FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Massachusetts' $600 Million GO Bonds 'AA+', Outlook Stable

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Fitch Ratings - New York - 27 Apr 2021: Fitch Ratings has assigned 'AA+' ratings to $600 million in Commonwealth of Massachusetts general obligation (GO) bonds, consisting of:

--$200,000,000 consolidated loan of 2021, series A;

--$400,000,000 consolidated loan of 2021, series B.

The bonds are expected to be offered by competitive sale during the week of May 3.

In addition, Fitch has affirmed the commonwealth's Long-Term Issuer Default Rating (IDR) at 'AA+' and the long-term and short-term ratings on the GO and other bonds linked to the IDR of the state as detailed.

The Rating Outlook is Stable.

SECURITY

The GO bonds are general obligations of the commonwealth, to which its full faith and credit are pledged. A statutory state tax revenue growth limit does not exclude principal and interest on debt obligations from the limit

ANALYTICAL CONCLUSION

The commonwealth's 'AA+' IDR reflects its considerable economic resources, adroit management of economic and revenue cyclicality and strong budget controls. A strong reserve funding mechanism that shields the general fund from volatility, careful revenue monitoring, and a requirement to cut spending or identify other balancing measures if revenues fall below planned spending, are among the fiscal management tools that position the commonwealth to confront economic and fiscal uncertainty. The commonwealth carries a long-term liability burden for debt and net pension liabilities, adjusted to Fitch's standard 6% investment return assumption, which is well above the U.S. state median, but remains a moderate burden on resources.

ECONOMIC RESOURCE BASE

The commonwealth has a broad and wealthy economy. Education levels are high, and although population growth is below the U.S. average, it continues to lead the region. Strength in the health care, technology and education sectors have supported GDP growth comparable to the nation's over time, and leave it well-positioned for solid future gains. Measured by per capita personal income, Massachusetts is the second-wealthiest state in the nation.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Tax revenues, while diverse, are dominated by individual income taxes, which are sensitive to economic conditions, particularly the components related to capital gains. Baseline growth prospects for taxes are strong, driven by the commonwealth's underlying economic fundamentals.

Expenditure Framework: 'aaa'

Consistent with most states, the natural pace of spending growth is likely to marginally exceed expected revenue growth over time, requiring ongoing cost control. The commonwealth has ample ability to reduce spending through the economic cycle.

Long-Term Liability Burden: 'aa'

Liability levels in Massachusetts, while comparatively high for a U.S. state, are a moderate burden on resources. The commonwealth's above-average liability position is partly the result of state funding of both capital needs and pensions that are more commonly funded at the local level, primarily for K-12 education.

Operating Performance: 'aaa'

The commonwealth has superior gap-closing capacity supported by a responsive fiscal management framework, including a requirement to cut spending in response to revenue gaps and strong reserve funding practices. Conservative budgeting, ongoing economic and revenue monitoring, and a mechanism to redirect a portion of economically sensitive capital gains tax receipts into the stabilization fund, the commonwealth's budget reserve, enhance fiscal flexibility.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A sustained reduction in the long-term liability burden accompanied by a reduction in carrying costs.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Economic growth trends shifting lower, signaling less robust revenue growth prospects and weakening financial resilience;

--Evidence of difficulty in absorbing rising needs for schools, Medicaid and long-term liabilities while maintaining strong operating performance;

--An increase in long-term liabilities that results in an elevated burden likely to consistently exceed 20% of personal income.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Federal Relief Provides Critical Support

Multiple federal stimulus and relief measures since the start of the coronavirus pandemic have boosted economic activity in Massachusetts and throughout the country. Federal measures passed in 2020 are estimated by the Committee for a Responsible Federal Budget (CRFB) to have provided a total of $71.8 billion to Massachusetts governments, residents, businesses, and healthcare providers and other recipients, the majority in the form of various loan programs such as the Paycheck Protection Program.

Direct fiscal aid has included a 6.2% increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for each quarter in which the federally-declared public health emergency is in place. This provision is currently expected to remain in place through the end of calendar year 2021 based on guidance from the federal government. Over this period, Massachusetts anticipates the provision will generate more than $1.7 billion in programmatic revenue for MassHealth, the commonwealth's main Medicaid program, as well as additional amounts in non-programmatic revenue and health and human services departmental revenue, outside of MassHealth. The state also received $2.5 billion from the Coronavirus Relief Fund (CRF) provisions included in the Coronavirus Aid, Relief and

Economic Security (CARES) Act early last year, and separate provisions supporting schools and transit further reduced potential fiscal demands on the state. The state has allocated its CRF funds for a range of pandemic response costs including medical equipment, hospital needs and targeted social services.

Under the $1.9 trillion American Rescue Plan Act of 2021 (ARPA), the CRFB estimates that recipients in Massachusetts will receive $15.6 billion, including governments. The package is expected to provide $4.5 billion in relatively flexible direct federal aid to the commonwealth itself. Separate provisions will provide additional funds to local governments, schools, universities and transit, further reducing contingent risks to the state. Massachusetts, like other states, is awaiting more formal guidance from the U.S. Treasury on how the ARPA funds can be used, even as the governor and legislature have begun deliberations on the budget for the fiscal year beginning on July 1.

Massachusetts Economic Update

Economic implications of the pandemic and related public health measures have been significant for Massachusetts as in all states. The labor market shock early in the crisis was more severe in Massachusetts than for the nation as a whole, and despite solid progress since then, Massachusetts has not yet recouped earlier job declines. Non-farm payrolls fell 19% at the start of the pandemic (from February to April 2020), more severe than the national decline (15%). Since April 2020, Massachusetts' jobs recovery (56% of jobs regained through March 2021) has been behind the national recovery (62%), and its official monthly unemployment rate of 6.8% in March 2021 remains above the 6% national rate. When the unemployment rate is adjusted to include labor force exits, the Fitch-adjusted rate for Massachusetts, at 6.8%, is below the 8.3% national rate (U.S. States Labor Markets Tracker, published April 2021 - https://www.fitchratings.com/research/us-public-finance/us-states-labor-markets-tracker-employment-recovery-remained-muted-through-february-pickup-expected-in-march-15-04-2021).

Feedback

Massachusetts Budgetary Update

To date Massachusetts has navigated the economic and fiscal disruptions of the pandemic without materially affecting its strong operating performance and remains well-positioned to continue doing so.

Solid economic gains in the final years of the economic expansion had supported tax collections that were consistently ahead of forecast. As of fiscal 2019, the final year before the pandemic, the stabilization fund had rapidly accumulated $3.4 billion (equal to 11.5% of tax receipts), up from only $1.3 billion in fiscal 2017 (5.1% of tax receipts).

Despite the severe economic shock of the pandemic and public health countermeasures, the Commonwealth's operating performance remained solid for fiscal 2020, supported by resilient tax revenue collections and the presence of federal aid. Fiscal 2020 tax revenues totaled $29.6 billion (including tax-related settlements and judgments), only 0.4% below the fiscal 2019 figure and 1.7% below the fiscal 2020 enacted budget level. Budgeted operating fund expenditures of $47 billion were $2.2 billion (4.8%) higher than the prior year, which included $1 billion in supplemental appropriations related to the pandemic and funded with federal aid. The fiscal 2020 fund balance remained solid, at nearly $4.3 billion, including the stabilization fund, which rose to $3.5 billion (equal to 11.8% of tax revenues).

Given fiscal uncertainties, Massachusetts delayed enactment of a fiscal 2021 budget, instead passing successive interim budgets early in the fiscal year. The governor ultimately signed a full fiscal 2021 budget in December. At enactment, fiscal 2021 tax revenues were forecast at $28.4 billion (including tax-related judgments and settlements), 4% below actual tax revenues for fiscal 2020. Fiscal 2021 budgeted operating fund expenditures (as of the most recent disclosure) are estimated at $49.4 billion, 5.2% higher than fiscal 2020 actual amounts, driven by higher spending for Medicaid and education. The enacted budget authorized a draw of up to $1.7 billion from the stabilization fund, unless tax revenues or federal funds exceed forecast. The Commonwealth's most recent disclosure assumes a draw of just under $1 billion, leaving the remaining balance at $2.5 billion (equal to 8.7% of tax revenues). Any draw would take place after fiscal year-end as part of the state's close-out, and this figure excludes any impact from ARPA funds.

Consistent with the experience of many states, tax revenue collections have remained robust in Massachusetts despite the cautious revenue forecast. Year-to-date through March, actual tax receipts were 7.2% higher than the prior year, and 6.9% above the state's January 2021 forecast benchmark. Individual income tax receipts were 9.3% above the prior year and 5.5% above forecast, while sales tax receipts were 1.9% above the prior year and 4.0% above forecast.

The fiscal 2022 budget process is now underway. The January 2021 forecast established a tax revenue benchmark of $30.1 billion in fiscal 2022, 3.5% higher than the revised forecast for fiscal 2021. The governor's executive budget assumes $45.6 billion in spending, 0.7% lower than projected fiscal 2021 spending on a comparable basis (this figure excludes transfers to the Medical Assistance Trust Fund, and certain transfers made prior to the budget, including for pension contributions). The proposal includes the first year of funding under a phased-in school funding expansion enacted in 2019, but delayed by the pandemic. The governor's proposal authorizes a maximum $1.6 billion draw from the stabilization fund, which as with fiscal 2021, would be lowered if tax revenues or federal funds exceed forecast; this draw would be partly offset by a planned transfer of $182 million to the stabilization fund, largely from capital gains receipts under the mechanism to redirect excess receipts into the commonwealth's budget reserve. The budget does not reflect the impact of the ARPA, which was finalized after the executive budget was completed, but the governor's administration has stated the goal of further offsetting the stabilization fund draw using discretionary ARPA funds.

REVENUE FRAMEWORK

General fund resources derive primarily from individual income, sales and corporate income taxes. The first two are particularly important, with an estimated 57% of tax revenues from individual income taxes and another 25% from sales taxes in fiscal 2021. The individual income tax is levied at flat rates based on type of income. A 5% rate has been applicable to most income categories since Jan. 1, 2020 under a statute that had gradually reduced the rate from 5.3% beginning Jan. 1, 2012. The statute also reinstated the state charitable deduction as of Jan. 1, 2021, although the fiscal 2021 budget delayed the provision by one year, and the governor's budget for fiscal 2022 delays it further, until the first fiscal year after one in which a transfer is made from the stabilization fund.

Revenues are economically sensitive, particularly individual income tax receipts from capital gains. Consistent with the experience of many other states, individual income tax collection trends have also been affected in recent years by tax law changes, most recently those associated with the December 2017 federal Tax Cuts and Jobs Act (TCJA).

Solid economic fundamentals and a diverse revenue system are the basis for a revenue profile that is likely to approximate national economic growth over time, in Fitch's view.

The commonwealth has no significant legal limitations on its ability to raise revenues. A statutory tax revenue growth limit based on average wage and salary growth has not hindered the commonwealth's ability to manage its revenue resources. The initiative environment also has periodically been active, and certain revenues have been affected by past initiative petitions, notably property taxes. Importantly, the legislature retains the ability to make changes to statutes passed by successful initiative petitions.

EXPENDITURE FRAMEWORK

Massachusetts' expenditure profile is very broad, driven by an expansive scope of services. Medicaid and other social services are the largest single spending commitment at just over half of general fund spending. Rising needs, including those emerging from implementation of the Affordable Care Act, have pressured spending in the last decade. Education is also a significant commitment, with extensive commonwealth funding of local schools and a broad higher education network. Funding formula changes for local schools under 2019's Student Opportunity Act (SOA) are intended to address needs in districts with higher concentrations of poverty. The SOA was expected to result in a seven-year, $1.5 billion ramp-up of formula funding beginning in fiscal 2021, although the pandemic has delayed initial increases. The commonwealth's education commitment extends to covering local teacher pension liabilities, although not the liability associated with their other post-employment benefits (OPEB). Consistent with practices in many smaller states, the commonwealth is responsible for delivering or funding many services routinely funded at local levels elsewhere.

As with most states, spending in the absence of policy actions is expected to be in line with to marginally above expected revenue growth, primarily driven by social services, particularly Medicaid. The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program as well as federal government rules limit the states' options in managing the pace of spending growth. Federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or Congressional leadership. As with all federal initiatives, Medicaid remains subject to regulatory changes that could affect various aspects of the program.

The commonwealth retains ample ability to cut spending; statute allows for swift response in the event of forecast revenue underperformance, including the governor's statutory powers to unilaterally cut allotments under Section 9C of commonwealth General Law, Chapter 29.

Carrying costs for long-term liabilities, including debt service, actuarially determined pension contributions and other post-employment benefit (OPEB) pay-go appropriations, are elevated relative to most states, at 11.2% of governmental expenditures in fiscal 2020. Under state finance law, revenues available for budgeting are net of statutory pension contributions and transfers for the Massachusetts Bay Transportation Authority (MBTA) and the Massachusetts School Building Authority (MSBA). Pension changes were undertaken in 2011, and the state maintains a relatively conservative statutorily closed amortization target for achieving full funding in 2040. Pension contributions have risen in part due to experience updates and shifts to more conservative actuarial assumptions. Based on a funding schedule that it updates every three years, most recently in 2020, the commonwealth forecasts contributions rising about 9.6% per year until the projected date of full prefunding, in fiscal 2036. Fitch views this trajectory of contribution increases as high, but manageable within the commonwealth's fiscal framework.

LONG-TERM LIABILITY BURDEN

Debt and Fitch-adjusted net pension liabilities are comparatively high for a state, but represent a moderate burden on resources. On a combined basis, the burden of direct debt and the adjusted net pension liabilities for employees and teachers equaled 18.8% of personal income, well above the 5% median for U.S. states, as of Fitch's 2020 state liability report, which used 2019 data. Fitch recalculates reported net pension liabilities using a standard 6% discount rate assumption per Fitch's U.S. Public Finance Tax-Supported Rating Criteria.

As of Feb. 28, 2021, Fitch estimates the commonwealth's direct debt at a comparatively high 7.8% of personal income, including sales tax-backed obligations of the MBTA and the MSBA and annual contract assistance commitments that support the Massachusetts Department of Transportation. This figure also includes the new money component of the current GO sale. GO bonds represent the majority of outstanding debt. The commonwealth's above-average role in funding local government capital needs, relative to most other states, partially drives the debt burden. Fitch expects direct debt to remain comparatively high for a U.S. state.

As of their June 30, 2020 financial reports, pension systems covering state employees and teachers (except in the City of Boston) held fiduciary assets covering 62.5% and 50.7% of their total pension liabilities, respectively, based on the 7.15% discount rates implemented as of their 2020 valuations; the rates have been lowered three times from the 7.5% used for the 2017 valuation. Using Fitch's standard 6% return assumption, the 2020 ratios would fall to 54.9% and 44.5%, respectively.

The commonwealth carries a net OPEB liability for state employees, but not local teachers, measuring $20.7 billion, based on a 3.6% discount rate and net of prefunding built in recent years from tobacco settlement monies, excess capital gains collections and other sources. The net OPEB liability measures 3.8% of personal income.

OPERATING PERFORMANCE

Fitch believes the commonwealth retains superior capacity to address cyclical downturns and has repeatedly demonstrated its commitment to maintaining a solid financial position. Mechanisms for maintaining balance include the governor's requirement to reduce allotments or identify alternative balancing measures in the event of a mid-year forecast deficiency, under Section 9C of commonwealth General Law, Chapter 29, noted above.

Additionally, since 2011 the commonwealth has operated under a mechanism to reduce the effect of volatile capital gains-related tax revenues on its budget. Capital gains-related receipts that can be included in the budget are capped annually at a level that rises by U.S. GDP, with excesses dedicated to the stabilization fund (90%) and retiree benefit obligations (10%). The threshold was $1.26 billion in fiscal 2020, although a planned transfer to the stabilization fund was retained in the general fund given pandemic-related stress. For fiscal 2021, the threshold is $1.312 billion, and for fiscal 2022 the threshold is $1.352. A similar mechanism covers one-time judgments and settlement payments.

FAST Analysis

The Fitch Analytical Stress Test (FAST) scenario analysis tool relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria. FAST is not a forecast, but represents Fitch's estimate of possible revenue behavior in a downturn based on historical revenue performance. Actual revenue declines will vary from FAST results, which provide a relative sense of the risk exposure of a particular state compared to other states. Despite its comparatively higher exposure to revenue declines shown by FAST, Massachusetts has superior financial resilience that would enable it to manage through fiscal stress, supported by the budget balancing and reserve replenishment mechanisms noted above.

Budgetary management during periods of economic recovery consistently supports the rebuilding of financial flexibility. Conservative revenue assumptions and the reserve funding mechanisms noted above enabled the commonwealth to eventually rebuild a sizable stabilization fund balance, and the commonwealth has limited its use of nonrecurring resources. Similar to many states, the commonwealth has faced budgetary challenges at several points in the current economic expansion, including from the effect of shifting federal tax law and from unexpected demands for Medicaid. Although these factors initially weighed on progress in rebuilding the stabilization fund balance to levels attained before the Great Recession, the budgetary mechanisms to shift cyclical windfalls to the stabilization fund raised its balance considerably in the period prior to the pandemic.

For the MassDOT MHS subordinate revenue bonds, the commonwealth's annual fixed, dedicated payments are a full faith and credit obligation of the commonwealth and are expected to cover all subordinated debt service, linking the rating to the 'AA +' rating of the commonwealth, rather than to the MHS toll revenues, which are also pledged to the bonds on a subordinated basis. Although a large share of outstanding debt is variable rate and thus exposed to potential, though unlikely, risks associated with variable rate debt, Fitch expects that MassDOT would work with the commonwealth if necessary to ensure that the annual payments are sufficient for debt service.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and Committee for a Responsible Federal Budget.

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REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Massachusetts, Commonwealth of (MA) [General Government]	LT IDR	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
• Massachusetts Turnpike Authority Metropolitan Highway System (MA) /Metro Highway System Revenues - Subordinated Obligations/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable
• Massachusetts,	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v2.4.0 (1)

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Dodd-Frank Rating Information Disclosure Form

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