THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE OFFICE FOR ADMINISTRATION AND FINANCE

STATE HOUSE ▪ ROOM 373 BOSTON, MA 02133

Friday, November 8, 2024
1:00 p.m.

A meeting of the Debt Affordability Committee was held on November 8, 2024. 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.

Zoom URL: https://us02web.zoom.us/j/83935411857?pwd=o0ViLM1tc6nFZpMbxuM9gNySafQYhm.1
Meeting ID: 839 3541 1857; **Passcode**: 040354
Teleconference line: 1-646-558-8656; **Passcode:** 040354#

Minutes:
The meeting was called to order at 1:00pm

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
Pauline Lieu, Office of the Comptroller
Michelle Scott, Massachusetts Department of Transportation
Susan Perez, Office of the Treasurer and Receiver-General
Catherine Walsh, Appointee of the Governor

Others in attendance:

Representative Michael J. Finn, Chair of the House Bonding, Capital Expenditures, and State Assets Committee
Senator Edward J. Kennedy, Chair of Bonding, Capital Expenditures, and State Assets Committee
Chris Czepiel, Senate Committee on Ways and Means
Peter DeGrandis, Joint Committee on Bonding, Capital Expenditures and State Assets
Aidan Bettencourt, Office of State Representative Michael Finn
Josh Tavares, Massachusetts State Senate
Cory Bannon, Office of the Treasurer and Receiver-General
Daniel Aldridge, Office of the Treasurer and Receiver-General
Christina Marin, Office of the Treasurer and Receiver-General
Timur Kaya Yontar, Executive Office for Administration and Finance

Minutes:

Ms. Connors called the meeting to order and conducted the roll to establish quorum. She immediately moved into the agenda and called the first item of business which was approval of the minutes from the October 25, 2024, committee meeting. Upon a motion made by Mr. Benison, and duly seconded, the minutes were approved unanimously.

Ms. Connors then moved on to the next item on the agenda: the DAC Model Review. She explained that the DAC uses an excel based model developed in-house by A&F staff, with DAC input to project debt service payments under various scenarios to inform its annual recommendation. The model projects future debt service payments over the next 30 years, considering annual debt service payments for existing General Obligation (GO), Special Obligation (SO), and Contract Assistance (CA) debt out 30 years and projected annual debt service payments associated with future GO and SO under various assumptions/scenarios It then compares projected future debt service payments compared to the DAC 7% and 8% annual revenue thresholds.

Ms. Connors acknowledged the model had many strengths, but noted there were several areas ripe for improvement. As a result, she has been working with PFM financial advisors to refresh the model - a process that is currently underway. Areas of growth to be addressed include improving ease of ease use (automating manual updates, making it more intuitive), enabling it to use more dynamic inputs, refreshing the way future debt is calculated, developing dashboards, and incorporating the direct debt limit calculation into the model. She noted that refreshing future debt projections and incorporating the direct debt limit were probably the two most important updates.

Ms. Bal asked if the model would be ready to use this year. Ms. Connors replied it would.

Ms. Connors then summarized the main inputs in the model and noted which ones vary across the scenarios that the Committee considers, which are tax revenue growth, projected forward interest rates for new debt issuances by maturity term, and the DAC recommendation for the FY26 bond cap limit. She then walked through each of the model inputs and the current market data and trends associated with each.

For revenue growth, the Committee typically uses the CAGR approach which looks at the 10 and 20 year compound annual growth rate (CAGR) history and conservatively take the lowest levels. Using this approach revenue growth assumptions used in the model for the conservative and stress test scenarios would be 3.2% (20 yr low) and 1.6% (10-yr low), respectively. The average annual year-over-year growth is 4.3%, which could be used as a moderate tax revenue scenario. Ms. Connors reported that the CAGR approach is generally accepted as an accurate way to compare growth rates over different timelines and has been historically used by the DAC for revenue projecting.

Ms. Perez noted that Dr. Kazim Ozyurt from the Department of Revenue (DOR) confirmed that this was the right approach when he presented to the Committee at the last meeting.

Mr. Benison agreed that the approach the Committee uses should align with DOR's approach and asked if DOR could confirm this is the approach they use. Ms. Connors confirmed that this was DOR's methodology, but said she would double check with DOR.

Ms. Bal asked if the projections included any of the new FairShare surcharge. Ms. Connors thought that it might, but said she would confirm.

Mr. Benison asked how capital gains was treated. Mr. Czepiel replied that there is cap gains threshold, and it's excluded from the calculation.

Ms. Perez remarked that the Committee should think about whether we need to include surtax revenues in the base. Ms. Bal responded that she would be worried including it would artificially increase the CAGRs.

Ms. Connors moved on to the next input: interest rate assumptions. She explained for modeling, the

Committee typically relies on Moody's forecasts for future interest rates. Moody's projections for 20yr Aa muni is typically used as the baseline, which represents a conservative approach given actuals interest rates for Commonwealth GO bond transactions typically fall between Aaa and Aa.

Ms. Connors then reviewed key interest rate trends and highlights. Moody's projects rates will increase slightly in 2025 and hold steady over the next 10 years. In recent years Moody's projections have tended to be conservative with actual interest rates coming in below original forecasts. Moody's 2023 projections for 2024 were ~68 bps higher than 2024 actuals. Historically Aa 20 yr rates between 2007 – 2024 have averaged: 3.57%, with a high 4.6% (seen 2008, 2013) and a low 1.97% (seen in 2020). Since 1995 (~ 3 business cycles) Moody's Aa 20 yr muni has averaged 4.17%, with a high of 5.7% (1995), and low of low 1.97% (2020). Going forward Moody's is currently forecasting rates will land slightly above average.

Because Moody's data only includes 20-yr maturities, Ms. Connors explained the Committee estimates rates for 10 and 30 year bonds by looking at current spreads between the 3 maturities (10/20/30 years) and then applying it to the 20-year baseline. Ms. Connors explained that in the past, Moody's baselines were escalated by 40 bps for a stress test scenario.

Ms. Perez asked whether DOR had new interest rate projections to reflect the election outcome. She noted that rates did react to the election and were somewhat volatile. Ms. Connors said she would reach out to DOR to find out.

Ms. Bal noted that Moody's rates have been somewhat conservative and cautioned the Committee to be mindful when thinking about assumptions to ensure we are not being overly conservative.

The Committee then discussed bond cap growth modeling approaches. Ms. Connors noted that illustrative modeling approaches to future bond cap growth have varied over the years; past approaches include a fixed % approach, a fixed annual dollar value approach, and an index approach which pegs growth to tax revenue growth or construction escalation. She reported that the updated model will result in improved future debt forecasting features that provide new ways to look at future growth and more visibility into capacity related to various debt limits & policies and provides the opportunity to rethink an alternative pacing tool to the $125 million administrative policy cap.

Mr. Benison recalled that the cap was likely put into place at a time when outstanding debt was relatively high and voiced support for rethinking the metric.

Ms. Perez noted that the $125 million growth is intended to cover CIP growth. Ms. Walsh asked if it covered growth or just escalation. Ms. Perez noted understanding what the overall goal for the CIP is would be helpful and asked whether the objective was to expand the CIP or simply maintain.

Chairman Finn stated for the record that he did not believe the surtax should be included in the base CAGR calculation. He also asked whether the pledged surtax revenues would be excluded from the CAGR calculation in general. Ms. Connors replied pledged surtax revenues should not be counted as in tax revenue growth base, but said she would confirm with DOR that their CAGR calculations would exclude it.

There were no more questions from Committee members.

Ms. Perez moved a motion to adjourn the meeting, which was seconded by Ms. Scott. The meeting was adjourned at 2pm.