THE COMMONWEALTH OF MASSACHUSETTS

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**Meeting Minutes**

**Debt Affordability Committee November 19, 2021**

**1:00 pm**

**Executive Office for Administration and Finance**

**Zoom URL:** [**https://mass-gov-anf.zoom.us/j/86554815985?pwd=ODEzcDR5a04xdmg0ZTNXWU5wUXBxQT09**](https://mass-gov-anf.zoom.us/j/86554815985?pwd=ODEzcDR5a04xdmg0ZTNXWU5wUXBxQT09)**;**

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 1:02PM

**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. Upon a motion by Ms. Ho, and duly seconded, the Committee unanimously voted to adopt the minutes from the October 22,2021, meeting.

Ms. Walsh abstained from voting because she was not present at the October 22, 2021, meeting.

Ms. Connors then started the presentation and explained that this meeting is focused on the debt affordability analysis, which considers models in practice and preliminary scenario review. Ms. Connors noted that the Committee is starting to look at the model and preliminary scenarios as far as levels of bond cap that the Committee would like to recommend for FY23.

Ms. Connors proceeded to provide an overview on the statutory and administrative limits on direct debt. Ms. Connors noted that the amount of outstanding principal the Commonwealth’s direct debt is capped at is 105% of the previous fiscal year’s limit. The limits for FY20- FY22 are provided below:

* FY20 Limit: $25.2 billion
* FY21 Limit: $26.5 billion
* FY 22 Limit: $27.8 billion

Ms. Connors noted that by policy, the annual debt service payments must be less than 8% of budgeted revenues. The FY20- FY22 borrowing limits are provided below:

* FY 20 Limit: $3.8 billion
* FY21 Limit: $4.2 billion
* FY22 Limit: $4.3 billion

Ms. Connors noted that the annual growth in the bond cap is < $125 million. Ms. Connors explained that the Commonwealth is currently at 23.4 B of its outstanding debt limit, which is about 11% below the FY 21 limit of $26.5 billion.

Ms. Lieu noted that there is an updated version of these numbers in the November 1st information statements. Ms. Connors noted that she would update the numbers in the presentation but that it probably is not a significant change.

Ms. Connors then moved on to the model reviews for the Committee to consider. Ms. Connors noted that the model being used was created 4 or 5 years ago and that the model itself has not changed. Ms. Connors noted that the Committee has the ability to change the assumptions and inputs, so those numbers have changed over the years, but the model itself remains the same.

Ms. Connors proceeded to go over the inputs held constant across scenarios, which include debt service on existing debt, contract assistance payments, issuance maturity terms for new debt and future bond cap growth. Ms. Connors then noted the inputs that are adjusted across scenarios, which include interest rates for new debt, revenue growth, and FY23 projected bond cap (DAC recommendation). Ms. Connors noted that the adjusted inputs are what the Committee will focus on today.

Mr. Butler asked Ms. Connors what DBC is.

Ms. Perez noted that it is the software used to model issuances, and it lists everything on outstanding debt and runs debt service for the length of bonds.

Ms. Connors then moved on to interest rates and the current yield curve on municipal bonds. Ms. Connors noted that the tables and charts provide yield rates for AAA, AA, and A rated municipal bonds in 10, 20 and 30 year maturity ranges. Ms. Connors noted that rates reflect the approximate yield to maturity that an investor can earn in today’s tax-free bond market. Furthermore, Ms. Connors explained that historically MA GO bonds trade in the range between Aaa and Aa and the current MA GO ratings are Aa1/AA/AA+. Ms. Connors also noted that MA GO bond rates have recently been below 2%.

Ms. Connors then moved to the next slide, which depicts the yield curve outlook for interest rates by Moody’s, Bond Buyer, and HIS Markit. Ms. Connors noted that the outlook reflects a steady rise in rates starting next calendar year (2022) with rates anticipated to increase roughly 2.5% over the following 6 years then flattening out. Ms. Connors then showed the historic yield curve, which shows what interest rates looked like over the past 15 years. Ms. Connors noted that the key takeaway is that Moody’s, Bond Buyer, and HIS Markit, are indicating that rates will go back to where they were back in 2008.

Ms. Connors then moved on to explain the long-term tax revenue growth CAGR Method. Ms. Connors noted the CAGR (Compound Annual Growth Rate) is the geometric average annual growth over a given period. It is generally accepted as an accurate way to compare growth rates over different timelines. Ms. Connors noted that the lowest 10-year tax CAGR was 1.6% and the highest was 3.2%. Ms. Connors noted that these are the two growth scenarios she incorporated into the modeling.

Ms. Connors then moved on to the DAC debt affordability model inputs prepared for the Committee to review. The scenarios include moderate, conservative and stress test. The low scenario for the FY23 bond cap increase is $90M and the high scenario is $125M. Ms. Connors explained that the interest rates for the moderate scenario would start at 1.5%-2.3% based on Moody’s and increase by .5% annually through 2027, based on Moody’s projected growth rate. After 2027, interest rates are held constant. Revenue is assumed to grow 3.2% annually, based on the 20-year lowest CAGR. In the conservative scenario interest rates would also start at 1.5%-2.3% and increase by .5% annually through 2027, however annual revenue growth is more conservative at 1.6% (based on the lowest 10-year CAGR). The stress test scenario has interest rates starting at a higher baseline of 2.6%-3.4%, which is 1.1% higher than Moody’s 2022 projection. Like the other scenarios, these rates are increased by 0.5% annually through 2027 and then held constant. Annual revenue growth is assumed to be 1.6% in the stress test scenario. Ms. Connors explained that in the preliminary moderate scenario 1, interest rates would be between 1.5%-5.0%, annual growth would be 3.2% and bond cap would continue to increase annually. For the conservative scenario 2, interest rates would be between 1.5%-5.0%, annual revenue growth would be 1.6% and the bond cap would continue to increase annually.

Ms. Connors asked Committee members if they had any comments or feedback about the models. Ms. Perez noted that it makes sense to start interest rates with Moody’s AA.

Mr. Butler noted that going back to the FY22 interest rates, it assumes they increase half a percent annually, and so that would be a total of 2 and a half percent over 5 years.

Ms. Connors confirmed that is correct.

Mr. Butler then asked why Ms. Connors increased Moody’s projection by 1.1% in the stress test model scenario. Ms. Connors noted that its more of an art than a science and she wanted to see where we would land. Ms. Connors noted that in the stress test scenario by 2027, the 30-year bonds were above 6% and she did that because last year when the Committee reviewed the stress test scenario, the 30 years ended up at 5%. Ms. Connors noted that it seems that we are in a faster growing interest rate environment than we were last year, so she wanted to reflect that in the scenario.

Mr. Butler thanked Ms. Connors for her analysis.

Ms. Connors then provided a recap by noting that, in all the scenarios- debt service stayed below 7% of revenues in first 10 years. In the conservative scenarios, debt service exceeded 8 percent in the 30-year range depending on the scenario. Ms. Connors noted that the key takeaway is that revenue growth is the driver of whether we are above or under our curve in the out years and that interest rates did not have that much of an impact.

Mr. Butler noted that in Slide 4, we have a bond cap growth of $125M and given that, are there any circumstances where the gap would actually close or shrink in the years ahead?

Ms. Connors noted further analysis could be done, if necessary, and asked if Ms. Perez or Ms. Lieu wanted to add anything on that point. Ms. Perez noted that there is nothing in the short term that would shrink the gap.

Mr. Butler noted that he asked because he could not think of anything, and it seems that over the past 5 or 6 years there has been growing delta between what the limit is by statute and what is outstanding. To him, it seems to close the gap, you would have to issue about $3B in incremental direct debt service, which he does not think is going to happen.

Ms. Perez noted that another piece to consider is that the Commonwealth has a lot of federal money coming in, and then we will see how much we have to issue. With that as a backdrop and on some of the other assumptions, Ms. Perez noted that she thinks scenario 1 is right. Further noting that last year the stressing in the models was because interest rates were so low and revenue growth was anticipated to be negative so the 20-year CAGR makes sense because it seems like we should be getting back on track. Thus, Ms. Perez thinks scenario 1 is a good one for the Committee to use.

Mr. Butler noted on slide 15, our debt service is slightly over 5% and when he looked at 2033 it is still in the same ballpark. Mr. Butler noted that the Committee may want to think about the thresholds that were established years ago for the 7% and 8% growth annually. Mr. Butler questioned whether those are the right thresholds to use, given that it was set at a time when there were much higher interest rates and a big backlog of capital for states. Mr. Butler noted that an option for next meeting is to consider the $125M scenario with bond cap continuing to increase annually at $125M.

Ms. Connors noted that the outstanding direct debt is in statute and is not something that can be changed as a Committee but the Committee could think about the $125 increase in volume cap. Ms. Connors also noted that the 7% and 8% thresholds are a policy that was established by ANF but is not in statute and thinks it is based in good practice in terms of where debt service should be but will take a look at it.

Ms. Connors noted that for the next meeting she will re-run the scenarios and will run a $100M or $110 M scenarios with a change to the bond cap growth and will assume a $125M increase over 30 years to see how that would change the modeling.

Ms. Connors asked if there were any further questions from Committee members or anyone else in the meeting.

There were no further questions.

Ms. Connors summarized her follow-up items and announced that the next meeting is scheduled for December 3rd at 1:00PM.

There were no further questions/matters. Meeting adjourned at 1:55PM.