THE COMMONWEALTH OF MASSACHUSETTS

EXECUTIVE OFFICE FOR

ADMINISTRATION AND FINANCE

STATE HOUSE ▪ ROOM 373 BOSTON, MA 02133**Meeting Minutes**

DRAFT

Debt Affordability Committee
December 2, 2022
1:00 pm
Executive Office for Administration and Finance

Zoom URL: https://mass-gov-anf.zoom.us/j/83166166805?pwd=b2xyWnE0bnVKT2pmVVRnMGFuampRUT09
Password: 120222
Teleconference line: *713-353-7024*; Conference code: 319738

A meeting of the Debt Affordability Committee was held on December 2, 2022. In accordance with Section 20 of Chapter 20 of the Acts of 2021, as extended by Chapter 107 of the Acts of 2022, this meeting will be conducted, and open to the public, via Zoom and Teleconference.

Minutes:
The meeting was called to order at 1:01 pm.

Board members comprising a quorum:

Kaitlyn Connors, Chair, Executive Office for Administration & Finance
Navjeet Bal, Appointee of the Treasurer
Martin Benison, Appointee of the Treasurer
Michelle Ho, Massachusetts Department of Transportation
Pauline Lieu, Office of the Comptroller
Susan Perez, Office of the Treasurer and Receiver-General
Catherine Walsh, Designee for Governor Baker

Others in attendance:
Sam Alejo, Executive Office for Administration and Finance (DAC Secretary)
Representative Danielle Gregoire
Patrick Walsh, Representative Gregoire's Office
Timur Kaya Yontar, Executive Office for Administration and Finance (Capital Director)

Minutes:

Ms. Connors called the meeting to order and conducted the roll call for attendance.

Ms. Connors then moved on to agenda item 1 adoption of the Meeting Minutes from the November 18, 2022 meeting which committee members had received in advance of the meeting. Ms. Bal and Ms. Ho noted that they had provided some comments and questions yesterday. Ms. Alejo acknowledged the edits were received and Ms. Connors stated that the minutes would be updated to reflect the technical changes committee members had recommended. Upon a motion by Mr. Benison, and duly seconded, the Committee unanimously voted to adopt the minutes from the November 18, 2022 meeting.

Ms. Connors then proceeded to the next item on the agenda: Approval of the DAC Fiscal Year 2024 Bond Cap Recommendation. Ms. Connors started with an overview of the Committee's work plan and then moved on to a recap of the two bond cap scenarios that the Committee reviewed in the last meeting which included a bond increase of $90 million (3.2% increase) and $125 million (4.5%). She then reviewed the three scenarios (moderate, conservative, and stress test) that each bond cap amount was modeled under. She noted that assumptions on interest rates were based on Moody's projections which ranged from 4.1% up to 6.4% depending on the scenario. She also noted that revenue growth assumptions were based on the lowest 10 year and 20-year Compound Annual Growth Rates (CAGRs), 1.6% and 3.2% respectively – which is below the average annual revenue growth since 2001 which stands at 4.6%,

Ms. Connors then reviewed the outcomes of the modeling and noted that in all scenarios for each of the bond cap recommendation levels ($90 million and $125 million increase) revenues stayed below 7% of revenues over the next 10 years, which is what the DAC has been focused on. In the moderate scenario debt service stayed below 8% over 30 years, whereas in the conservative and stress test scenarios debt service exceeded 8% of revenues around 2040, although exact year depends on what scenario you are looking at. Ms. Connors said that both scenarios assumed the lowest annual revenue growth at 1.6% and noted that in an alternative stress test modeling scenario where the revenue growth assumption is increased from 1.6% to 3.2%, debt service stays below 8% over the 30 years.

Ms. Connors then moved on to the proposed formal recommendation of $125 million increase. She reminded the Committee that this recommendation is for FY 2024 even though the modeling makes assumptions about future bond cap growth. She asked whether there was any other feedback, questions, or additional information the Committee would like to have.

Mr. Benison, Ms. Walsh and Ms. Ho indicated they were comfortable with the recommendation. Ms. Ho recognized that the Committee has thoroughly discussed the modeling and noted that the difference between the $90 million and $125 million scenarios is very small. She stated she is very comfortable going forward with recommendation, especially since the Committee is using such low revenue projections. Ms. Connors noted that she also ran an $80 million bond cap scenario and the outcomes in terms of meeting thresholds were basically the same to the $90 and $125 million scenarios, illustrating the importance revenue growth (vs. bond cap amount or interest rates) plays in meeting thresholds.

Ms. Bal then asked if the Committee should acknowledge inflation risk on the cost of capital. Ms. Ho agreed that it was reasonable to acknowledge. Mr. Yontar mentioned the Committee may want to consider revisiting the $125 million cap in light of inflation. Ms. Connors said it may be worth noting as the policy limit has remained unchanged for a long time, however she did not believe that introducing the notion of changing the policy limit should be mentioned in the final recommendation letter at this point in time.

Ms. Perez suggested it might make sense to include the concept in the new section of the Committee's report (related to the new reporting requirements). On one hand the Committee is being asked to increase the cap and on the other hand its being asked to respond to the question of how to reduce debt service. She mentioned that the $125 million cap does reduce debt service as a percentage of expenditures that Committee ultimately allows for. Mr. Benison agreed that it was something to consider, but as a course of process he felt the Committee should not be introducing this concept at the end of the process without due diligence. Ms. Ho noted this is a policy consideration. Mr. Benison asked how long the policy was in place? Ms. Ho stated that the policy was established back in 2009.

Ms. Connors then read the proposed motion that the Committee vote to recommend to the Governor a bond cap increase of $125 million bringing the total recommended bond cap amount for FY 2024 to $2.905 B and to make the modeling and slide deck publicly available online. Ms. Walsh moved the motion to approve which was duly seconded by Ms. Ho. Ms. Connors proceeded with the roll call and the motion passed unanimously.

Ms. Connors moved on to the next agenda item which was reviewing the section of the DAC report related to the new legislative requirement. Ms. Connors stated that the slides being reviewed are for the final report which the Committee will be finalizing over the next two weeks. She then reviewed the "reducing debt service principles" that the Committee had discussed in a prior meeting which revolved around reducing debt service payments on existing debt and reducing the cost of future debt. Ms. Bal asked if the Treasurer's Office was looking at variable rate debt to deal with debt service. Ms. Perez responded that they continually are looking at all possibilities, although the market in recent years has favored fixed rate debt. Mr. Benison suggested the report recognize that the Treasurer's Office continually takes advantage of opportunities. Ms. Walsh, Ms. Bal and Ms. Perez agreed. Ms. Perez added that optionality and overall debt portfolio composition is something they are always looking at.

Ms. Connors then discussed future debt costs. Cost of debt service is driven by amount of bonds issued and the interest rates at the time of issuance. The amount of bonds issued is based on the approved Capital Investment Plan (CIP), which is guided by the DAC recommendation on how much debt can prudently be afforded by the Commonwealth each year. In general, if the Commonwealth would like to limit relative debt service costs going forward, it would need to reduce the amount of bonds it issues.

Ms. Connors then provided context around current long-term liabilities. She reminded the Committee that **rating** agencies give Commonwealth high marks across all credit factors, except existing long-term liabilities (debt & pension/OPEB) but noted that debt metrics have been improving and that overall, the combined costs of long-term liabilities has remained flat over the past decade. She emphasized that Commonwealth has been making progress on reducing its debt burden. Ms. Perez suggested that charts on key metrics be included in the report. Ms. Lieu asked if authorized, but unissued impacted the debt portfolio at all. Ms. Perez responded that it does not impact it until its issued. Ms. Ho offered that authorization is key for MassDOT in terms of being able to contract.

Ms. Connors then discussed measures for improving credit ratings. She stated that the Committee will provide a fact-based, high-level discussion on the measures and will not be endorsing any one of these measures as there are policy trade-offs and considerations that policy makers will have to evaluate in more detail. She then discussed the two potential strategies: (1) reducing future annual capital budget by decreasing investment in state own facilities and/or decreasing investments in communities; and (2) Identify non-bond related funding sources.

Ms. Connors then walked through the policy considerations which had mostly been discussed at the last meeting, acknowledging potential negative consequences that could arise if some were to be pursed. Ms. Bal suggested that equity be included as a consideration under decreasing community funding. Ms. Bal also asked if the MSBA authority debt is included in outstanding debt and whether looking for similar opportunities is worth exploring. Ms. Perez noted that MSBA debt is not part of the Treasurer's debt portfolio, but it is included in the financial statements and the rating agencies do consider it in their analysis. Ms. Perez agreed that special obligation debt as a new revenue source would be good to include. Ms. Bal also suggested thinking about adding a reference to public private ventures. Ms. Perez also recommended adding some language around the benefits of long-term financing versus using pay go capital. Ms. Connors agreed and noted that long-term financing enables the costs of the asset to be spread to current and future beneficiaries. Ms. Ho emphasized that leveraging federal funding opportunities will likely require an additional state match requirement, which can help reduce costs

Ms. Connors then quickly discussed reducing pension and OPEB as another measure to improve credit ratings. She said that many of the strategies for reducing pension and OPEB are strategies the Commonwealth is already undertaking and noted that there were several graphs in the report that visually illustrate the progress that has been made. Ms. Connors said the Committee could discuss these in more detail at the next Committee meeting. She asked if anyone had any questions. Mr. Benison suggested that we include a broad statement on the Committee's approach and be very clear upfront that the Committee is not making a recommendation and that there are many policy trade-offs (beyond the scope of this Committee) that policy makers will need to further evaluate.

With no further business, the meeting was formally adjourned at 2:03 pm.

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