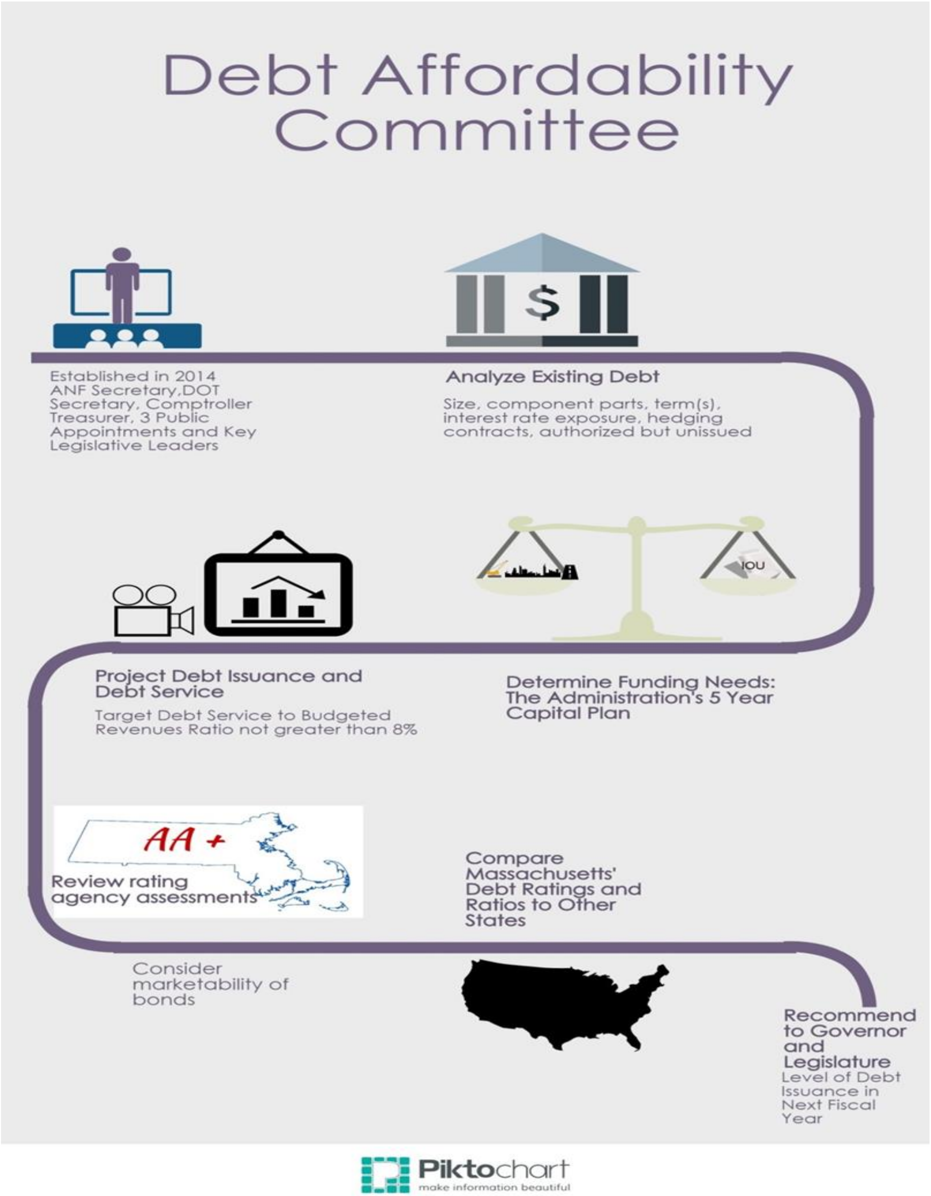
The Commonwealth of Massachusetts

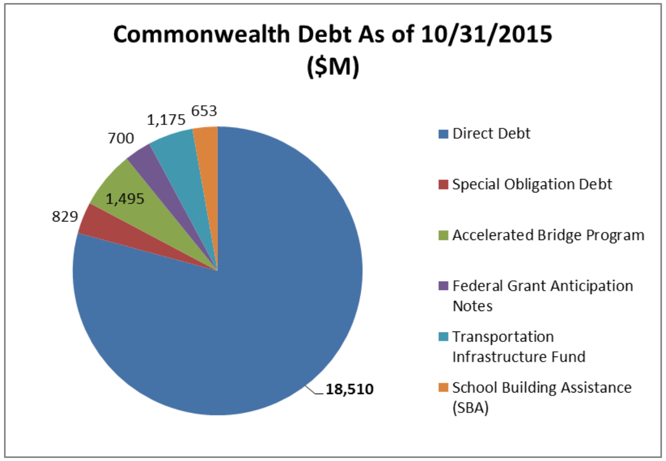
Debt Affordability Committee Recommendation

12/15/2015

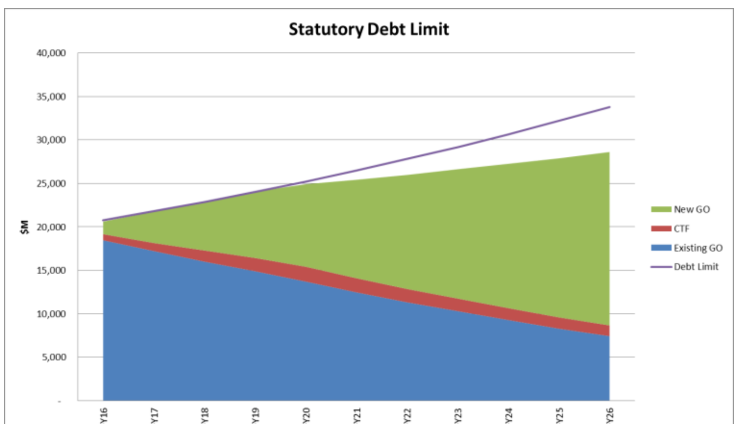
Debt Affordability Committee



Commonwealth Debt and Debt Limit



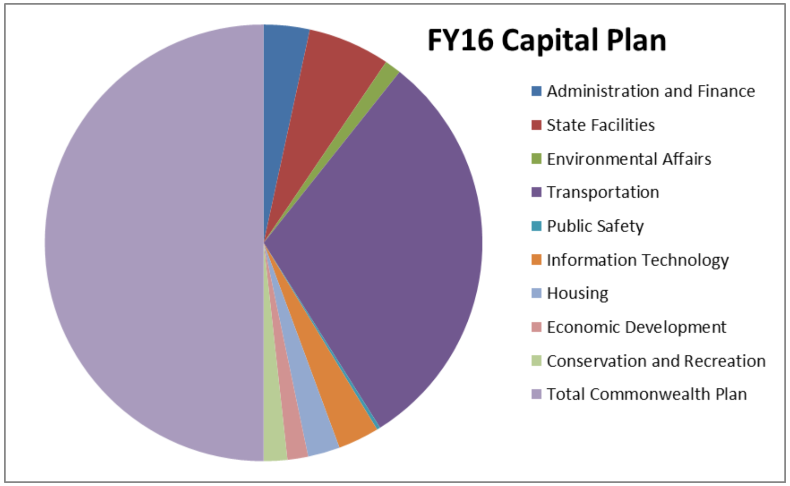
Source: November 13, 2015 Information Statement



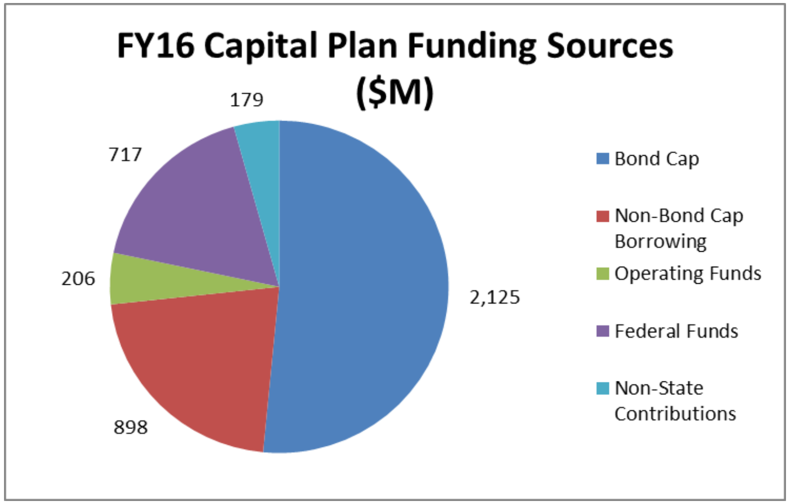
Source: Executive Office of Administration and Finance

- 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

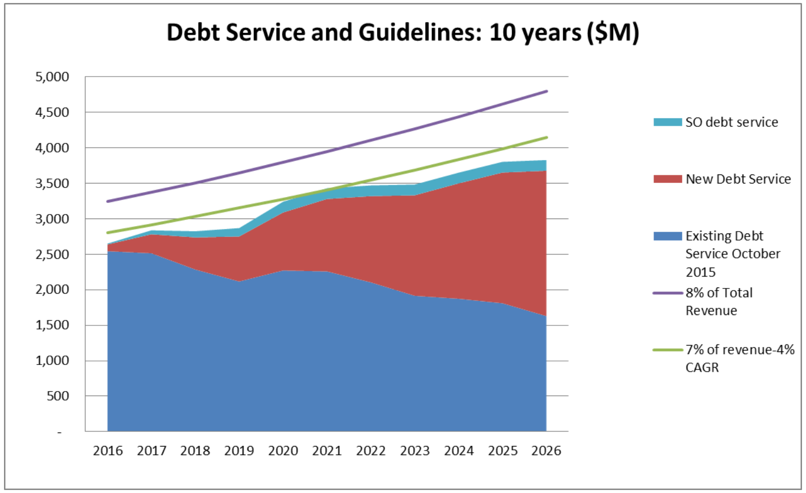
- Borrowing is made up of General Obligation Bond Cap, Commonwealth Transportation Fund, and projects that generate enough revenue or savings to fund debt service

- While the Committee only makes recommendations regarding Bond Cap-funded spending, the affordability analysis considers all types of direct Commonwealth debt

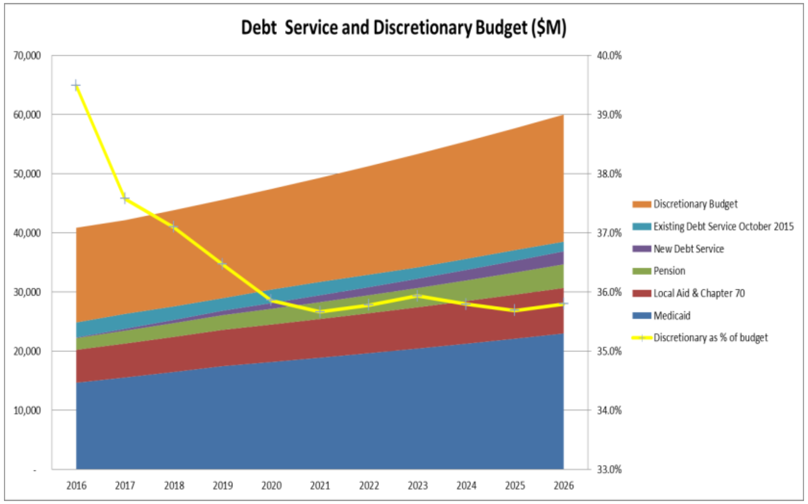
Affordability Analysis

- 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 Srvc. as % of Expenditures	Debt Srvc. 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

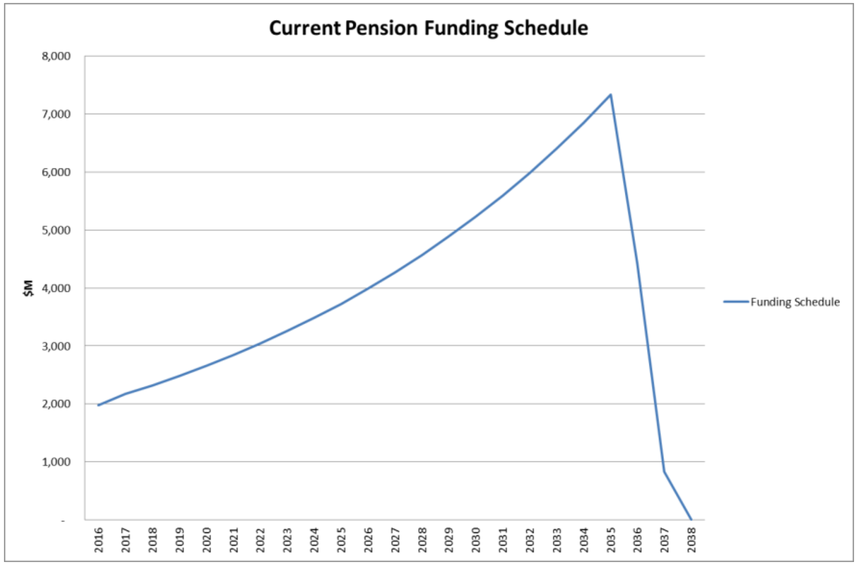
- From S&P's November 23, 2015 report:
  - "By most measures, we believe Massachusetts' debt burden remains high compared with that of other states. Debt per capita was high, in our view, at $5,121 at fiscal year-end 2014 and 8.7% of personal income.... We view fiscal 2014 total tax-backed debt service 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



OPEB Liability

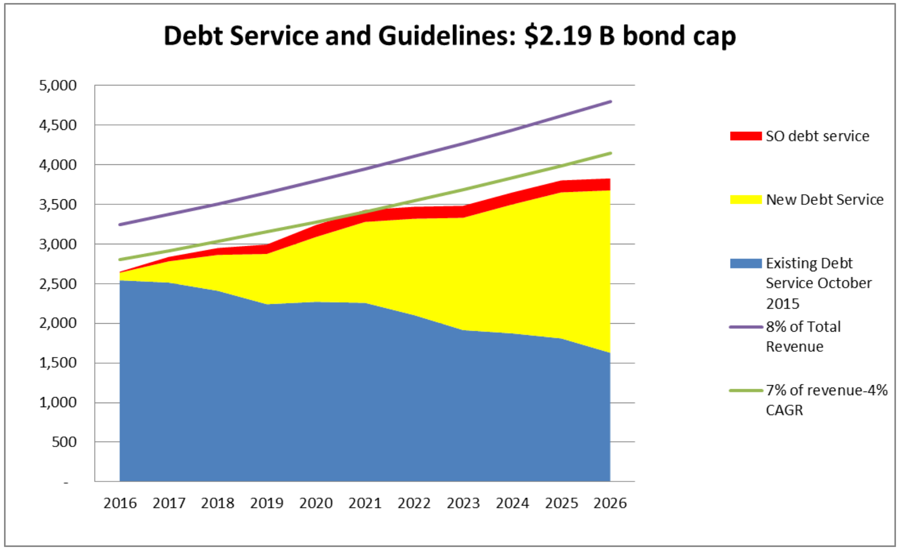
	2015
Results in millions	**4.50% Discount rate**
Liability	$16,502.8
Assets	$610.0
Unfunded Liability	$15,892.8

Source: Comptroller

- 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

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