

FITCH RATES MASSACHUSETTS' \$293MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-19 July 2010: Fitch Ratings assigns an 'AA+' rating to the following Commonwealth of Massachusetts general obligation (GO) bonds:

- \$119,640,000 GO refunding bonds, 2010 series B;
- \$173,460,000 GO bonds, consolidated loan of 2010, series C.

In addition, Fitch affirms the following ratings:

- Approximately \$17.5 billion of outstanding Commonwealth GO and Commonwealth guaranteed bonds at 'AA+'.

The Rating Outlook is Stable.

The bonds are expected to sell through negotiation the week of July 19, 2010.

RATING RATIONALE:

- Massachusetts has a fundamentally strong and wealthy economy, although population growth is slow.
- The Commonwealth has benefited from conservative budgeting and sound financial practices over time. Although significantly reduced, reserves remain to provide a hedge against the Commonwealth's somewhat volatile revenue stream.
- Debt levels are high.

KEY RATING DRIVER:

Continued timely action to ensure budget balance and maintenance of an adequate budgeted reserve position.

SECURITY:

Massachusetts' 'AA+' rating reflects considerable economic resources and a record of prudent financial management. Credit strengths are tempered by a very heavy debt burden; net tax-supported debt equals about 9% of personal income and Fitch expects that debt levels will remain high. The Stable Rating Outlook reflects the expectation that the Commonwealth will continue to act to ensure budget balance and maintain an adequate budgeted reserve position in a weak economic and revenue environment and as federal stimulus funds that have supported the budget expire.

The Commonwealth, which has a somewhat volatile revenue system that quickly reflects changing economic conditions, has taken timely action to ensure budget balance in recent downturns while maintaining some level of reserves. 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 Commonwealth responded with spending cuts and controls, the application of extraordinary federal stimulus assistance funds, and a large reserve draw; the year closed with a small surplus.

The budget for fiscal 2010, which ended on June 30, included a 25% increase in the Commonwealth's sales tax rate (to 6.25%) and other revenue measures totaling about \$1 billion, as well as additional spending control, another reserve fund draw, and federal stimulus to address a gap of about \$5 billion. Gaps that developed over the course of the year, due to reduced revenue expectations and increased spending needs (largely for social services), were addressed promptly. As of the July 15 report, actual revenue performance was \$78 million above the downwardly revised estimate of \$18.5 billion (as compared to the original budget forecast of \$18.9 billion). Total taxes were down 3.4% (baseline) versus fiscal 2009, reflecting a 3.9% sales tax drop, a 4.4%

personal income tax decline, and a 1.3% corporate and business tax increase. Underperformance in income tax revenues, largely attributable to weaker than expected capital gains-related revenue, was offset by above-forecast returns of the other tax revenues.

The consensus tax revenue forecast for fiscal 2011 assumes baseline growth of 2.5% from fiscal 2010. The executive budget proposal for the year was released in January 2010. The governor's proposal closed an estimated gap of \$2.75 billion, including through a \$175 million reserve fund draw, up to \$300 million from debt restructuring for budget relief, and federal stimulus funds of \$1.4 billion (with more than \$600 million of that from an assumed six-month extension of federal stimulus funds related to the Medicaid program). Following the 25% increase in the sales tax rate that became effective on Aug. 1, 2009, the executive budget did not include any broad-based tax increases. The final budget was generally in line with the governor's proposal, and the current offering implements a portion of the debt restructuring for budget relief. As the extension of federal stimulus funds related to the Medicaid program has not been approved, the enacted budget replaced those funds with additional spending cuts and a reserve fund draw of \$100 million. The estimated fiscal 2011 ending reserve fund balance of \$556 million, although reduced from the peak funding level of \$2.3 billion at the end of fiscal 2007, provides some financial cushion against revenue underperformance or above-budget spending.

The November 2010 ballot will include voter initiatives to reduce the sales tax rate to 3% and reverse the recent expansion of the sales tax to alcoholic beverages, measures that would result in a significant reduction in revenues. If approved by voters, the initiatives become law 30 days after the date of the election but may be subsequently amended or repealed by the legislature. Initiatives in the past to lower or eliminate the personal income tax have failed.

The variability and unpredictability of capital gains-related tax revenue has been a key factor in the volatility of the Commonwealth's overall budget. The fiscal 2011 enacted budget included a new mechanism for budgeting capital gains-related tax revenue that will limit the amount of such revenue that can be included in the Commonwealth's budget going forward, with excesses dedicated to reserve funding. Fitch believes that this change is a budgeting policy improvement.

Massachusetts has a fundamentally strong and wealthy economy, with the third highest personal income per capita in the nation (127% of the U.S.). The Commonwealth experienced among the steepest employment drops in the country during the last recession and, despite registering year-over-year employment gains in every month from July 2004 to September 2008, did not regain its prior peak. Employment began to decline in November 2008 but losses have been below those of the U.S. May 2010 employment was essentially flat to May 2009, compared to a 0.4% loss for the nation; this follows losses of 3.6% and 4.3% for the state and the nation, respectively, in 2009. The Commonwealth's unemployment rate of 9.2% in May 2010 was high for Massachusetts but 95% of the U.S. level. Job losses have been significant across all sectors except for the important education and health services sector, which continues to show solid growth.

Applicable criteria available on Fitch's website at 'www.fitchratings.com' include:

--'Tax-Supported Rating Criteria' (Dec. 21, 2009);

--'U.S. State Government Tax-Supported Rating Criteria', (Dec. 28, 2009).

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

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