Fitch Ratings

FITCH RATES MASSACHUSETTS' $400MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-15 December 2011: Fitch Ratings assigns an 'AA+' rating to the following Commonwealth of Massachusetts general obligation (GO) bonds:

--$400,000,000 consolidated loan of 2011 series E.

In addition, Fitch affirms the following ratings:

--Approximately $18 billion of outstanding Commonwealth GO and Commonwealth guaranteed bonds at 'AA+'.

The Rating Outlook is Stable.

The bonds are expected to sell through competitive bid on Dec. 20, 2011.

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 reduces the volatility of economically sensitive revenues, and the Commonwealth has shown a commitment to reserve funding.

--HIGH DEBT BURDEN: Massachusetts' debt levels are high for a U.S. state government, and Fitch expects them to remain so.

CREDIT PROFILE

Massachusetts' current financial position is significantly improved from the downturn. Revenue performance for fiscal 2011, which ended on June 30, was strong after a period of steep decline. Tax revenues came in well above budget estimates, rising 9.3% (baseline) above fiscal 2010 results, primarily due to strength in the personal income tax, which was up 13.5% year-over-year. Surplus revenues allowed for an increase in the stabilization fund balance to $1.4 billion, up from $670 million at the end of fiscal 2010. Although reduced from the peak funding level of $2.3 billion at the end of fiscal 2007, the reserve fund provides meaningful financial cushion against revenue underperformance or above-budget spending. Fitch expects continued, albeit slower, revenue growth to continue.

The enacted budget for fiscal 2012 assumed relatively modest baseline tax revenue growth over fiscal 2011 (about 1.7%). A large budget gap that reflected the phase-out of federal stimulus funds was resolved primarily through spending control, particularly in the area of health care. The revenue forecast was raised from $20.6 billion to $21 billion in October due to revenue overperformance in the first few months of the year, and now projects year-over-year baseline growth of 3.7%. The current forecast projects only a modest $124 million drawdown from the stabilization fund.

Through November, revenues are in line with revised estimates. Personal income tax withholding revenues are up 3.3% (baseline) year-to-date compared to the prior fiscal year, while estimated payments are 21.5% higher. Sales and use tax revenues are 3.2% ahead of the prior year. The governor's executive budget proposal for fiscal 2013 is scheduled to be released in late January.

Due to the strong revenue performance, the state's flat income tax rate is expected to automatically drop from 5.3% to 5.25% effective Jan. 1, 2012. The Commonwealth estimates the impact of such a 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.

Massachusetts consistently has 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; $81 million of such revenue has been deposited to date in fiscal 2012.

Massachusetts has a fundamentally strong and wealthy economy. At 128% of the U.S. average, the Commonwealth's personal income per capita is the second highest in the nation. After experiencing among the steepest employment drops in the country during the prior recession, the Commonwealth's performance in the recent downturn was significantly better than the national experience. Employment losses in 2009 were below those of the U.S. (3.3% versus. 4.4%) and the Commonwealth's employment in 2010 rose 0.2% while the U.S. dropped 0.8%. Employment gains have improved in 2011, and October year-over-year growth of 1.6% in Massachusetts compares to a 1.2% increase for the nation. Massachusetts' unemployment rate of 7.3% for the month was 81% of the U.S. level.

The Commonwealth's net tax-supported debt equals a comparatively high 10% 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 other states. Fitch expects debt to remain high. GO debt continues to represent the majority of the Commonwealth's outstanding debt.

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.

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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.

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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