Commonwealth of Massachusetts

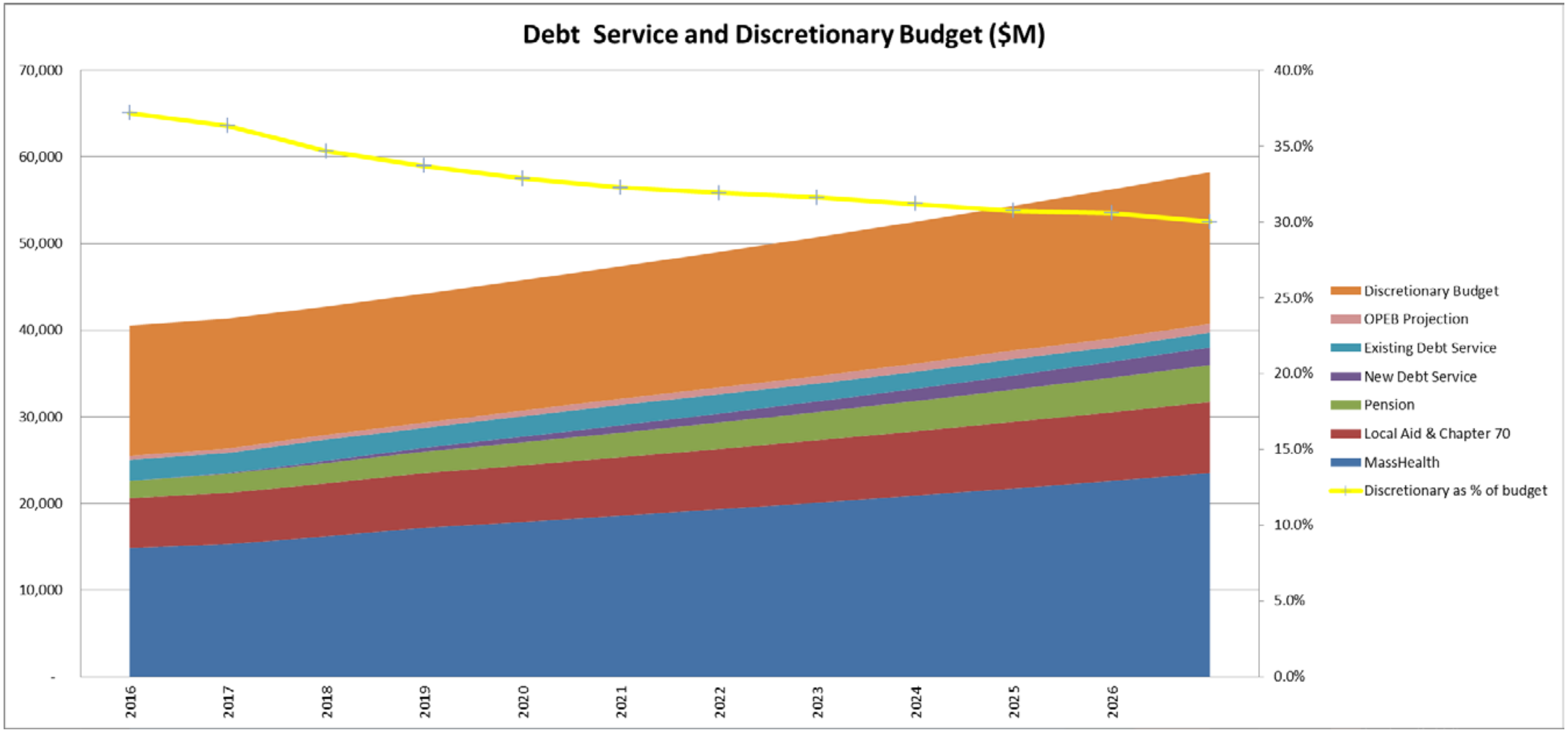
Debt Affordability Committee

11/14/16

Debt Affordability Committee (DAC) Meeting #3: Objectives and Agenda

- **Review Additional Research**
  - Discretionary Budget with OPEB
  - Debt Affordability using 15 year Revenue history
- **Draft Recommendations**
  - 3 Options
- **Draft Recommendation Discussion**
  - Discussion

Discretionary Budget with OPEB

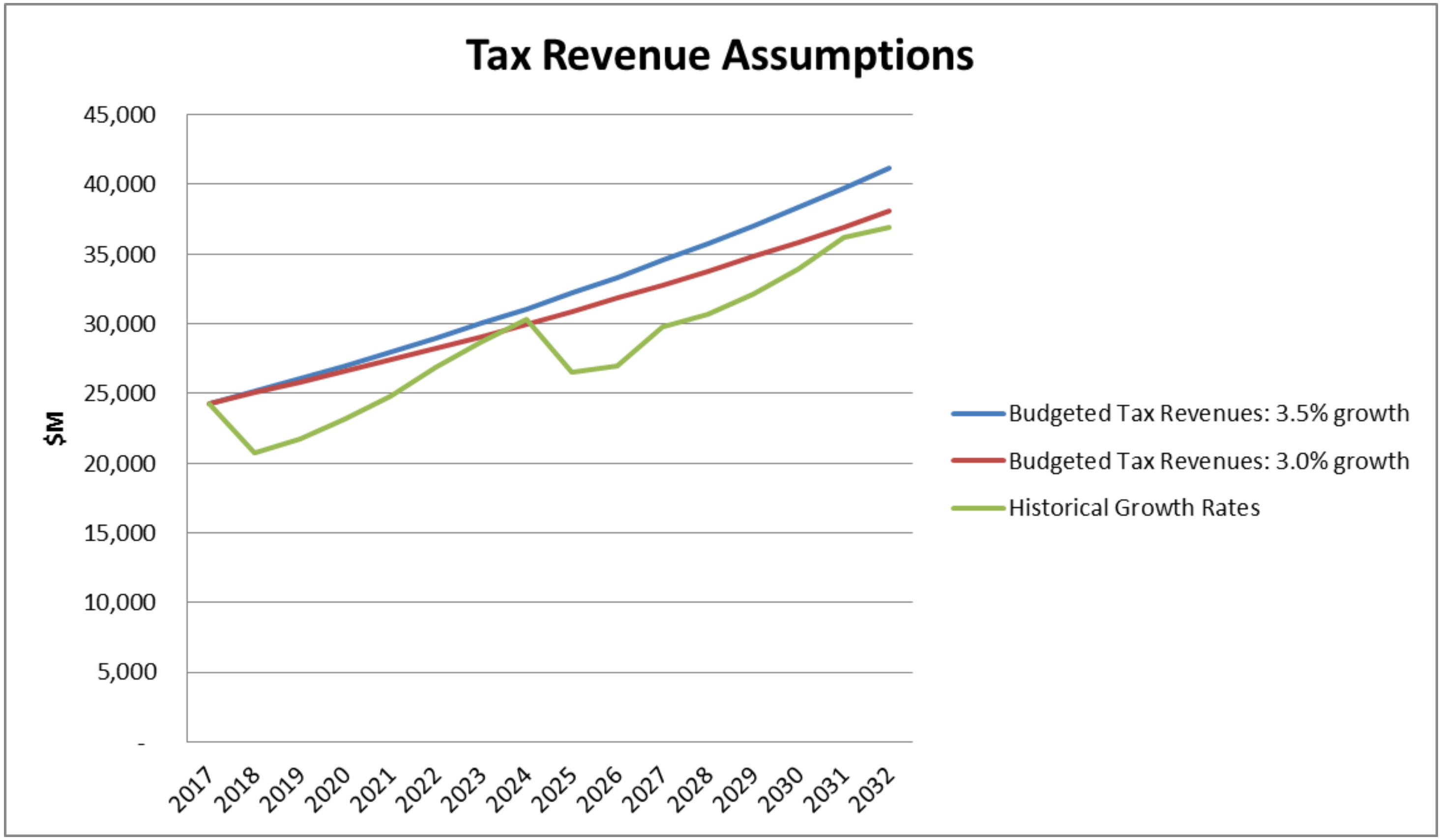


- Annual OPEB PAYGO expected to rise 9.5% annually through FY24, from $460 M in FY16 to $950 M
- While growth rate significantly exceeds revenue, OPEB is the smallest of the “long term fiscal pressures” in annual dollar terms and does not significantly change discretionary budget ratios.
- Nevertheless, this increased costs will incrementally. pressure the operating budget

Debt Affordability with Recessions

- Models presented in past two meetings used steady revenue growth of 2.5-4%. Real world revenue is significantly more volatile. In FY02 and FY09 revenue *dropped* by 15% and 13% YOY, respectively.
- Revenue experience from FY01-FY16 includes two recession and two recoveries. While there was significant “bounce-back”, the recessions resulted in permanent lost revenue relative to steady 3-4% growth.
- From FY01-FY16, tax revenue grew at a CAGR of 2.8%; using FY05 as a start year increases growth rate to 3.7%.
- Modeled tax revenues, debt service to budget ratios, and discretionary budget using FY01-FY16 growth rates applied to FY17-FY32.
- As debt service is a fixed obligation, a high debt service to revenue ratio reduces fiscal flexibility and the ability to fund critical operating programs during recessions.

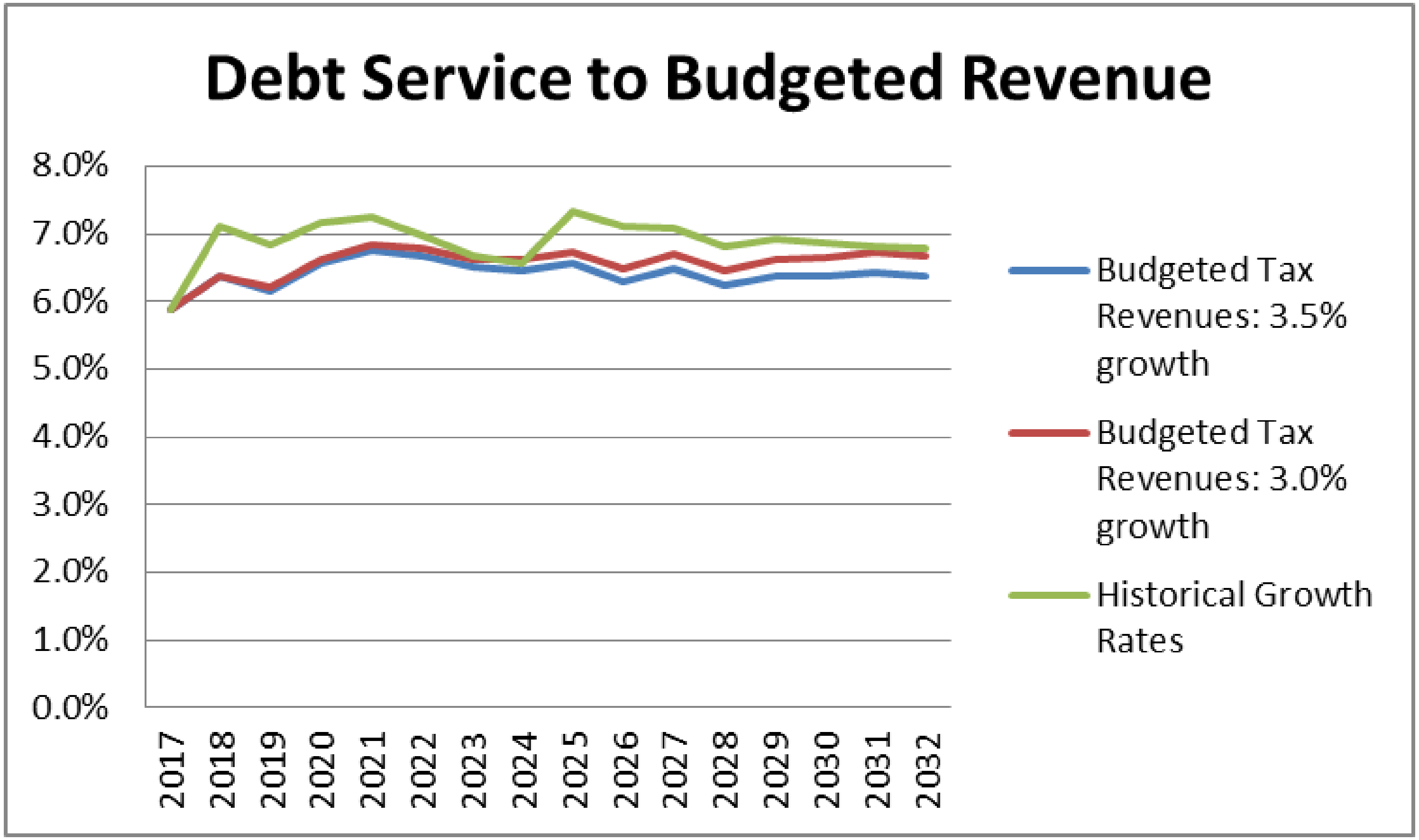
Tax Revenue



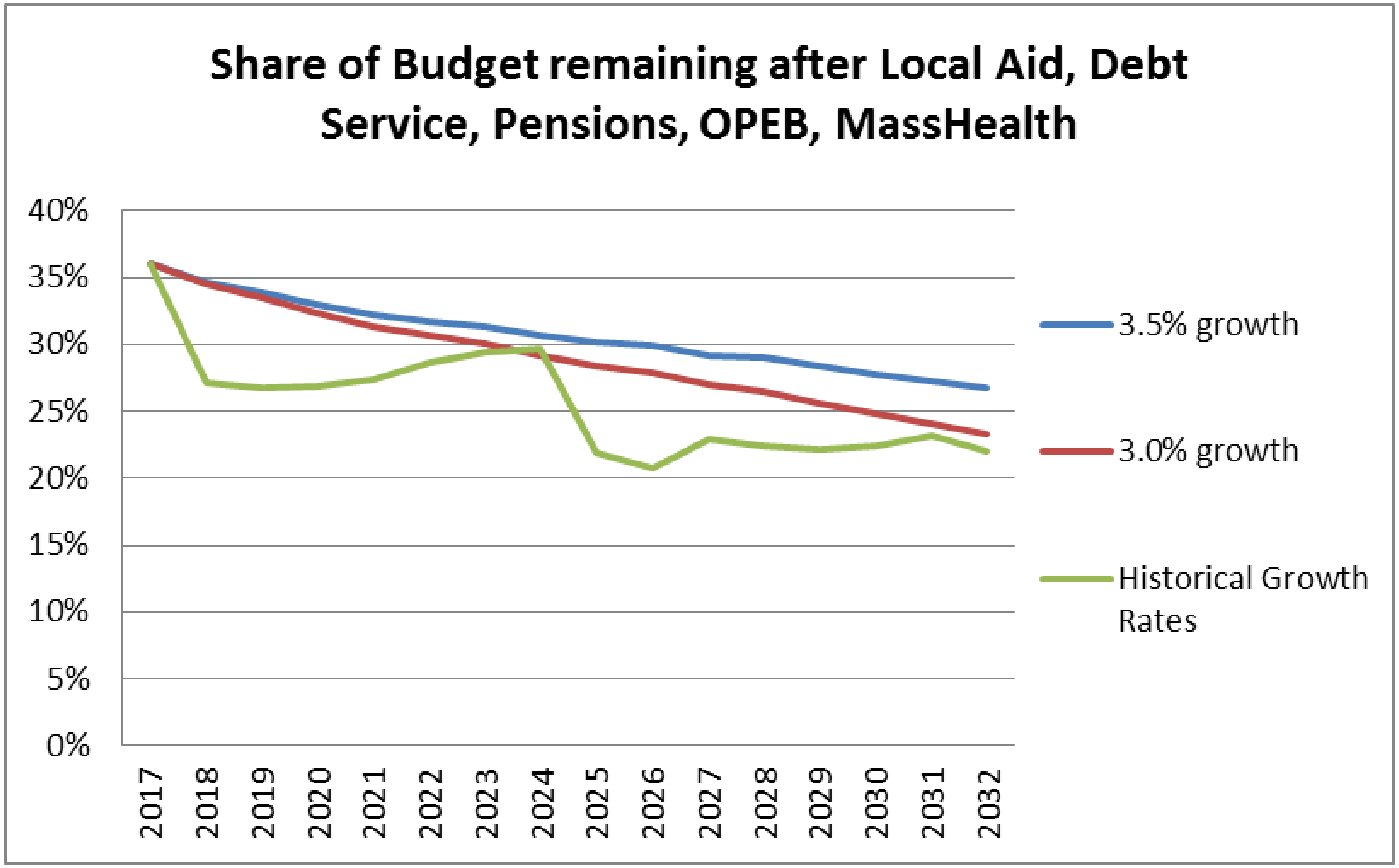
- Historical growth rates show effects of 2 recessions
- Represent cumulative revenue loss of $58.7 B (11.5%) over 15 years relative to base 3.5% growth assumption

[*For policy development and discussion purposes only.*]

Debt Service to Budgeted Revenue



Discretionary Budget



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Debt Affordability Decision: Context

- As seen in the previous slide, increasing pension payments, Medicaid growth, and debt service put pressure on the remaining "discretionary" budget that funds government operations, non-MassHealth human services, higher education, environment and other important policy areas.

- This model does not make the most conservative assumptions about long-term obligations; the pension funding schedule will likely increase in FY18 based on the 1/1/16 actuarial valuation.

- Debt Service, while difficult to change by large amounts in a single year, is the fixed obligation most under the administration's control growing forward.

- Given the ratings outlook, increasing burden from other fixed obligations, and pressure on the operating budget, the state needs to carefully weigh benefits of additional capital spending in fostering economic development and reducing asset maintenance backlogs against costs and loss of flexibility.

Option 1: No growth to Bond Cap

- Bond Cap Remains at $2.190 B

  - Debt service and contract assistance rises from 5.9% to 6.4% of budgeted revenues in FY18 (based on level debt projections).

  - Without further bond cap increases, debt service stays within 7% of budgeted revenues through FY22 reaching a max of 6.8% in FY21.

  - Still includes approximately $1.8 B of non-bond cap Transit and ABP spending through FY20.

  - Limits capacity to make new investments given committed nature of capital plan in FY18 & FY19.

Option 2: $70 M (3%) increase to bond cap

- Increases bond cap to $2.260 B
  - Debt service and contract assistance rises from 5.9% to 6.4% of budgeted revenues in FY18 (based on level debt projections).
  - Outstanding principal will grow more slowly than projected revenue and gross state product growth
  - Debt service stays below 7% of budgeted revenues through FY22, reaching 6.8% in FY21.
  - Allows for targeted new investments and completion of existing projects.

Option 3: $125 M increase to bond cap

- Bond Cap increases to $2.315 B
  - Debt service and contract assistance rises from 5.9% to 6.4% of budgeted revenues in FY18 (based on level debt projections).
  - Debt Service reaches 6.8% of budgeted revenues in FY21, but stays below 7% under base revenue assumptions.
  - Outstanding principal grows faster than projected revenue and gross state product growth.
  - Increases Debt service by $119 M FY18-FY22 compared to no increase in bond cap
  - Increases Commonwealth’s fixed obligations at greatest rate among 3 options.
  - Provides the greatest capacity for new investment and absorption of project cost escalation.

Discussion