FitchRatings

FITCH RATES MASSACHUSETTS' $525MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-15 March 2013: Fitch Ratings has assigned an 'AA+' rating to the following Commonwealth of Massachusetts general obligation (GO) bonds:

--$450 million consolidated loan of 2013, series A;
--$75 million consolidated loan of 2013, series B (federally taxable).

The bonds are scheduled to sell through competitive bids on March 20, 2013.

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

--COMPARATIVELY HIGH LIABILITY BURDEN: Massachusetts' debt levels are high for a U.S. state government, and Fitch expects them to remain so. This is partially explained by the above-average role played by the Commonwealth in relation to local levels of government when compared to most other states. In addition, the Commonwealth is responsible for the pension benefits of not only Commonwealth employees but also teachers statewide, contributing to a combined burden of debt and pensions that is also well above the median for U.S. states rated by Fitch.

RATING SENSITIVITIES

The rating is sensitive to shifts in fundamental credit characteristics including the state's commitment to strong financial management practices.

CREDIT PROFILE

Massachusetts' 'AA+' GO rating reflects considerable economic resources and a record of prudent financial management. Credit strengths are tempered by a comparatively heavy debt burden that Fitch expects to remain high. The Stable Rating Outlook reflects the expectation that the Commonwealth will continue to act as needed to ensure budget balance and maintain an adequate budgeted reserve position.

FINANCES AND MANAGEMENT

Massachusetts' financial position has stabilized in recent years following a period of steep revenue decline in the recession. The enacted budget for fiscal 2013 assumed baseline tax revenue growth of 5.4% over fiscal 2012. Revenue underperformance in the first half of the year led to a reduction in the revenue forecast of $515 million, to $21.5 billion, in December 2012. Through February 2013, tax revenues were $332 million above the revised estimate, with baseline growth of 4.1% overall, sales tax revenue up 2%, personal income tax withholding up 4%, and estimated payments up 16.6% year-over-year. These figures are partially attributable to the acceleration of income into calendar 2012 that took place in anticipation of federal tax increases.

Overall, though risk remains in the economic and revenue environment in Massachusetts, as in most states, Fitch believes that the Commonwealth retains significant flexibility to address budget underperformance and has repeatedly demonstrated its commitment to do so. Strong revenue results in fiscal 2011, which saw 9.3% year-over-year baseline tax revenue growth, allowed for an increase in the stabilization fund balance to $1.4 billion, up from $670 million at the end of fiscal 2010. Recovery continued in fiscal 2012, albeit at a more modest pace, with a 3.5% baseline increase in tax collections; the stabilization fund balance grew further to $1.65 billion. Although funds are expected to be drawn on in the current fiscal year 2013, which ends on June 30, reserve funding is expected to remain a solid $1.3 billion at year-end.

The governor's proposed budget for the coming fiscal 2014, which is based on the assumption of 3.9% baseline tax revenue growth, was released in January. The proposal includes significant tax code modifications, including a 1% increase in the personal income tax rate (to 6.25%), changes to many personal income tax exemptions and deductions to yield increased revenues, and a reduction in the sales tax rate to 4.5% from 6.25%. In aggregate, the governor's tax proposals are estimated to generate $1.9 billion on a full-year basis, which the governor would use to support transportation and education. The governor's budget also includes a $400 million borrowing for fiscal 2014 spending in anticipation of the phase-in of the tax increases, as well as a further drawdown of the stabilization fund balance to $1 billion. Although moderate in size, Fitch would consider the proposed bonding to be a deficit financing and would evaluate closely the Commonwealth's plans for reserve funding going forward given the material drawdown of funds at a time of revenue recovery.

Massachusetts's demonstrated commitment to taking timely action to ensure budget balance in recent downturns while maintaining some level of reserves 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 the 6.25%) and other revenue measures totaling about $1 billion. Fiscal 2010 taxes were down 3.2% (baseline) versus fiscal 2009.

In addition to solid ongoing budget management, the Commonwealth has proactively taken steps to reduce the impact of volatile revenues on its budget in recent years. The variability and unpredictability of capital gains-related tax revenue has been a key factor in 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 (adjusted annually by a U.S. GDP growth-based formula starting in fiscal 2014), 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; the fund benefited from an unusually high $375 million of such revenue in fiscal 2012. Along the same lines, the Commonwealth has developed a long-term fiscal policy framework focused on budget sustainability.

ECONOMY

Massachusetts has a fundamentally strong and wealthy economy. At 129% of the U.S. average, the Commonwealth's personal income per capita is the second highest of the states. The Commonwealth's economic performance in the recent recession was significantly better than the national experience, in contrast to 2002-2004 when Massachusetts experienced among the steepest employment drops in the country. Employment losses in 2009 were less severe than those of the U.S. (3.3% versus 4.4%), and Commonwealth employment rose 0.3% in 2010 while U.S. employment fell 0.7%. Employment continued to grow in 2011, with year-over-year growth of 0.6% in Massachusetts equaling about half the increase for the nation, and was up 1.6% year-over-year in December 2012, in line with the nation. Massachusetts' unemployment rate of 6.7% for December 2012 was 86% of the U.S. level.

DEBT AND OTHER LONG-TERM LIABILITIES

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. GO debt continues to represent the majority of outstanding debt. Fitch expects debt levels to remain high.

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. Massachusetts has undertaken some pension reforms and projects manageable growth in pension funding requirements going forward. The governor recently proposed significant reforms to lower the Commonwealth's other post-employment benefits liability.

Contact:
Primary Analyst
Laura Porter
Managing Director
+1-212-908-0575
Fitch Ratings, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst
Douglas Offerman
Senior Director
+1-212-908-0889

Committee Chairperson
Karen Krop
Senior Director

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

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', Aug. 14, 2012;
--'U.S. State Government Tax-Supported Rating Criteria', Aug. 14, 2012.

Applicable Criteria and Related Research
Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033