



## RATING ACTION COMMENTARY

# Fitch Rates Massachusetts' \$1.2 Billion GO Bonds 'AA+'; Outlook Stable

Mon 10 Oct, 2022 - 10:57 AM ET

Fitch Ratings - San Francisco - 10 Oct 2022: Fitch Ratings has assigned a 'AA+' rating to approximately \$1.2 billion of Commonwealth of Massachusetts general obligation (GO) bonds, consisting of:

--\$1.0 billion GO bonds Consolidated Loan of 2022, series C;

--\$200 million GO refunding bonds 2022 series A.

Par amounts are subject to change pending final sale. The bonds are expected to be offered by negotiated sale during the week of Oct. 17, 2022.

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 GO and other bonds linked to the IDR of the state as detailed at the end of this release.

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 ramifications of the limit, but any impairment of debt service due to tax revenue growth is highly unlikely.

## **ANALYTICAL CONCLUSION**

The commonwealth's 'AA+' IDR reflects its considerable economic resources, adroit management of economic and revenue cyclicity, and strong budget controls. A strong reserve funding mechanism that shields the general fund from capital gains-related volatility has accelerated rebuilding of Massachusetts' stabilization fund. The commonwealth carries a long-term liability burden for debt and Fitch-adjusted net pension liabilities that 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 northeast region. The strength of the health care, technology and education sectors has supported GDP growth comparable with the nation's over time, and leaves 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 conservative budgeting, ongoing fiscal monitoring and a requirement to cut spending in response to revenue gaps, and a mechanism to redirect a portion of economically sensitive capital gains tax receipts into the stabilization fund, the commonwealth's budget reserve.

### **RATING SENSITIVITIES**

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

--Continued progress in budget management during times of economic recovery including rapid rebuilding of financial flexibility even as the commonwealth faces rising carrying costs;

--A sustained reduction in the long-term liability burden closer to, or below, 10% of personal income, accompanied by a reduction in carrying costs.

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

--A slowing of economic growth that signals the commonwealth's revenue growth prospects will trail national economic growth;

--Rapid growth in spending demands, particularly for fixed costs such as pension liabilities, which weakens Massachusetts' expenditure flexibility and historically strong operating performance;

--An increase in long-term liabilities that results in an elevated burden consistently exceeding 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

### Massachusetts Economic Update

Massachusetts has recovered a lot of economic activity lost to the pandemic. Early in the pandemic, Massachusetts suffered a more severe job market shock than the nation as a whole, with non-farm payrolls falling 19% from February to April 2020, more severe than the national decline (15%). By August 2022, Massachusetts recovered 92% of jobs lost at the pandemic's trough, below the 102% national jobs recovery rate.

The reentry of residents into the labor market brought the Massachusetts' August 2022 unemployment rate to 3.6%, just below the 3.7% national unemployment rate. The commonwealth's employment-to-population ratio (EPOP) in August 2022 was 0.6% below its pre-pandemic ratio of 64.0% in February 2020. This compares favorably to the national EPOP of 60.1% for August 2022. See "[U.S. States - Labor Market Quarterly Tracker - 2Q22 \(Employment Recovery Resilient Despite Recession Concerns and Inflation\)](#)" on [fitchratings.com](https://www.fitchratings.com).

### Massachusetts Budgetary Update

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. The state's position has been bolstered by a solidly funded stabilization fund, its budget reserve, and substantial federal economic stimulus and pandemic aid.

Individual income tax receipts drove state revenues to continue to outperform prudent budget expectations. Unaudited fiscal 2022 revenues of \$41.2 billion (including tax-related settlements) were 11.6% higher than the January 2022 revised forecast of \$36.9 billion.

The transfer of capital gains revenue above the statutory threshold brought the stabilization fund to a new high of \$6.9 billion (16.9% of total revenue) in fiscal 2022, marking significant increases from the \$4.6 billion balance (13.5% of total revenue) in fiscal 2021 and the \$2.3 billion balance the commonwealth had in fiscal 2007 heading into the Great Recession.

Including the stabilization fund, the total fiscal 2022 fund balance reached \$18.0 billion (43.8% of total revenue).

The current fiscal 2023 budget stands at \$62.9 billion, including one-time expenditures. Excluding large one-time transfers, spending is forecast at 11.2% over fiscal 2022. The budget includes several one-time items and does not include any tax reductions. Notable items include a \$485 million increase in chapter 70 aid to cities and towns, \$266 million to the Massachusetts Bay Transportation Authority (MBTA) for safety upgrades, and an additional \$1.5 billion to the stabilization fund. Budgeted stabilization fund deposits would bring its balance to \$8.4 billion (21.2% of total revenue).

Massachusetts received \$5.3 billion in direct ARPA federal aid for the state, as well as \$3.4 billion for local governments and over \$1 billion for transit. The governor and legislature appropriated approximately \$4 billion (\$2.55 billion of ARPA aid and \$1.45 billion from fiscal 2021 surplus), with \$1.1 billion in health and human services, \$600 million towards homeownership and housing, \$500 million to the unemployment trust fund, \$500 million for essential workers, \$400 million for water, sewer and environmental infrastructure, and \$900 million in other one-time projects. The commonwealth retains more than \$2 billion in unallocated direct ARPA aid.

### Chapter 62F Revenue Growth Limits Triggered in Fiscal 2022

Fiscal 2022 is the first year since 1987 that commonwealth revenue growth exceeded the limit, leading to approximately \$2.9 billion in income tax refunds scheduled for fiscal 2023. Chapter 62F limits state tax revenue growth of a given fiscal year to the average of the last three years' wage and salary growth.

## CREDIT PROFILE

Fitch has affirmed the ratings on the commonwealth's GO and GO-linked bonds of the commonwealth as follows:

--GO bonds at 'AA+';

--Massachusetts Development Finance Agency (MDFA) special obligation bonds (commonwealth contract assistance) at 'AA+';

--Commonwealth guaranteed bonds issued by the MBTA and the University of Massachusetts Building Authority, at 'AA+';

--MassDOT metropolitan highway system revenue bonds (subordinate), commonwealth contract assistance secured, at AA+.

For the commonwealth contract assistance bonds issued by MDFA and commonwealth-guaranteed bonds issued by the MBTA and the University of Massachusetts Building Authority, the commonwealth's obligation under the contract to make payments equal to debt service is a general obligation of the commonwealth, to which its full faith and credit are pledged.

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.

## 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](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT ⇅

RATING ⇅

PRIOR ⇅

Massachusetts, Commonwealth of (MA) [General Government]	LT IDR	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
		Affirmed	
Massachusetts Turnpike Authority Metropolitan Highway System (MA) /Metro Highway System Revenues - Subordinated Obligations/1 LT	LT	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
		Affirmed	
Massachusetts, Commonwealth of (MA) /Commonwealth Guaranteed Revenues/1 LT	LT	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
		Affirmed	
Massachusetts, Commonwealth of (MA) /General Obligation - Unlimited Tax - MDFA/1 LT	LT	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
		Affirmed	
Massachusetts, Commonwealth of (MA) /General Obligation - Unlimited Tax/1 LT	LT	AA+ Rating Outlook Stable	AA+ Rating Outlook Stable
		Affirmed	

[VIEW ADDITIONAL RATING DETAILS](#)

**FITCH RATINGS ANALYSTS**

**Bryan Quevedo**

Director

Primary Rating Analyst

+1 415 732 7576

bryan.quevedo@fitchratings.com

Fitch Ratings, Inc.

One Post Street, Suite 900 San Francisco, CA 94104

**Douglas Offerman**

Senior Director

Secondary Rating Analyst

+1 212 908 0889

douglas.offerman@fitchratings.com

**Eric Kim**

Senior Director

Committee Chairperson

+1 212 908 0241

eric.kim@fitchratings.com

## **MEDIA CONTACTS**

**Sandro Scenga**

New York

+1 212 908 0278

sandro.scenga@thefitchgroup.com

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

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## **APPLICABLE CRITERIA**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

## **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, v3.0.0 (1)

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Massachusetts, Commonwealth Of (MA)

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US Public Finance   North America   United States

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