FitchRatings

FITCH RATES MASSACHUSETTS' $475MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-20 September 2011: Fitch Ratings assigns an 'AA+' rating to the following Commonwealth of Massachusetts general obligation (GO) bonds:

--$475,000,000 consolidated loan of 2011 series D.

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 Sept. 21, 2011.

KEY RATING DRIVERS
--Massachusetts has a fundamentally strong and wealthy economy.
--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.
--Debt levels are high for a U.S. state government.

SECURITY
General obligations of the Commonwealth, to which its full faith and credit are pledged.

CREDIT PROFILE
Massachusetts' 'AA+' rating reflects considerable economic resources and a record of prudent financial management. Credit strengths are tempered by a very heavy debt burden. Fitch expects debt levels to remain high.

After significant declines in the downturn, revenue performance for fiscal 2011, which ended on June 30, was strong. In January 2011 the Commonwealth raised its revenue forecast for the year by $706 million as compared to the budget estimate, to $19.8 billion, and actual revenue came in $723 million above the revised estimate, with taxes 9.1% (baseline) above fiscal 2010 results. The overperformance was due primarily to strength in the personal income tax, which was up 13.5% year-over-year (baseline), reflecting 6% growth in withholding revenue, 20.9% growth in estimated payments, and 34.8% growth in final payments. Sales and use taxes were up 3.7% (baseline), in line with the January forecast. Surplus revenues are expected to allow for an increase in the stabilization fund balance to $1.1 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.

The enacted budget for fiscal 2012 assumes relatively modest baseline tax revenue growth over fiscal 2011 (about 2.5%). 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 budget authorizes a draw of $200 million from the stabilization fund, although the Commonwealth currently assumes it will use slightly less than this amount.

Under current law the state's flat income tax rate will automatically drop from 5.3% to 5.25% effective Jan. 1, 2012 if strong revenue trends continue through September. The Commonwealth estimates the impact of such a change, which is not included in budget assumptions, at only approximately $55 million in fiscal 2012, rising to about $115 million in fiscal 2013. Although there appears to be agreement on licensing 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 taken timely action to ensure budget balance in recent downturns while maintaining some level of reserves. This is important given the Commonwealth's somewhat volatile 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.

Massachusetts has a fundamentally strong and wealthy economy, with the second highest personal income per capita in the nation (127% of the U.S.). 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% vs. 4.4%) and the Commonwealth's employment in 2010 rose 0.2% while the U.S. dropped 0.8%. Employment gains have steadily improved in 2011, and August year-over-year growth of 2% in Massachusetts was twice the increase for the nation. The Commonwealth's unemployment rate of 7.4% 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 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