THE COMMONWEALTH OF MASSACHUSETTS

EXECUTIVE OFFICE FOR

ADMINISTRATION AND FINANCE

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Meeting Minutes

Debt Affordability Committee
November 18, 2022
1:00 pm
Executive Office for Administration and Finance
Zoom URL: https://mass-gov-anf.zoom.us/j/83548928062?pwd=WXUydlJ2ZHNtc2dUc2hUR21EWTE0dz09
Password: DAC111921
Teleconference line: 713-353-7024; Conference code: 319738

A meeting of the Debt Affordability Committee was held on November 19, 2021, pursuant to notice duly given, and in accordance with the Governor's Executive Order Suspending Certain Provisions of the Open Meeting Law, G.L. c. 30A, § 20, signed and dated March 12, 2020, was held via WebEx and teleconference.

The meeting was called to order at 1:02 PM

Board members comprising a quorum:

Kaitlyn Connors, Executive Office for Administration & Finance
Catharine Walsh, Governor's Appointee, Northeastern University
Sue Perez, Office of the Treasurer and Receiver-General
Michael Butler, Treasurer's Appointee
Michelle Ho, Massachusetts Department of Transportation
Pauline Lieu, Comptroller's Appointee, Office of the Comptroller

Others in attendance:

Kelly Govoni, Executive Office for Administration and Finance
Jimmy Cowdell, Executive Office for Administration and Finance
Joshua Tavares, Office of State Senator Ryan Fattman
Corrine Corcoran, Senator Feeney's Office

Minutes:

Ms. Connors called the meeting to order and proceeded to provide an update on committee membership. She welcomed Navjeet Bal the Treasurer's most newly appointed voting committee member. Ms. Perez then provided a brief overview of Ms. Bal's professional background. Ms. Connors then introduced Sam Alejo as

A&F's new Special Project Manager who will serve as Secretary to the DAC.

Ms. Connors then took a formal roll call before moving on to the next agenda item: approval of the minutes from the last committee meeting. Upon a motion by Ms. Ho, and duly seconded, the Committee unanimously voted to adopt the minutes from the October 28, 2022, meeting.

Ms. Connors then proceeded to the next item on the agenda – DAC Bond Cap Recommendation modeling. Ms. Connors reviewed the work that had been completed to date and went over the remaining schedule. She then explained that this meeting is focused on the debt affordability analysis and will include an overview of modeling assumptions and two preliminary modeling scenarios that will be used to inform the Committee's recommendation for FY24.

Ms. Connors started the modeling discussion with a recap of outstanding direct debt the Commonwealth levels since 2016. She noted that the current amount of outstanding debt (~$23.9 B) is well below the statutory limit of $27.8 B and that the buffer between actual outstanding debt and the statutory limit has increased significantly since 2016.

Ms. Connors then reviewed a chart showing prior year bond cap recommendations and introduced the two bond cap recommendation scenarios the Committee would be reviewing: a $90 M bond cap increase and a $125 M bond cap increase, which represented an increase over prior's bond cap of 3.24% and 4.5% respectively.

Ms. Connors proceeded to go over the two modeling scenarios in more detail, reviewing the assumptions that were embedded in the model. She noted that the assumptions used were based on discussions that committee had in prior meetings and were aligned with the approach the Committee had taken in past years. She reminded the group of the inputs that are held constant across all scenarios in the model, which include debt service on existing debt, contract assistance payments, assumed bond maturities, and future bond cap growth.

Ms. Connors then reviewed the inputs that are adjusted across scenarios, which include interest rates for new debt, revenue growth, and the FY24 projected bond cap (DAC recommendation). She explained that since the last meeting nothing has changed in terms of interest rates and revenue growth assumptions. She then laid out the three scenarios that each bond cap recommendation ($90 M and $125 M) would be run through:

(1) A moderate scenario which would assume interest rates based on Moody's projections and revenue growth based on the low 20-yr tax CAGR (3.2%);
(2) A conservative scenario that uses Moody's interest rate projections but assumes the low 10-yr tax CAGR (1.6%)
(3) A stress test scenario that escalates Moody's current interest rate projections by 25 basis over the next five years) and uses low 10-yr tax CAGR)

Ms. Connors then reviewed the results of the $90 million bond cap modeling scenarios. For each scenario, results were depicted graphically; debt service associated with the additional $90 million bond cap was layered on top of existing debt service. Total debt service payments were then compared to the 7% and 8% of expenditures threshold over 30 years.

While the model projects debt service 30 years out, Ms. Connors explained that the Committee is particularly focused on debt service over the first ten years and does not like to see annual debt service go above 8% of revenues in the first ten years. While the Committee's formal policy threshold for annual debt service as a percentage of revenues is 8%, Ms. Connors noted that the Committee

Ms. Connors walked through each of the $90 million scenario results in detail. The shape of the curves for each of the scenarios was very similar. In all three scenarios debt service stayed below 7% of revenues.

However, in the conservative and stress test scenarios annual debt service did exceed the 8% threshold around 2040.

Before reviewing the results of the modeling for the $125 million modeling scenarios, Ms. Connors asks if there were any questions. Ms. Bal asked if Ms. Connors to confirm that the model assumed the bond cap would increase in future years by $125 million annually even though we're modeling the first year as a $90 million increase? Ms. Connors confirmed that is correct

Ms. Bal noted that it looks like contract assistance payments are being held constant Ms. Connors confirmed that is correct. She explained that she held Clean Water Trust contract assistant payments constant starting in 2023 based on the assumption that future payments would likely remain somewhere around current levels, rather than decline (as current contract assistance schedule suggests). Ms. Connors stated she's open to a different approach but noted that maintaining current payment levels going forward seemed like a conservative approach Ms. Bal then asked what was considered revenues. Ms. Connors explains that the revenues are "budgeted revenues" which include taxes, federal funding, departmental revenue and "other" revenue after netting out the MBTA, MSBA, and Workforce Training UI Surcharge transfers. Ms. Connors also reminded everyone that 2 meetings ago Kazim Ozyurt from Department of Revenue discussed revenue assumptions and the economic outlook and noted that DOR is assuming tax revenue will decrease this year. Ms. Connors pointed out that that this year's decrease has been factored into modeling projections.

Ms. Connors then moved on to the next scenarios for the $125 million bond cap scenario and explained that the difference between the 90 million and the 125 million scenario is minimal when you're looking at it from a 10- and 30-year perspective. She also noted that on average revenues have grown 4.4% annually, furthering supporting the notion that the Committee's is taking a conservative approach.

Ms. Connors then reviewed the results of the $125 million bond cap modeling scenarios taking the same approach as she did for the $90 million scenario. For each scenario (for $125 million bond cap), results were depicted graphically; debt service associated with the additional $125 million bond cap was layered on top of existing debt service. Total debt service payments were then compared to the 7% and 8% of expenditures threshold over 30 years.

Ms. Connors then walked through each of the $125 million scenario results in detail. She noted that the trends and results in these scenarios were similar to those of the $90 million scenarios and explains that the same thing is happening. Debt service stays under 7% of revenues in the first 10 years for all scenarios. However, in the conservative and moderate scenarios it is projected to go exceed 8% over the next 30 years, around 2039 – a couple years before with staying under for the 10 years and we go over in the 30 years. The increase is reached in 2039. Looking at the conservative scenario and you look at the stress test it is the same results except you hit the 8% threshold one year in 2038.

Ms. Connors then provided a recap noting that all the scenarios are similar and that these results are similar to the modeling results the Committee saw last year.

Ms. Connors noted that she also ran an alternative stress test scenario which assumed a bond cap increase of $125 million and the higher interest rate scenario, however it assumed the higher revenue growth rate (3.2% vs. 1.6%) and in this scenario annual debt service stayed below the 8% threshold over the next 30 years.

Ms. Connors asked Committee members if they had any comments or feedback about the models. Mr. Benison asked Ms. Connors to confirm that the Committee's recommendation is for FY 24 only and not the out years. Ms. Connors confirmed that is correct.

Ms. Bal then asked how accurate these recommendations have been over the years in terms of actual debt issued. Mr. Connors explained that the Committee is charged with coming up with a bond cap recommendation and the Governor uses that recommendation to set the annual capital budget. The Governor does not have to use the DAC's recommendation, but historically the Governor has based the capital budget on the Committee recommendation.   Last year we increased the bond cap by 125 million (the max), but the actual amount spent ended up being lower. Ms. Connors noted that this committee is charged with recommending what the Commonwealth can prudently afford and reminded the group that the Commonwealth bonds in arrears, meaning it issues bonds to reimburse itself for capital costs spent. The Commonwealth carefully keeps track of capital spending and then issues that bonds to repay itself.

Ms. Connors then moved to next agenda item and the last sections of the presentation: DAC new report requirements. Ms. Connors explained that over the summer this committee was charged with producing a new report that discuses measure to (1) reduce overall debt service paid by the commonwealth and (2) increase bond ratings. The deadline for this report is July 15th but this the DAC has decided to incorporate this item into it its standard bond cap report. Ms. Connors then provided a recap of former discussion the Committee has had on the topic. She noted the committee has agreed to not provide a recommendation as to which measures the Commonwealth should take, but will provide a fact-based, high-level discussion on decreasing annual debt service and increasing credit ratings. Mr. Benison reiterated his support for this approach and suggested we be clear on the potential trade-offs any potential measure may have.

Ms. Connors then moved on to discuss reducing debt service. She explained that once bonds are issued, debt service is fixed and cannot be changed. She then goes on to explained that refunding opportunities (to take advantage of a lower interest rate environment) are very limited and driven by financial markets. She also noted that refunding savings are typically realized in equal amounts over the life of the refunded bonds (on average over 20 years) and that the Treasurer's Office actively manages the debt portfolio and is poised to take advantage of interest savings opportunities as they arise.

Mr. Connors then discussed strategies to reduce future debt service and explained that cost of debt service is driven by the amount of bonds issued and interest rates/market conditions at the time of issuance. She also noted that the amount of bonds issued is based on the approved CIP which is based on this Committee's recommendation. 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.   Next Ms. Connors then walked the Committee through the strategies and tradeoffs around increasing credit ratings that they had discussed as a group in prior committee meetings. The first potential action identified was reducing long term liabilities. Potential strategies for doing so include: Continue to increase annual pension contributions to fully amortize unfunded liabilities by FY 2036 (per schedule) (2) Continue to maintain state finance law requiring 5% of capital gains income to be transferred into each of the Pension Liability Fund and State Retiree Benefits Trust Fund (i.e. do not suspend law)' (3) Appropriate budget surplus (when available) to pension & OPEB funds. Policy considerations for this measure included notion that Policy makers will need to determine the benefits associated with reducing long term liabilities are greater than the benefits of other investments that could have otherwise been made with those funds.

Ms. Connors then discussed measures related to reducing future debt, which included reducing future annual capital budgets and identifying non-bon related funding sources.   She then proceeded to walk the committee through the policy considerations associated with reduced CIP which mostly related to the negative consequences of reducing capital spending (increased deferred maintenance, costly repairs outdated & potential unsafe assets and facilities, inability to meet climate goals, or decreased support to local cities and towns). She mentioned that alterative non-bond funding sources for capital could include state operating funds and/or federal grants, but use of operating funds would require policy makers to examine the benefits associated with capital investments with other operating needs. She also mentioned that The Commonwealth has processes in place for tracking federal funding opportunities and incorporating federal funding into the CIP (~22% of FY 23 CIP is funded with federal funds). The recent passage of key Federal legislation (IIJA/BIL, Inflation Reduction Act) could help relieve pressure on bond cap budget through increased federal support, note most federal funding opportunities require a state match.

Ms. Connors noted that there are two more meeting that will be used to further refine the report and encouraged everyone to reach out put any thoughts or additional questions.

Ms. Connors then asked if there were any further questions from Committee members or anyone else in the meeting. There were no further questions.

Ms. Connors announced that the next meeting is scheduled for December 2rd at 1:00PM.

There were no further questions/matters. Meeting adjourned at 2:15PM**.**