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Capital Budget

The Commonwealth's capital budget is developed on a different cycle than the operating budget. Capital budget requests are made after the operating budget has been released in the spring. Then a five-year plan is developed and typically released early in the fall for the then current fiscal year and the next four fiscal years. The following is excerpted from the Commonwealth's fiscal year 2011-2015 Five-Year Capital Investment Plan, which was published in October 2010 and is available in its entirety at mass.gov/capital.

Preface

A key component of the Patrick-Murray Administration's strategy for long-term economic growth is continued investment in the Commonwealth's capital assets. Improving the safety and condition of our roads and bridges; building new classrooms and academic buildings; restoring our public housing stock; and investing in clean and renewable energy sources improves economic opportunity in communities across Massachusetts and creates thousands of new jobs.

As Massachusetts emerges from the unprecedented global economic recession, the Patrick-Murray Administration is delivering on its promise to reverse decades of neglect. In a targeted, fiscally responsible way, we are investing in lasting improvements that will ensure we emerge from the economic downturn faster and stronger than before, while improving our infrastructure Commonwealth-wide.

Since the Patrick-Murray Administration took office, there have been eleven bond bills enacted into law, authorizing funding for the capital investments reflected in the Administration's five-year plan and, in some instances, for years beyond the plan. The capital investments authorized by the bond bills reflect Governor Patrick's priorities, including investments in schools, infrastructure to support economic development, roads and bridges, affordable housing, parks and a clean environment. These capital investments have created thousands of jobs and ensure that Massachusetts will continue to be a great place to live, work, start a business and raise a family for years to come.

The current capital investment plan continues to implement the vision and priorities established in each of the Administration's first three capital plans. In large part, the investments included in the fiscal year 2011-2015 plan continue projects launched in prior years or commence projects anticipated by the prior years' five-year plans.

There is strong evidence that the worst of the economic crisis is now behind us. Nevertheless, we still face economic challenges, and it is as important as ever that we prioritize our capital investments in a way that will maximize our ability to spur economic growth. Significant investments in higher education, transportation and housing continue to be high on the Patrick-Murray Administration's list of priorities. And investments in the innovation economy – including expanded broadband, the life sciences and clean energy – will ensure that Massachusetts is ready to compete in the 21st Century.

This capital investment plan is fiscally responsible. Three years ago, the Administration developed and published a debt affordability analysis and policy to ensure that the annual borrowing needed to support the capital investment plan is set at affordable levels. This debt affordability analysis and policy was a first for the Commonwealth, and it was positively reviewed by the credit rating agencies. The Administration has updated and republished the debt affordability analysis (see Mass.gov/capital) with the current capital investment plan, and the borrowing levels used to develop the plan were determined based on the debt affordability policy. Due to the stressed economic and fiscal condition of the Commonwealth over the last three years reflected in the debt affordability analysis and policy, planned borrowing to support this five-year capital investment plan has been reduced by over $1 billion since the original five-year capital plan published by the Administration three years ago.

This capital investment plan provides for the Commonwealth to invest significant resources in infrastructure and other public assets that are critical to our quality of life, the strength of our economy, and the efficient functioning of government at every level. Among other things, these investments will continue to attract private investment and support long-term economic growth that creates sustainable jobs for our citizens; build and maintain roads, bridges and rail we use for our daily commutes; improve public college facilities that educate our workforce and nurture our innovation economy; and create and preserve safe, affordable housing for the people of Massachusetts. Through the investments included in this plan, we will create thousands of jobs in the near term and we will create the environment needed to support job creation and economic growth over the long term.

Overview

The Commonwealth is responsible for maintaining a large inventory of capital assets, including transportation infrastructure, courts, correctional facilities, state hospitals, office buildings, parks and more. In addition, the Commonwealth makes targeted capital investments to support economic growth, strengthen communities and improve the quality of life in the Commonwealth. These investments include funding for public infrastructure to support private development and job growth, local infrastructure improvements and protection of our natural resources.

These capital investments are planned and funded through the Commonwealth's capital budget, which is separate and distinct from the annual operating budget. The capital budget is funded mainly by borrowing through the issuance of bonds. Other sources of funding for the capital budget include federal funds to primarily reimburse transportation infrastructure improvements; federal funds pursuant to the American Recovery and Reinvestment Act of 2009 which are targeted to specific capital purposes; and other sources of funding available to finance certain capital investment projects.

The issuance of bonds to fund the capital budget must be authorized by the Legislature. Pursuant to these legislative authorizations to borrow, the Governor determines the amount and timing of any authorized borrowing to fund capital investments. At the request of the Governor, the State Treasurer issues the bonds to borrow the funds. The Governor approves the use of the borrowed funds by agencies to pay for authorized and budgeted capital projects.

The primary factor constraining the amount of the Commonwealth's capital budget is affordability. The Commonwealth must pay principal and interest costs each year on the bonds it issues to fund its capital investment program. These annual debt service expenses on outstanding Commonwealth bonds are funded each year in the Commonwealth's annual operating budget. The Patrick-Murray Administration is the first to develop and publish an analysis of the amount of debt the state can afford in terms of its impact on debt service and the operating budget, and it is the first to develop a policy for determining the annual borrowing amount to fund the capital budget. This debt affordability analysis and policy, as updated to reflect current market and economic conditions, can be found in its entirety at Mass.gov/capital.

There are certain capital investments that are not funded by the Commonwealth through its capital budget and consequently are not reflected in this capital investment plan. There are a number of independent state authorities responsible for maintaining certain public infrastructure from revenues generated from those infrastructure assets or from dedicated state tax or other revenues that are not available to the Commonwealth for general budgeting purposes. Examples of these entities include the Massachusetts Bay Transit Authority, the Massachusetts Housing Finance Authority, and the Massachusetts School Building Authority. Because these entities carry out their own capital projects and are solely responsible for financing them from their own funding sources, the capital investments made by these entities are not included in the state's capital investment plan. In addition, small equipment purchases and information technology projects funded by state agencies through their operating budgets are not reflected in the capital investment plan.

Administration Accomplishments and Initiatives

Despite the overwhelming need for capital investments and the limited resources available to fund them, the Patrick-Murray Administration has made great progress in improving the Commonwealth's capital investment program since taking office four years ago. The following highlights summarize some of the Administration's accomplishments in the areas of capital investments and capital finance generally.

- *Unprecedented Commitment to Capital Investments* – From fiscal year 2008 through fiscal year 2011, the Patrick-Murray Administration will have made over $10 billion in capital investments into the Massachusetts economy.

- *First-Ever Debt Affordability Policy* - The Patrick-Murray Administration developed and published the first-ever debt affordability policy, which has been positively reviewed by credit rating agencies.

- *First-Ever Five-Year Capital Investment Plan* - The Administration published the first-ever comprehensive and transparent five-year capital investment plan based on the new debt affordability policy, and has updated the report annually.

- *Bond Bills* **-** After publication of its first five-year capital investment plan in the summer of 2007, the Governor filed a series of multi-year bond bills authorizing over $16 billion in capital investments that, together with the $1.8 billion Immediate Needs Bond Bill passed earlier in 2007, reflected the capital investment priorities for the Commonwealth included in the five-year plan. The legislature overwhelmingly approved each of the bond bills. In August 2010, the Governor signed into law an economic development bill that included new bond authorization for certain economic development programs.

- *Initiation of Key Projects* **-** A number of important new capital projects and programs have been initiated by the Administration, including: the Accelerated Bridge Program, the South Coast Rail project, the new Worcester State Psychiatric Hospital project, the Emerging Technologies and Innovation Center at the Lowell campus of the University of Massachusetts, new courthouse projects in Taunton, Salem and Fall River, the correctional facilities master plan, the transit projects legally-required as mitigation for the Central Artery project and many more. These and many other capital investment project highlights are described later in this report in the respective investment category sections.

- *Accelerated Bridge Program* - The Administration, working with the legislature and the Treasurer, developed a $3 billion Accelerated Bridge Program which will repair hundreds of structurally-deficient bridges, create new construction jobs, build conditions for long-term economic growth, and save the Commonwealth hundreds of millions of dollars in avoided construction cost inflation and deferred maintenance costs. This program is underway and is discussed in more detail in the Transportation section herein.

- *Transportation Reform* - On June 26, 2009, the Governor signed legislation to reform the Commonwealth's transportation system. The legislation, which took effect November 1, 2009, consolidated various transportation agencies into a new authority called the Massachusetts Department of Transportation (MassDOT). The consolidation and the reforms in the legislation have already resulted in significant savings and increased capacity for investments in transportation infrastructure improvements.

- *State Facility Maintenance* - The Administration has taken steps to improve maintenance of state facilities. Funding in the capital budget is dedicated for small capital maintenance and repair projects. By dedicating more funding to these types of projects, the state will defer less of its capital investment needs and avoid larger, more expensive capital project needs in the future. The funding for these projects is allocated based on a new, need-based evaluation process through the Division of Capital Asset Management and Maintenance. The Administration is committed to building on its efforts to improve the maintenance of state facilities.

- *Energy Efficiency Requirements for State Building Projects* - Governor Patrick issued Executive Order 484 which, among other things, established the Governor's "Leading By Example Program" requiring that all state agencies reduce their environmental impact by promoting energy conservation and clean energy practices. In January 2010, the Governor created the Clean Energy Investment Program as a means to affordably finance energy efficiency and renewable energy improvements to state facilities – such investments being crucial to achieving the goals of Executive Order 484. The Administration has also set high minimum "green building" standards for all new state building projects and is striving to go above and beyond such standards wherever possible, including plans for certain buildings to be "energy neutral".

- *Financing Initiatives* – In addition to the Clean Energy Investment Program mentioned above, the Administration has pursued various other financing initiatives to more effectively leverage state resources to fund more capital project needs. These initiatives include: increased allocation of private activity bond volume cap to multi-family affordable housing projects to leverage related federal tax credits to fund millions of dollars of affordable housing projects, including improvements to our public housing supply; "I-Cubed" legislation to finance infrastructure improvements needed to support new private development with the new state tax revenues generated from the development; and the financing of the East-West Parkway project at the former South Weymouth Naval Air Base from new state tax revenues to be generated from private development at the base.

- *Oversight and More Transparency through Finance Advisory Board* - Through new gubernatorial appointments, staff support provided by the Executive Office for Administration and Finance (ANF), and greater oversight responsibilities included in recent legislation, the Administration has strengthened the role of the Finance Advisory Board in ensuring transparency, accountability and best practices among state entities that borrow, invest and manage public funds. For the first time in the Board's history, the Board, with Administration assistance, complied with its statutory obligation to gather information about and to report on outstanding debt of the Commonwealth and other debt-issuing state entities. In furtherance of promoting transparency, accountability and best practices, the Board has adopted regulations with respect to debt issuance and derivative transactions. In the context of the turmoil in the financial markets over the last two years, this oversight is critical to ensure public confidence in the sound management of public funds.

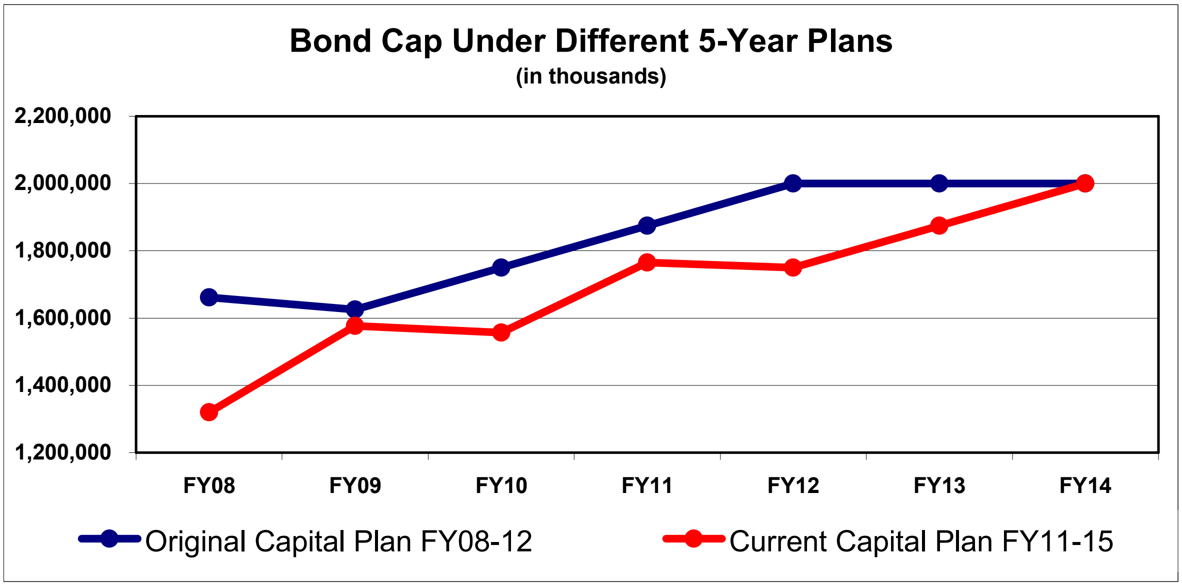
- *Creation of MassWorks Infrastructure Program* – The Administration created the MassWorks Infrastructure Program to consolidate state infrastructure grant programs that support economic development and to provide one-stop shopping for municipalities seeking to participate in these programs. This program will coordinate state review of applications and decision-making.

Development of the Fiscal Year 2011-2015 Capital Investment Plan

The FY11-15 Capital Investment Plan represents the fourth five-year plan since the Patrick-Murray Administration took office. As with the prior plans, the Administration has engaged in a diligent, fiscally responsible, and comprehensive process for developing this five-year capital investment plan. One common challenge shared by each of the previous five-year plans is the fact that demand for capital improvements far exceeds affordable funding capacity. The inevitable consequence is that many worthy projects will not receive funding.

Development of last year's capital budget was distinguished by the historic decline in budgeted revenues over the prior year due to the economic downturn. By all accounts, the Massachusetts economy has stabilized and is recovering faster and stronger than the rest of the nations. Nevertheless, this year's capital plan is constrained by a lower base of revenues this year when compared to prior year's revenue growth expectations. The effect of a lower revenue base is exacerbated by the fact that the vast majority of the capital budget is committed to ongoing projects, which reduces our ability to introduce new or discretionary spending. Finally, increased cost estimates for the large transit projects associated with environmental mitigation relating to the Central Artery/Tunnel project and to which the Commonwealth is legally committed are crowding out other worthy projects.

In order to establish the total amount of the bond-funded capital program within an affordable level, the Administration conducted a rigorous review of the Commonwealth's debt capacity within its debt affordability policy. As indicated in that analysis and illustrated below, the Administration has set the bond cap for fiscal year 2011 and the projected bond caps for future fiscal years at lower levels than it had previously planned in order to ensure that the amount of debt issued to fund the capital program is kept within affordable levels consistent with the Administration's debt affordability policy. Between the fiscal year 2008-2012 Plan and the fiscal year 2011-2015 Plan, planned bond-funded capital investments have been reduced by over $1 billion during the period covered by those plans.



A full 90 percent of the bond-funded fiscal year 2011 capital budget is needed to fund "hard" commitments, including ongoing construction contracts, investments needed to generate federal matching funds, legal commitments and personnel needed to carry out capital programs. This high level of commitments leaves limited budget capacity to start new projects in fiscal year 2011.

The entire fiscal year 2011 capital investment plan can be found at Mass.gov/capital, and includes project descriptions in the appendices.

Affordability and Fiscal Responsibility

Because the capital program is funded primarily through bond proceeds, the total size of the capital program is determined primarily by the amount of debt the Commonwealth can afford to issue. Since fiscal year 1991, the Executive Office for Administration and Finance (ANF) has established what is known as the "bond cap" to limit annual bond issuance in support of the capital program to affordable levels. For the fourth consecutive year, the Patrick-Murray Administration engaged in a rigorous analysis of the state's outstanding debt within affordable levels. Based on this analysis, the Administration has established the fiscal year 2011 bond cap at $1.625 billion, $1.75 billion for FY12, $1.875 billion for FY13, $2.0 billion for FY14 and $2.125 billion for FY15.

In summary, the Administration takes a fiscally responsible approach to setting the annual bond cap, analyzing the Commonwealth's capacity for debt issuance from the point of view of affordability. Specifically, the Executive Office for Administration and Finance sets annual constraints on both the size of the bond cap and its future rate of growth.

For purposes of its analysis of existing payment obligations, ANF takes into account not only debt service on general obligation bonds, but also debt service on certain special obligations, contract assistance obligations and certain capital lease payments. Although the accelerated bridge program is being carried out in addition to the regular capital program in order to achieve savings from avoided cost inflation and deferred maintenance and to achieve the other objectives of the program, the debt service resulting from the bridge program is also taken into account within the 8% limit under the debt affordability analysis.

ANF also takes a conservative approach to projecting future budgeted revenues, basing its growth estimate on the lesser of 3% or the actual compound annual growth rate of the Commonwealth’s revenues over the last ten years – which included both economic booms and downturns. ANF models future debt issuance using fiscally conservative assumptions about interest rates, maturities, dates of issuance and market conditions.

Based on this analytic approach, ANF has projected that the Commonwealth will have the capacity to accommodate steady increases in the bond cap over the next four years – albeit at lower base levels than originally planned due to economic conditions – while maintaining the percentage of the Commonwealth’s budgeted revenues needed to pay debt service during that period below 8%.

The Patrick-Murray Administration intends to limit the total amount of virtually all future bond-funded capital projects to the bond cap. There are certain, limited circumstances in which the Administration plans to undertake borrowing outside the bond cap when there is a sound policy justification for doing so. For example, there are certain projects for which a dedicated stream of new, project-related revenues can be identified to support debt service costs related to those projects.

The debt affordability analysis methodology is based on the Commonwealth’s current available financing resources and mechanisms; changes in financing structures and resources in the future may impact how ANF examines the administrative bond cap and the state’s capacity for additional borrowing. The Administration plans to revisit the debt capacity and affordability analysis every year, revising its estimates for future years by taking into account fluctuations in interest rates, budgeted revenues, and other changes impacting the Commonwealth’s debt capacity. In addition, the Administration will annually assess the appropriateness of the methodology and constraints for establishing the bond cap described above.

Impact of Capital Budget on the Operating Budget

Each year, as part of the annual development and of the capital infrastructure plan, ANF evaluates the operating budget impacts for all requested projects. This is an important practice during this time of a challenging economy and constricting budgets, as well as helpful for agencies to prepare long term spending plans that consider the potential increased costs or savings of new facilities, property, and information technology programs.

Every state government capital spending request must show the incremental on-going annual operating costs/savings that are expected to be incurred upon completion of the project. Much of the information for facility projects is based on data and operation cost profiles provided by Whitestone Research in "The Whitestone Facility Operations Cost Reference 2009-2010." ANF will not consider any request for the five-year spending plan without this information.

Examples of questions in this process include:

- What are the changes in staffing needs at a new facility or project?
- What is the change in the agency operating cost needed to run new facility (energy, rent, etc)?
- What is the new capital equipment cost needed for new facility? (Examples include new desks, computers, lab equipment, etc)
- What is the annual maintenance impact as a result of this project?
- What fiscal year will this project begin operation?
- What is the change in costs as a result of new IT equipment or programs?

- Will this facility generate additional state revenue? If so, how much each year? (Examples include federal reimbursements, user fees, parking fees, etc)
- Does the creation of this new facility mean an increase in services provided?

The following capital budget projects are expected to result in and FY12 operating budget impact that exceeds $500,000 per year:

- Bridgewater State University –Science Building Modernization and Expansion
- Fire Training facility in Springfield
- Department of Developmental Disability Services Wrentham Facility - Heffron A / B Upgrade
- New Fall River Trial Court
- Salem/J.M. Ruane Judicial Center
- New Taunton Trial Court Facility
- North Shore Community College - Danvers Campus Consolidation/New Allied Health Bldg
- Human Resource Compensation Management System Upgrade

When agencies are preparing their annual budget requests during ANF's spending plan process they are asked to ensure that the additional operational costs associated with capital projects are reflected in their projected funding requirements.

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Debt Service

Debt service is a significant component of the operating budget and arises from the issuance of debt to finance the Commonwealth's capital investment plan, the accelerated bridge program and other capital investments. The Patrick-Murray Administration recognizes the need for increased capital investment as a means to create jobs in the near term and create the environment needed to support job creation and economic growth over the long term. The Administration also recognizes that the level of annual borrowing to support these capital investments must be set at affordable levels.

Debt Service Generally

Although a portion of the Commonwealth's capital investments is funded from federal grants and other sources, including the American Recovery and Reinvestment Act of 2009, the Commonwealth borrows funds through the issuance of bonds to fund the majority of its capital investments. The issuance of bonds generates financial resources to fund capital programs, and also obligates future annual operating revenue for repayment of the bonds. Debt service is the annual payment of principal and interest on these borrowed funds.

The issuance of bonds to fund capital projects must be approved by a two-thirds vote of each house of the Legislature. The State Treasurer is responsible for the issuance of the Commonwealth's debt obligations upon the request of the Governor. The Governor, through the Executive Office for Administration and Finance (A&F), allocates the proceeds of the bonds to support authorized projects and monitors spending.

Fiscal Year 2012 Debt Service Budget

The Commonwealth's budget includes several line items for the payment of debt service or other debt-like obligations, as described below.

Line Item	Description	FY11 Budget
0699-0015 Consolidated Long-Term Debt Service	For the payment of principal and interest on general obligation bonds (secured by a pledge of the full faith and credit of the Commonwealth) and special obligation bonds (secured by a pledge of certain gas tax receipts credited to the Commonwealth Transportation Fund.	$1,865.3 million
0699-9100 Long-Term Debt Service Retained Revenue	For the payment of principal and interest on general obligation bonds (secured by a pledge of the full faith and credit of the Commonwealth) and special obligation bonds (secured by a pledge of certain gas tax receipts credited to the Commonwealth Transportation Fund.	$18.0 million
0699-9100 Short Term Debt Service	For the payment of interest on bond and revenue anticipation notes and for the payment of the fees associated with the costs of liquidity or credit support on outstanding variable rate notes and commercial paper. Also for the payment of costs of issuance on bonds and bond and revenue anticipation notes.	$27.9 million
0699-0016 Accelerated Bridge Program	For the payment of debt service related to the Accelerated Bridge Program, including payment of principal and interest on special obligation bonds (secured by a pledge of certain gas tax and registry receipts credited to the Commonwealth Transportation Fund) and payment to a trust account of interest due on federal grant anticipation notes. The principal of such notes is paid by future federal highway construction grants.	$25.2 million
0699-2004 Central Artery/Tunnel Debt	For the payment of principal and interest on bonds issued to finance the Central Artery/Tunnel project.	$86.2 million

Line Item	Description	FY11 Budget
Service		
0699-9101 Grant Anticipation Notes Debt Service	For the payment to a trust account of interest due on federal grant anticipation notes. The principal of such notes is paid by future federal highway construction grants.	$22.6 million
1599-0093 Water Pollution Abatement Trust Contract Assistance	Funds the Commonwealth's general obligation commitment to provide debt service assistance to bonds issued by the Water Pollution Abatement Trust that fund water infrastructure projects throughout the Commonwealth through the State Revolving Fund programs capitalized by federal grants and state matching funds.	$70.0 million
0599-1970 Massachusetts Turnpike Authority Contract Assistance	Funds the Commonwealth's commitment to make contract assistance payments to the Massachusetts Department of Transportation for the purposes of defraying costs, including relating to operation and maintenance of certain roadways in the Metropolitan Highway System and debt service on certain MassDOT bonds relating to the former Massachusetts Turnpike Authority.	$125.0 million
1599-0050 Route 3 North Contract Assistance	Funds the Commonwealth's payment obligations associated with bonds issued to finance Route 3 North improvements.	$5.41 million

Limitation on Commonwealth Debt

Statutory Debt Limits – Legislation enacted in December 1989 restricts the amount of the Commonwealth's outstanding direct debt (M.G.L. Chapter 29, Section 60A). This legislation imposed a "statutory debt limit" of $6.8 billion in fiscal year 1991 and set the limit for each subsequent year at 105% of the previous fiscal year's limit. The statutory debt limit is calculated according to certain rules and excludes several direct and contingent obligations of the Commonwealth. The statutory debt limit on "direct" debt during fiscal year 2010 was approximately $17.2 billion, and the Commonwealth's outstanding direct debt subject to that limit was $14.7 billion.

Legislation enacted in January 1990 imposes a limit on debt service appropriations in Commonwealth operating budgets (M.G.L. Chapter 29, Section 60B). No more than 10% of total budgeted appropriations may be spent on debt service (both interest and principal) on Commonwealth general obligation debt in any fiscal year. Payments on debt not subject to the statutory debt limit described above are also excluded from the debt service limit. In fiscal year 2010, budgeted debt service on debt subject to this limit was approximately $1.6 billion, representing 5.2% of total budgeted expenditures, which were approximately $30.6 billion.

Administrative Bond Cap – The statutory debt limit and debt service limits represent only an upper limit on the amount of direct debt the Commonwealth may incur, and they do not count many types of Commonwealth debt and debt-like obligations (e.g., contract assistance liabilities). Since fiscal year 1991, A&F has established an "administrative bond cap" to limit annual bond issuance to affordable levels. Prior to the Patrick-Murray Administration, the stated bond cap was not based on transparent, analytical measures of affordability.

Debt Affordability

The Patrick-Murray Administration is the first to engage in an affordability analysis which has resulted in a transparent, rational policy for determining the annual bond cap. The Administration believes that this analysis and policy is necessary to ensure that the state's capital budget is based on a level of debt that will keep annual debt service payments in the operating budget at affordable levels.

Based on the debt affordability analysis, the Administration established a policy for setting the bond cap subject to the following constraints: (a) payment of debt service and debt-like obligations for existing and new debt must stay within 8% of total annual budgeted revenues and (b) future growth of the bond cap to fund the regular capital program is limited to not more than $125 million per year. This policy ensures that the annual borrowing limit is informed by changing fiscal conditions – such as the challenging current economic conditions we have faced for the last three fiscal years.

A $3 billion capital investment program, known as the Accelerated Bridge Program, was authorized in 2008 to rehabilitate and repair bridges in the Commonwealth that are structurally deficient or that would otherwise become structurally deficient within the next few years. In an effort to achieve the public safety and cost savings benefits through the acceleration of investment in these bridges, the amounts to be borrowed for the Program will be in addition to the annual bond cap. The debt service impact of financing the Program has, however, been taken into account for purposes of determining the affordable level of debt to fund the regular capital program.

The Administration revisits the debt affordability analysis at least annually to reflect fluctuations in interest rates, revenues, and other changes impacting the Commonwealth's debt capacity. See "Debt Affordability Analysis" at mass.gov/capital for more information.

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