of a true-up condition, defined as a situation where the aggregate amount appropriated by law from the HTF is less than \$17.1 billion for the current federal fiscal year and the debt service coverage ratio for the following state fiscal year is less than 1.2x. As the senior lien is closed, with a final maturity in June of 2015, these tests have been met for the remaining life of the bonds and a true-up condition will not be triggered.

The subordinate GANs are secured by a subordinate lien on all federal highway reimbursements received by the Commonwealth. Additionally, these bonds have a secondary pledge of net CTF revenues, after the payment of any CTF bond obligations, consisting of Chapters 64A, 64E and 64F tax receipts, all registry motor vehicle fees, Build America Bond subsidies, and any additional pledged CTF funds.

CREDIT UPDATE

Projected federal highway reimbursement revenues provide solid coverage of GANs debt service.

However, in Fitch's view, the unsustainable trajectory of the HTF may lead to policy changes that could affect debt service coverage afforded to GAN bondholders from this revenue stream.

The HTF's expenditures have been exceeding revenues over the past several years. The most recent authorization, Moving Ahead for Progress in the 21st Century (MAP-21), provides funding certainty through federal fiscal year (FFY) 2014 but does not address longer-term issues regarding the sustainability of the federal program or solvency of the HTF, instead relying on a total of \$18.8 billion in general fund transfers in FFYs 2013 and 2014. Funding levels have become less certain and difficult to predict beyond the current authorization. In addition, the increase in corporate fuel economy standards approved in August 2012 would adversely impact gas tax revenues which support the HTF.

Given uncertainty related to the federal program, Fitch believes that the additional pledge of net CTF revenues is critical to the strength of the GANs. The 4x ABT for CTF senior bonds provides strong protection against overleveraging. Although it has no current intent to do so, the Commonwealth

retains the legal flexibility to issue subordinate CTF bonds that would have a claim senior to the GANs. However, Fitch believes that the need for the Commonwealth to fund its ongoing transportation program provides a practical limit on issuance, and, based on full issuance under the Commonwealth's current financing program, projected debt service coverage is very strong. Issuance beyond the current ABP authorization would require legislative action.

In 2008, the Massachusetts legislature approved the ABP. The program authorizes the issuance of up to \$1.108 billion in federal highway GANs and up to \$1.876 billion in special obligation bonds of the Commonwealth to finance the construction, reconstruction and repair of or improvements to bridges and approaches. The Transportation Reform Act, passed in June 2009, created the CTF revenue source to fund transportation needs and secure the special obligation bonds under the Bridge Program Act. Fitch notes that the ABP has resulted in a nearly 20% reduction in the amount of structurally deficient bridges in the Commonwealth, from 543 at the program's beginning to 436 as of August 2013. In addition, construction contract advertisements are 93% complete, with 70% of overall construction contracts executed.

Fitch also notes that earlier in 2013, the Commonwealth raised the current state gas tax to \$0.24 from \$0.21, showing a willingness and ability to raise rates to bolster what is expected to be a longer-term declining revenue stream. The Commonwealth's Department of Revenue (DOR) estimates that the increase will add \$95 million annually to the CTF, adding an additional layer of debt service coverage to bondholders.

The Commonwealth will issue any future GANs to fund the ABP on the subordinate lien as the senior lien is now closed, maturing in 2015. Subordinate lien principal amortization begins in 2016, after the 2015 series is retired. Current expectations are to issue the remaining GAN authorization in multiple offerings through 2015.

Commonwealth management projects 2014 federal reimbursements to total \$627.8 million, which would result in an aggregate debt service coverage ratio (DSCR) on senior and subordinate lien GAN principal and interest payments of 3.8x, compared to a forecasted 2.6x at the time of the 2010 issuances. Using net CTF revenues only, coverage is a strong 5.5x. All pledged federal and state funds provide 9.0x coverage. Fitch estimates the average DSCR through maturity of the entire authorization of GANs to be 4.4x with federal funds alone and a robust 13.6x using both state and federal revenues.

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Applicable Criteria and Related Research:

--'Leveraging Federal Transportation Grants: Rating Criteria for GARVEE Bonds' (Aug. 15, 2012);
--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Leveraging Federal Transportation Grants: Rating Criteria for GARVEE Bonds
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685504
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033

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