THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE OFFICE FOR
ADMINISTRATION AND FINANCE
STATE HOUSE ▪ ROOM 373
BOSTON, MA 02133

TEL: (617) 727-2040
FAX: (617) 727-2779
www.mass.gov/eoaf

Meeting Minutes

Debt Affordability Committee
October 16, 2020
1:30 pm
Executive Office for Administration and Finance
WebEx: URL: https://www.webex.com; Meeting ID: 173 4992 1155; Password: DAC101620
Teleconference: Conference line: 1-617-315-0704; Access code: 173 4992 1155

A meeting of the Debt Affordability Committee was held on October 16, 2020, 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 1:32 pm.

Board members comprising a quorum:

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

Others in attendance:

Dr. Kazim Ozyurt, Department of Revenue
Senator Michael Moore
Colin Young, State House News Service
Jamie Howell-Walton, House Committee on Bonding, Capital Expenditures and State Assets
Jason King, Office of Senator Ryan Fattman
William Archibald, Executive Office for Administration & Finance

Minutes:

Ms. Connors called the meeting to order. Upon a motion by Ms. Ho, and duly seconded, the Committee voted to adopt the minutes and meeting presentation from the September 18, 2020 meeting.

Dr. Ozyurt began his presentation by offering the Department of Revenue's (DOR) preliminary FY20 tax collection numbers, explaining that the pandemic-induced recession has caused an economic slowdown in Massachusetts. Dr. Ozyurt continued explaining the other factors that attribute to lower tax collections in FY20, which included various payment deadline and tax return extensions. Dr. Ozyurt stated that after booking back income tax payments and refunds received in FY21 but that were originally due prior to the new fiscal year, FY20 tax collections were down $121M (0.4% from FY19). Dr. Ozyurt also noted that in the absence of expanded unemployment insurance benefits, we would have been likely below benchmark with respect to withholding taxes, and that non-withheld personal income tax was $134M below benchmark.

Dr. Ozyurt mentioned the deferrals on sales, rooms, and meals taxes that will be due in May 2021, but DOR is unsure what this amount will be. Additionally, Dr. Ozyurt stated that corporate tax collections were still $46M below benchmark, while DOR observed significant declines in other taxes as well, although there were strong estate tax collections that exceeded benchmark by $108M.

For FY21 numbers so far, Dr. Ozyurt reported that DOR saw around a 1% increase in total tax collections YTD as of September, and again, cautioned that the increase is likely due to the aforementioned expanded UI benefits, which are an unknown variable going forward, along with the unknown status or amount of federal fiscal stimulus in the future. Dr. Ozyurt stated that DOR is cautioning folks to interpret the FY21 numbers carefully so far. When going into specifics, Dr. Ozyurt stated that online sales and home and improvement sales did well recently, but DOR's economic vendors have interpreted these as representing pent-up demand during the summer, and that this is likely unsustainable. Dr. Ozyurt also reported that meals taxes declined massively (around 33.3%), offsetting the large increases in regular and motor vehicle sales taxes, and that while corporate tax collections are up $102M (13.5%) over the same period in FY20, these tax collections tend to be relatively volatile.

Dr. Ozyurt highlighted the forecasts that were presented at the October 7, 2020 Economic Roundtable: DOR's upper and lower bounds were wide, but so were some of the other estimates (MTF's $27.27B vs. cSPA's $29.6B), and ultimately, A&F's October 15 revision was pretty close to the midpoint ($27.592B).

Ms. Connors asked Dr. Ozyurt as to whether he agrees with the Committee using a model with assumptions based on the Compound Annual Growth Rate (CAGR) method as in previous years (looking at the 10- and 20-year history) to project out revenue estimates. Dr. Ozyurt responded that the 10-year CAGR method makes perfect sense, especially if the Committee is looking at longer term trends, since obviously in the short term we will see significant revenue swings in the midst of a recession. Dr. Ozyurt further stated that he believes the current revenue estimate ranges are wide enough to capture where we will end up by the end of FY21, and while the nature of the recession is different from prior recessions, it still fits the Commonwealth's experiences in past recessions. Dr. Ozyurt said there is an opportunity for revenues to recover next year, but a lot of unknowns remain, including more federal stimulus and an effective vaccine. Dr. Ozyurt explained further that most of DOR's vendors (including Moody's) all show positive improvements at some point next year, and they suggest slow but better than expected growth in the following year.

Mr. Merkowitz stated that if we assume 2-3% revenue growth, there will be a big difference between starting based on FY21 forecast vs. a "normal year," and in looking at the CBO numbers, it seems like they expect faster revenue growth, but still below the longer-term trend that was starting in FY19. Mr. Merkowitz asked Dr. Ozyurt if any of DOR's vendors predict whether GDP will catch up back to where it would have been without the pandemic, or if it will be on a permanently lower path going forward.

Dr. Ozyurt responded that Moody's baseline assumption was a V-shaped recovery, but IHS Markit assumed a U-shaped recovery (much slower, longer recovery), but neither expect to return to pre-pandemic GDP levels any time soon.

Mr. Merkowitz followed up to clarify his question: whether we will ever reach the point of 2% growth over FY19 or if the Committee should use a lower number, since it seems reasonable to use a lower number. Mr. Merkowitz further suggested that it might make sense for the Committee to review the longer-term forecasts from the vendors and perhaps look at the CBO forecast as well.

Mr. Butler stated that the 20-year CAGR is just slightly sloping downward and the FY20 CAGR is the lowest CAGR in recent history. Mr. Merkowitz cautioned that this number did not reflect the actual growth of the economy due to the implementation of many tax cuts. Dr. Ozyurt agreed, absent the tax cuts, we might have seen higher revenue growth. Mr. Merkowitz responded that the income tax cuts were already factored into the CAGR, but also included the implementation of the charitable tax deduction.

Following the questions, Ms. Walsh and Dr. Ozyurt departed.

Ms. Connors then continued with the presentation, recapping the Committee's previous conversation on the current debt policy, which is to keep debt service below 8% of net revenues. Ms. Connors stated that the Commonwealth has kept it below 6% for the past five fiscal years.

Ms. Connors reviewed the inputs and assumptions incorporated in the Committee's model, explaining that many of the inputs are dynamic and the Committee has control to change them. Ms. Connors continued, this begins with interest rates—the spread between AAA and AA bonds are fairly tight and moderately sloped between 10- and 20-year curves. However, she explained, there is a caveat that projections of future interest rates are incredibly uncertain, and thus the question is how far out the Committee wants to project interest rates for modeling purposes.

Ms. Connors presented the yield curve outlook based on multiple economic vendors' projections. Mr. Merkowitz asked why the Bond Buyer index was so much lower than Moody's indices. Ms. Connors responded that she would need to follow up on this but seemed to think it had something to do with their different methodologies.

With respect to the CAGR discussion, Mr. Butler noted that we should double check the lowest 20-year tax CAGR of 3.2%. Ms. Connors responded that the formulas themselves should be correct but will check on the numbers to make sure.

Ms. Connors then presented two preliminary modeling scenarios for the Committee to contemplate.

In the first scenario, the underlying assumptions are a 1.6% growth rate based on the lowest 10-year CAGR, 2.5-3.5% interest rates based on Moody's projections, and 0.3% annual interest rate increases through 2026, in line with the vendors' projections. Ms. Connors noted that the revenue growth is over the revenue projections in the revised FY21 budget. Ms. Connors also said the Committee will need to think about the bond cap increase, which is assumed at $100M based on last year's recommendation and then increases 3% annually.

In the second scenario, the interest rate and bond cap increase assumptions remain, but the model assumes a 3.2% growth rate based on the lowest 20-year CAGR instead.

Mr. Merkowitz stated he believed the 1.6% growth rate was relatively pessimistic since we already factor in the revised revenue estimates for FY21. Ms. Perez agreed with Mr. Merkowitz. Ms. Ho asked if the transportation bond bill and GANs were incorporated into the assumptions for bond cap as well, which Ms. Perez confirmed. Ms. Ho stated that given supportive statements from both legislative committees in conference, this would be a good assumption to make.

Ms. Connors asked if anyone had any input on the interest rate assumptions. Ms. Perez asked what we used for last year's model. Ms. Connors responded that we assumed the same 0.3% interest rate growth. Mr. Merkowitz responded that he thinks there is no good reason to be skeptical of the various third-party forecasts. Mr. Butler stated that the previous assumptions ended up at around 5 or 6% after seven years.

Ms. Connors stated that she planned to run a few more scenarios for the next meeting and summarized that the 3.2% scenario seemed to be a better prediction, and would perhaps play with the bond cap as to how it relates to net revenues.

Ms. Perez requested running these scenarios with the interest rate assumptions from last year and compare them to this year to see how much of an impact the interest rate growth would have. Ms. Ho agreed with Ms. Perez's suggestion and recommended to vary the amount of bond issuance as well. Ms. Connors agreed.

Ms. Connors announced that the next meeting is scheduled for November 20, 2020, at 1:30pm.

There were no further questions/matters.

Meeting adjourned at 2:29pm.