

FITCH RATES MASSACHUSETTS' \$463MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-17 January 2012: Fitch Ratings assigns an 'AA+' rating to the following Commonwealth of Massachusetts general obligation (GO) bonds:

- \$171,240,000 GO refunding bonds (SIFMA Index Bonds) 2012 series A;
- \$291,815,000 GO bonds consolidated loan of 2012, series A (SIFMA Index Bonds).

The bonds, which are expected to sell via negotiation this week, will bear interest at a floating rate based on a fixed spread, established at pricing, to the SIFMA index rate.

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

--**COMPARATIVELY HIGH DEBT 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.

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 2011 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 nominal \$42 million drawdown from the stabilization fund.

Through December, revenues are slightly below revised estimates, with underperformance in income tax estimated payments possibly attributable to timing factors. Personal income tax withholding revenues are up 3.7% (baseline) year-to-date compared to the prior fiscal year, while estimated payments are 0.4% lower. Sales and use tax revenues are 4.3% ahead of the prior year. The consensus tax revenue forecast of \$21.95 billion for fiscal 2013, released on Jan. 12, assumes baseline tax revenue growth of 5.4%. This will be the basis for the governor's executive budget proposal for the year, which is scheduled to be released on Jan. 25.

Due to the strong 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 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 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; \$163 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 of the states. 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.' fell 0.8%. Employment gains improved in 2011, and November year-over-year growth of 1.7% in Massachusetts compared to a 1.2% increase for the nation. Massachusetts' unemployment rate of 7% for the month was 80% 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 most 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.

The 2012 series A refunding bonds are expected to mature serially on Feb. 1, 2013-17, to be finalized based on market conditions at pricing, but the Commonwealth intends to undertake refinancings to maintain the amortization of the series 2005A variable-rate demand bonds that were refunded with a prior SIFMA Index Bond offering. The series 2005A bonds had a final maturity in 2028. Fitch is comfortable with the ability of the Commonwealth to execute SIFMA bond refinancings given the adequacy of the timing provisions, the manageable size of the maturities, and the Commonwealth's demonstrated market access.

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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.

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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

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