

The Commonwealth of Massachusetts



Debt Affordability Committee Recommendation

12/15/2015



Debt Affordability Committee



Debt Affordability Committee



Established in 2014
ANF Secretary, DOT
Secretary, Comptroller
Treasurer, 3 Public
Appointments and Key
Legislative Leaders



Analyze Existing Debt

Size, component parts, term(s),
interest rate exposure, hedging
contracts, authorized but unissued



Project Debt Issuance and
Debt Service

Target Debt Service to Budgeted
Revenues Ratio not greater than 8%



Determine Funding Needs:
The Administration's 5 Year
Capital Plan



Review rating
agency assessments

Compare
Massachusetts'
Debt Ratings and
Ratios to Other
States

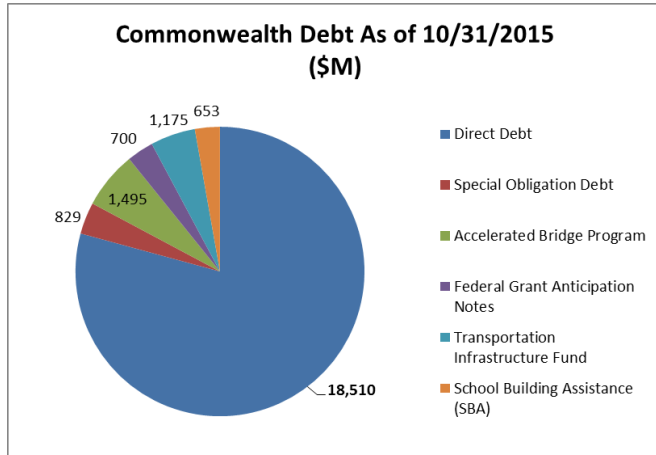
Consider
marketability of
bonds



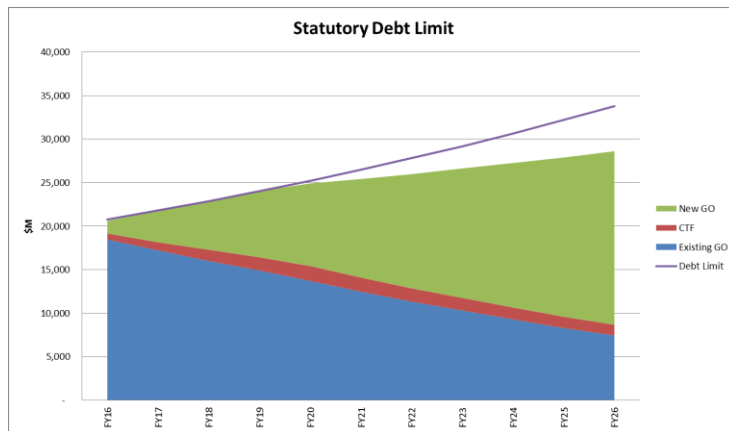
Recommend
to Governor
and
Legislature
Level of Debt
Issuance in
Next Fiscal
Year



Commonwealth Debt and Debt Limit



Source: November 13, 2015 Information Statement

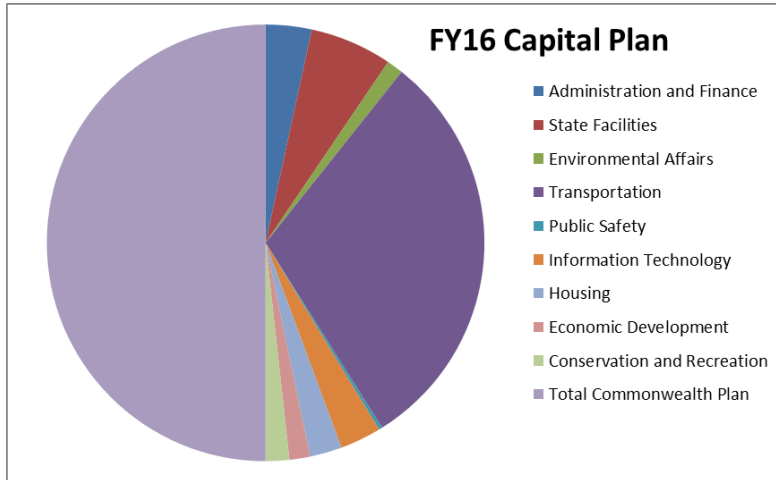


Source: Executive Office of Administration and Finance

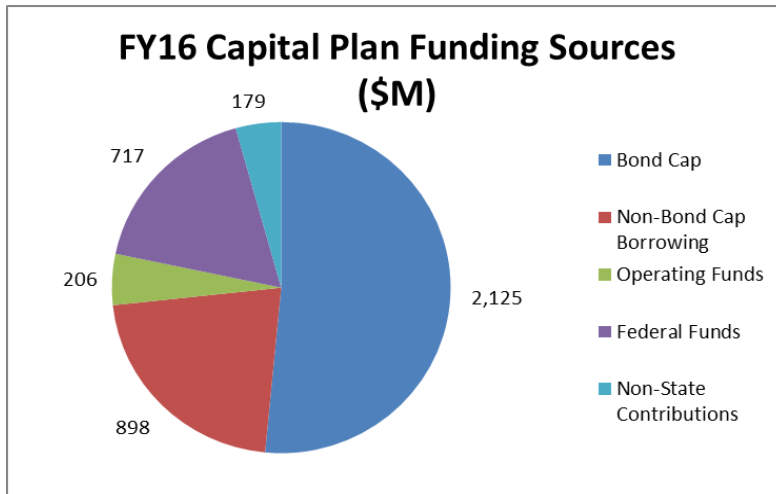
- As of 10/31/2015, the Commonwealth had \$23.4 B of outstanding debt, of which \$18.5 B was direct debt pledging the full faith and credit of the Commonwealth and subject to the debt limit.
- The debt limit for FY16 is \$20.7 B and for FY17 is \$21.8 B
- Under the current issuance plan, we project approximately \$20.6 B of outstanding statutory debt by 6/30/2016 and approximately \$21.8 B of outstanding debt by 6/30/2017
- Under this projection, the statutory debt limit may constrain the capital plan depending on rate of capital spending
- Under current law, the Rail Enhancement Bonds backed by the Commonwealth Transportation Fund are *not* exempt from the statutory debt limit



Capital Funding Needs



Source: FY16 Capital Plan



Source: FY16 Capital Plan

- The Commonwealth's FY16 Capital Plan includes \$4.124 B of spending from all sources, of which \$3.023 B is to be funded by Commonwealth borrowing
- Borrowing is made up of General Obligation Bond Cap, Commonwealth Transportation Fund, and projects that generate enough revenue or savings to fund debt service
- While the Committee only makes recommendations regarding Bond Cap-funded spending, the affordability analysis considers all types of direct Commonwealth debt



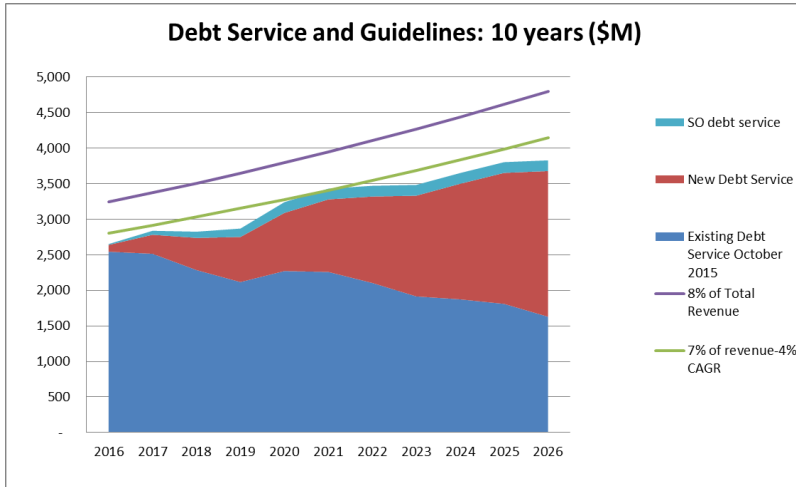
Affordability Analysis



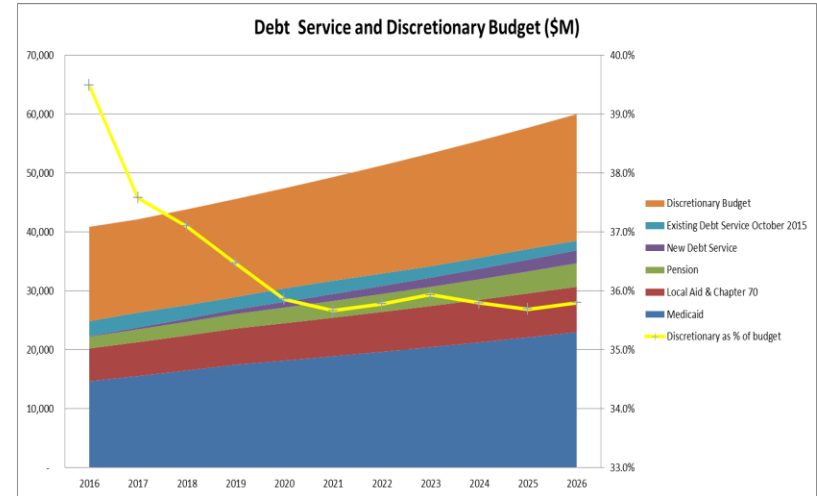
- Affordability estimated by measuring debt service spending as a percentage of budgeted revenue
- DAC developed a 30 year revenue and debt service projection model with assumptions as follows:
 - Budgeted revenue growth of 4%
 - Debt Issuance based on:
 - Level debt service for new issuance
 - 10 year term for 10% of issuance, 20-year term for 60% of issuance and 30 year term for 30% of issuance
 - 20 year interest rate 3.5%; 30 year interest rate 4.00%, but both increasing 0.1% a year for 15 years
 - Contract Assistance included in debt service
- DAC evaluated other measures in addition to debt service/revenue ratios, including discretionary spending



Affordability Analysis



Source: Executive Office for Administration and Finance



Source: Executive Office for Administration and Finance

Conclusion:

- Forecasted debt service to revenue was evaluated and falls within these important parameters
 - Debt service as a percent of budgeted revenues is within 7.0% - 7.5% (DAC's recommended target)
 - Debt service as a percent of budgeted revenues is < 8.0% (DAC's formal policy)
 - Debt service below 20% of projected discretionary budget



Compare Debt Ratios of Peer States



| STATES FOR COMPARISON | Debt to Personal Income | Debt Service to Personal Income | Debt per Capita | Debt as % of GDP | Debt Service as % of GDP | Debt Svc. as % of Expenditures | Debt Svc. as % of Revenues |
|-----------------------|-------------------------|---------------------------------|-----------------|------------------|--------------------------|--------------------------------|----------------------------|
| Connecticut | 8.68% | 0.95% | \$5,630 | 8.70% | 0.95% | 8.41% | 8.90% |
| Maine* | 0.30% | 0.30% | \$120 | 0.31% | 0.31% | 2.19% | 2.27% |
| Maryland | 3.46% | 0.36% | \$1,875 | 3.49% | 0.37% | 3.52% | 3.82% |
| MASSACHUSETTS | 5.66% | 0.70% | \$3,324 | 5.28% | 0.65% | 5.54% | 5.80% |
| Minnesota | 3.23% | 0.40% | \$1,581 | 2.99% | 0.37% | 3.26% | 3.16% |
| New Hampshire | 3.78% | 0.20% | \$1,994 | 3.99% | 0.21% | 2.70% | 2.91% |
| New York | 3.81% | 0.48% | \$2,119 | 3.27% | 0.41% | 3.91% | 3.91% |
| North Carolina | 1.99% | 0.23% | \$778 | 1.76% | 0.20% | 2.12% | 2.12% |
| Ohio** | 3.21% | 0.25% | \$1,356 | 2.96% | 0.23% | 2.99% | 2.89% |
| Rhode Island | 4.83% | 0.59% | \$2,334 | 4.87% | 0.59% | 4.46% | 4.77% |
| Vermont** | 2.04% | 0.25% | \$948 | 2.19% | 0.26% | 2.28% | 1.99% |
| Virginia | 1.40% | 0.20% | \$705 | 1.37% | 0.19% | 2.54% | 2.58% |

Source: Treasurer's Office

- Massachusetts has the second highest level of debt among peer states, based upon the ratios of debt per capita, debt as a percentage of GDP and debt to personal income.
- Massachusetts issues debt at the state level that many other states issue at the county/municipality level, which contributes to its debt ratios appearing higher than peer states
- Massachusetts' strong economy allows it sustain relatively more debt than some other states, though the high level of fixed obligations can constrain other spending



Rating Agencies' Criteria



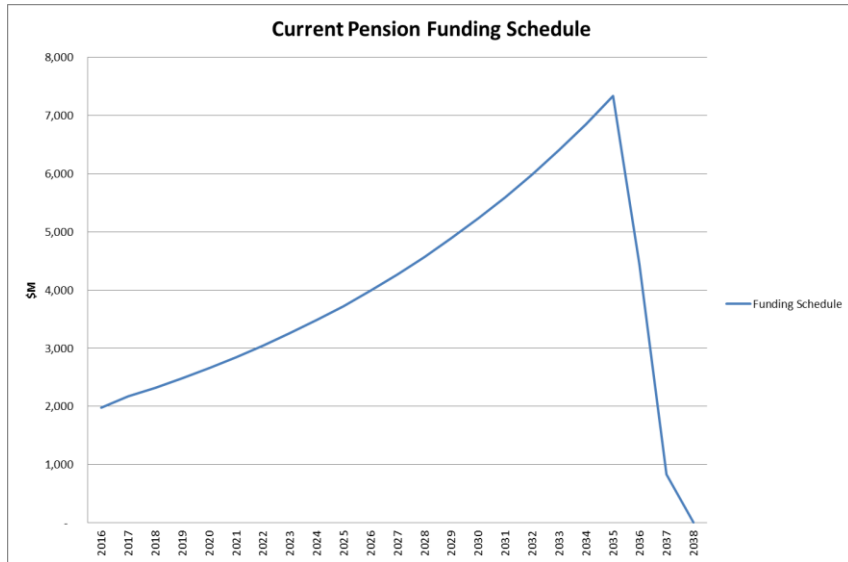
- From S&P's November 23, 2015 report:
 - "By most measures, we believe Massachusetts' debt burden remains high compared with that of other states. Debt per capita was high, in our view, at \$5,121 at fiscal year-end 2014 and 8.7% of personal income.... We view fiscal 2014 total tax-backed debt service of about 6% of general governmental spending as moderately high."
 - "On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a score of '3.3' to Massachusetts' debt and liability profile"
 - "Strong historical budget performance, with timely monitoring of revenues and expenditures and swift action when needed to make adjustments, with a focus on structural solutions to budget balance"
- From Moody's November 19, 2015 Report:
 - "The outlook for Massachusetts is stable, reflecting its satisfactory reserve levels and efforts to regain structural budget balance."
 - "Increased leveraging of the commonwealth's resources to pay debt service or further erosion in pension funding ratios" could cause a ratings downgrade
 - "The commonwealth has a high but well-managed debt burden, with \$20.3 billion in outstanding general obligation bonds and \$33.0 billion in total net tax-supported debt"

Key Conclusions

- Moody's rates the Commonwealth's G.O. debt at Aa1. See [Moody's 11.19.15 report](#)
- See: Standard & Poor's rates the G.O. debt at AA+ with a **negative** outlook. See: [S&P 11.23.15 report](#)
- Maintaining high credit ratings is an important factor in obtaining low cost debt financing and marketability of bonds
- Managing the Commonwealth's fixed obligations, including debt service, is critical to maintaining current ratings



Other Factors for Consideration



- Fixed obligations are growing faster than budgeted revenues:
 - Current pension funding schedule increases 10% a year FY18 through FY36
 - Pension funding schedule may be adjusted based on updated actuarial valuation
- Other Post Employment Benefits (OPEB) represent a \$15.9 B unfunded liability and are not substantially prefunded
 - Benefit payouts projected to increase from \$529 M FY15 to \$915 M FY24

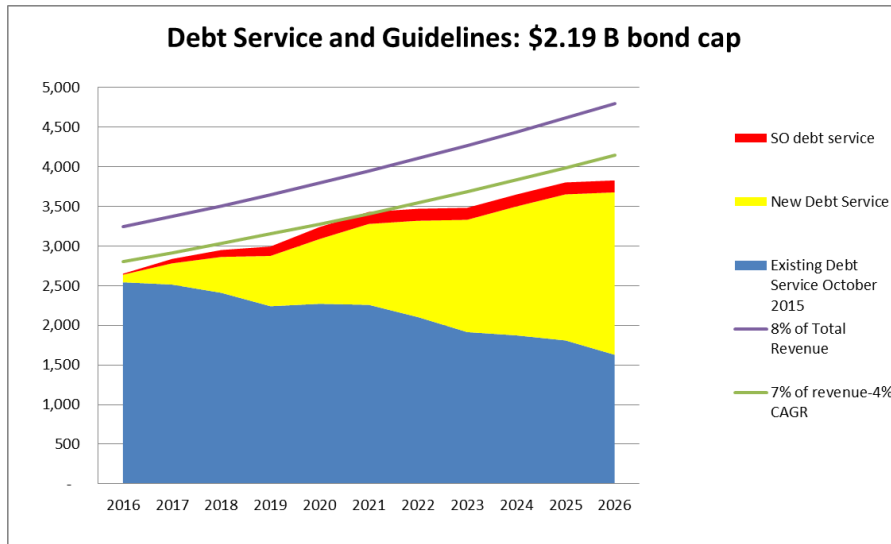
OPEB Liability

| 2015 | |
|---------------------------|---------------------|
| Results in millions | 4.50% Discount rate |
| Liability | \$16,502.8 |
| Assets | \$610.0 |
| Unfunded Liability | \$15,892.8 |

Source: Comptroller



Recommendation



Recommendation:

- The Debt Affordability Committee estimates that an increase of the bond cap to \$2.19 B may be prudently authorized in FY17
- This recommendation balances demand for state infrastructure investment with recognition that increasing fixed obligations may limit fiscal flexibility in the future
- The Committee finds that this level of debt issuance falls within targeted debt service to revenue ratio levels