

FITCH RATES MASSACHUSETTS \$500MM GO BONDS 'AA'; OUTLOOK STABLE

Fitch Ratings-New York-04 November 2009: Fitch Ratings assigns an 'AA' rating to the Commonwealth of Massachusetts' approximately \$500 million general obligation (GO) bonds, consolidated loan of 2009 series E. The bonds, which are scheduled to price the week of Nov. 9, 2009, may be sold as either tax-exempt bonds or federally taxable Build America Bonds with a direct pay of the federal subsidy to the issuer, depending on market conditions at the time of the sale. In addition, Fitch affirms the 'AA' rating on approximately \$16 billion of outstanding Commonwealth GO and Commonwealth guaranteed bonds. The Rating Outlook is Stable.

Massachusetts' 'AA' rating reflects considerable economic resources and a record of prudent financial management. Credit strengths are tempered by a very heavy debt burden. Net tax-supported debt equals about 8.7% of personal income and Fitch expects that debt levels will remain high. The Rating Outlook is Stable based on the expectation that the Commonwealth will continue to address economic and revenue weakening in a manner consistent with its demonstrated sound financial practices. On Oct. 15, 2009 the fiscal 2010 revenue estimate was reduced by \$600 million. The governor's plan to close the resulting budget gap relies on spending cuts, fiscal 2009 surplus, federal stimulus funds, and various revenue actions. Though significantly reduced from prior years, the reserve fund balance is maintained at \$571 million as budgeted. The Commonwealth is also managing about \$365 million in net state fund spending pressures, largely caseload driven.

With economic deterioration, tax revenue forecasts were reduced significantly over the course of fiscal 2009 and actual receipts came in \$177 million below the downwardly revised estimates. Total taxes were down 13% (baseline) compared to the prior year, sales taxes dropped 6%, and personal income taxes fell 15.5%, reflecting a steep drop in capital gains tax revenues, which are particularly significant to the Commonwealth's budget. The Commonwealth responded with spending cuts and controls, extraordinary federal stimulus assistance, and a large reserve draw, and the year is now estimated to have closed with a small \$60 million surplus. The stabilization fund balance dropped from \$2.1 billion at the close of fiscal 2008 to \$766 million at fiscal 2009 year-end.

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, as well as additional spending control, another reserve fund draw, and federal stimulus. The remaining stabilization fund balance of \$571 million provides some hedge against the economically sensitive tax base. Through September, actual revenue performance was \$212 million below the estimate upon which the budget was based, with total taxes down 11.5% (baseline) versus fiscal 2009, reflecting an 8.3% sales tax drop, a 12.1% personal income tax decline, and a 17.8% corporate and business tax decline. In the formal review of the forecast in mid-October the fiscal 2010 revenue estimate was lowered by \$600 million, to \$18.3 billion, opening up a current-year gap. The forecast now assumes a baseline 4% decline in tax revenues.

As required, the governor has released a proposal to close the gap. The plan includes \$277 million in executive branch spending cuts that do not require legislative approval, \$75 million in additional cuts pursuant to expanded executive powers that are being requested of the legislature, \$60 million in fiscal 2009 surplus, \$62 million in additional federal stimulus funds, and about \$126 million in additional revenues, including \$20 million from tax amnesty. The state is also managing about \$365 million in budget exposures on the spending side, largely driven by caseload increases, particularly in health care.

Massachusetts has a fundamentally strong and wealthy economy, with the third highest personal income per capita in the nation (127% of the U.S.). The Commonwealth experienced among the steepest employment drops in the country in the last recession and, despite registering year-over-year employment gains in every month from July 2004 to August 2008, did not regain its

prior peak.

Employment began to decline in October 2008. The year-over-year rate of loss was 3.2% for the three months through September 2009. The Commonwealth's unemployment rate rose to 9.3% in September 2009, a high level for Massachusetts but 95% of the U.S. level. Job losses have been significant across all sectors except for the important education and health services sector.

The Commonwealth, a regular issuer of commercial paper (CP) and revenue anticipation notes (RANs), issued \$1.2 billion fiscal 2010 RANs in September 2009. Although up to \$1 billion in CP is available, no CP issuance is planned for fiscal 2010. The Commonwealth is reserving this more flexible capacity in the event of unplanned needs. Both CP and RANs must be repaid by the June 30 end of the fiscal year.

Considerations for Taxable/Build America Bonds Investors

The following sector credit profile is provided as background for investors new to the municipal market.

--State General Obligation Bonds: The general obligation full faith and credit pledge is the broadest security a U.S. state government can provide to the repayment of its long-term borrowing, and therefore is the best indicator of its overall credit quality. State ratings generally fall within the two highest rating categories of 'AAA' or 'AA', with a few outliers. The top tier ratings reflect states' inherent strengths: states generally have broad economic and tax base resources and all possess sovereign powers under a federal government system, with substantial, although varying, control over revenue raising and spending. Given these inherent strengths, in only a few instances have economic concentration and long-term structural decline or the inability or unwillingness to address large financial challenges led to ratings below the 'AA' category. For additional information on State ratings, see Fitch's report, 'U.S. State General Obligation Bond Rating Criteria' dated April 25, 2008, and available on the Fitch web site at 'www.fitchratings.com'.

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