

Tax Supported
New Issue

Commonwealth of Massachusetts

Ratings

New Issue	
General Obligation Refunding Bonds, Series 2008A	AA
Outstanding Debt	
General Obligation Bonds	AA

Fitch issued an exposure draft on July 31, 2008 proposing a recalibration of tax-supported and water/sewer revenue bond ratings, which, if adopted, may result in an upward revision of this rating (see Fitch Research on "Exposure Draft: Reassessment of Municipal Ratings Framework"). Fitch has deferred its final determination on municipal recalibration due to market conditions and plans to revisit the recalibration in the first quarter of 2009 (see press release "Fitch Defers Final Determination on U.S. Municipal Ratings Recalibration," dated Oct. 7, 2008).

Rating Outlook

Stable

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New Issue Details

Sale Information: \$552,755,000 General Obligation Refunding Bonds, Series 2008A, scheduled to sell during the week of Nov. 17 via negotiation.
Security: General obligations of the commonwealth, to which its full faith and credit are pledged.
Purpose: To refund outstanding variable-rate bonds of the commonwealth and the Route 3 North Transportation Improvement Association.
Final Maturity: Sept. 1, 2032.

Rating Rationale

- Massachusetts has a fundamentally strong and wealthy economy, although population growth is slow and economic performance in the past few years has been below average.
- The commonwealth has benefited from conservative budgeting and sound financial practices. Reserve levels remain solid, providing a hedge against the commonwealth's somewhat volatile revenue stream.
- Debt levels are high and are expected to remain so.

Key Rating Drivers

- Continued commitment to sound financial practices as the economic and revenue environment weakens.

Credit Summary

The 'AA' rating reflects the commonwealth's considerable economic resources and record of prudent financial management. Even after a significant draw in the current fiscal year, reserve levels remain solid, providing a hedge against the commonwealth's economically sensitive tax base. Credit strengths are tempered by a very heavy debt burden. Like most states, the commonwealth is currently experiencing a decline in the pace of economic and revenue growth. A \$1.4 billion current-year shortfall, based on Oct. 15 estimate revisions, is being addressed primarily through spending cuts.

Net tax-supported debt of about \$30 billion equaled 9.3% of 2007 personal income as of June 30, 2008. Fitch Ratings expects that debt will remain high. The commonwealth's cash flow borrowing is through a commercial paper program and revenue anticipation notes that are paid by the end of the fiscal year; the commonwealth successfully sold \$750 million in revenue anticipation notes in October 2008 and had \$239.6 million in commercial paper outstanding as of Nov. 5, 2008.

A bond bill that passed in 2007 authorized the commonwealth to refinance contract assistance and capital lease obligations with general obligation (GO) bonds, as is being done with the refunding of Route 3 North Transportation Improvement Association (contract assistance) bonds in the current transaction. In addition to other initiatives, the commonwealth has announced plans to issue \$1.1 billion in grant anticipation notes and \$1.9 billion in gas tax revenue bonds to fund an eight-year accelerated bridge rehabilitation program. Earlier this year, the extension of the commonwealth credit to certain Massachusetts Turnpike Authority obligations was authorized. The governor has also proposed abolishing the turnpike authority and splitting its responsibilities between the Massachusetts Port Authority and the highways department; given that the plan is in its early stages, the implications for the commonwealth's GO credit are not foreseeable at this time.

The commonwealth is responsible for the pension benefits of not only commonwealth employees, but also teachers statewide. As of Jan. 1, 2008, the funded ratio of all systems was 78.6%. As part of the commonwealth's actions to resolve a fiscal 2009 gap identified in October 2008, the pension funding schedule was extended from 2023 to

Related Research

- *Commonwealth of Massachusetts, Aug. 28, 2008*
- *U.S. State General Obligation Bond Rating Criteria, April 25, 2008*
- *Massachusetts School Building Authority, March 7, 2007*

Rating History

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	11/14/08
AA	Affirmed	Stable	4/13/06
AA	Upgraded	—	7/8/05
AA-	Upgraded	—	1/21/98
A+	Upgraded	—	10/13/93
A	Assigned	—	10/1/92

2025 for \$100 million in current-year savings. The governor has announced his intent to file legislation to reform the pension systems.

Massachusetts built up significant fund balances through fiscal 2001 and used the large accumulated reserve position as a safety valve when revenues, under pressure from recession and drastically reduced capital gains, dropped sharply in fiscal 2002. The commonwealth did not rely as heavily on nonrecurring resources to solve its budget problems as did some other states, although the stabilization fund balance dropped from \$1.7 billion in fiscal 2001 to \$641 million in fiscal 2003.

With recovery, revenue performance meaningfully exceeded forecasts in every year from fiscal year 2004–2008 and reserves were rebuilt. Consistent with strong revenue growth and conservative forecasting practices, fiscal 2008 tax revenues of \$20.9 billion were 6.4% over fiscal 2007 results (after correcting for tax law changes), more than \$650 million higher than revised estimates, and \$1 billion above the consensus forecast on which the budget was based. The commonwealth drew on stabilization fund moneys to a lesser degree than originally budgeted and ended the year with \$2.2 billion in the fund, down from \$2.3 billion at fiscal 2007 year-end.

The budget for fiscal 2009 included corporate tax measures expected to generate \$285 million, a cigarette tax increase dedicated to health care spending, and a stabilization fund drawdown. On Oct. 15, 2008, a \$1.4 billion fiscal 2009 shortfall was projected, largely due to a \$1.1 billion reduction in estimated tax revenues for the year. The revision reflected a particularly steep drop-off in the estimate for capital gains tax revenues, which are assumed to be down about 30%. The governor is implementing about \$755 million in spending cuts pursuant to his budgetary powers and has received legislative approval to draw down the stabilization fund an additional \$200 million (to \$1.6 billion) and extend the pension funding schedule from 2023 to 2025 for current-year savings of about \$100 million. Other spending reductions and \$168 million in additional revenues are expected to cover the balance of the shortfall. This plan is expected to result in about 1,000 staff cuts, although it does not incorporate any formal early retirement program. Local aid to cities and towns was spared. Fiscal 2009 revenues through October are down 1% (baseline) compared to the prior year, with sales and use taxes down 3.5% and personal income taxes up 2.8%. This is in line with the new forecast.

The personal income tax accounts for about 60% of commonwealth tax revenues. A Nov. 4, 2008 ballot initiative that would have eliminated the tax effective in 2010 was soundly defeated.

Massachusetts has a fundamentally strong and wealthy economy, with the third highest personal income per capita in the nation (127% of the U.S.). After experiencing among the steepest employment drops in the country in the last recession, the commonwealth has registered year-over-year employment gains in every month since July 2004. Nonfarm employment is still below peak levels, and economic recovery had lagged the U.S.; however, employment growth of 1% in 2007 was just less than the nation's 1.1%. Commonwealth employment rose 0.3% in September 2008 year-over-year, compared to a loss of 0.5% for the U.S. for the same period. Construction employment fell 3.4% in September 2008, compared to prior-year levels, and financial activities was down 0.9%. In contrast, education and health services and professional and business services employment rose 2.1% and 1.5%, respectively. Massachusetts's unemployment level was 5.3% in September, below the nation's level of 6.1%. Personal income growth of 6.2% in 2007 exceeded that of the U.S. and New England, and this trend continued in the first two quarters of 2008. The percentage of the Massachusetts population with a bachelor's degree is the highest in the nation.

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