THE COMMONWEALTH OF MASSACHUSETTS

EXECUTIVE OFFICE FOR

ADMINISTRATION AND FINANCE

STATE HOUSE ▪ ROOM 373 BOSTON, MA 02133

Meeting Minutes

Debt Affordability Committee
October 28, 2022
1:00 pm
Executive Office for Administration and Finance

Zoom URL: https://mass-gov-anf.zoom.us/j/86951147704?pwd=aE5ueXFjY0xYSlJ4UjBDTHhkT3BFZz09
Password: DAC102822
Teleconference line: *713-353-7024*; Conference code: 319738

A meeting of the Debt Affordability Committee was held on October 28, 2022. 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.

Minutes:
The meeting was called to order at 1:01 pm,

Board members comprising a quorum:

Kaitlyn Connors, Chair, Executive Office for Administration & Finance
Martin Benison, Appointee of the Treasurer
Michelle Ho, Massachusetts Department of Transportation
Pauline Lieu, Office of the Comptroller
Susan Perez, Office of the Treasurer and Receiver-General
Catherine Walsh, Designee for Governor Baker

Others in attendance:

Representative Danielle Gregoire
Jennifer Mercadante, Representative Gregoire's Office (Chief of Staff)
Patrick Walsh, Representative Gregoire's Office
Timur Kaya Yontar, Executive Office for Administration and Finance (Capital Director)

Minutes:

Ms. Connors called the meeting to order and conducted the roll call for attendance. She provided an update on Committee membership, specifically welcoming Martin Benison as a new voting member, and announcing Navjeet Bal, both of whom are appointees of the Treasurer. Upon a motion by Ms. Ho, and duly seconded, the Committee unanimously voted to adopt the minutes from the October 14, 2022, meeting (Mr. Benison abstained as he was not present at that meeting).

Ms. Connors then proceeded to the next item on the agenda, an update on Commonwealth Credit Ratings. She noted that all 3 major credit rating agencies had released new reports for the Commonwealth's General Obligation bonds. Moody's and Fitch reaffirmed their ratings at Aa1 and AA+, respectively, both with stable outlooks; these are their second-highest possible ratings. S&P reaffirmed its rating at AA, its third-highest possible rating. S&P also updated its outlook to positive and advised that there is a "one-third chance that we could raise the rating over the next two years if future budgets show continued commitment to maintaining reserves at very strong levels and a goal of structural balance as it progresses to fully funding its pensions."

Ms. Connors also noted that each of the rating agencies lists 5 key credit factors, and that the Commonwealth has high scores on all of these except for long-term liabilities, meaning that there is limited room for upward mobility. Mr. Benison asked if there is any guidance on what S&P means by Budget Performance or Moody's by Governance. Ms. Connors said the score on the former is lowered by the Commonwealth not fully funding pensions' actuarily required contribution ("ARC") and by not staying the course in the past on replenishing reserves. Ms. Perez said the latter measures institutional ability to react to changing circumstances. Mr. Benison also asked whether the tardiness of passing the budget affected our score, and Ms. Perez said she believed not.

Ms. Connors then went into a bit more depth on what each ratings agency said would be needed for an upgrade and reminded the Committee that, in addition to addressing the current negatives, the Commonwealth must continue doing all the positives; for example, continuing the capital gains tax transfer to reserves. Ms. Perez noted that the agencies expect states to tap reserves as "rainy day funds" during downturns, but only to use them "when it's raining" and to replenish reserves in good times, not use them to balance the budget.

The following four slides in the presentation allowed Ms. Connors to go into key credit strengths per the rating agencies' reports: continued commitment to maintaining strong reserves (budget stabilization fund or "BSF"), which have quintupled in the last 5 years; maintaining a BSF balance in the top 5 largest among the states; and benefitting from both the 2nd-highest state per capita income in the country and a strong, diverse, and resilient economy. Mr. Yontar noted that the BSF's size may be even more impressive if calculated as a percent of state GDP, and Mr. Benison thought that NASBO might be able to provide such data.

Turning to credit offsets, Ms. Connors first noted pension liabilities. Although contributions made as a percentage of ARC has steadily increased, those contributions are still well below the full amount. The Commonwealth has also reduced its investment return assumptions to the more realistic 7% per annum, down from 8.25%, and has increased annual contributions by nearly 10% per annum over the past decade with a goal of fully amortizing unfunded liabilities by 2036. Ratings agencies are uncertain that the 10% annual increase rate is sustainable. Ms. Perez added that ratings agencies look at what percent funded the pension is, as opposed to the trajectory of contributions made as a percentage of ARC. She also noted that every ¼ percentage-point reduction in return assumptions costs the Commonwealth $2 billion in the value of the pension fund assets.

The second offset is Other Employee Benefits (OPEB), for which liabilities also remain high. Ms. Perez observed that, unlike pensions, the Commonwealth can always change OPEB payments. Mr. Benison noted that annual funding has been highly variable, and that the Commonwealth could be more intentional on how we fund OPEB in the future.

The final offset is elevated long-term liabilities, for which Massachusetts ranks 3rd in state debt per capita. While the Commonwealth has shown improvement in key metrics, and attributes its elevated level to state issuance of debt for local purposes (mitigating the impact of Proposition 2½ limits on local services), Ms. Perez observed that the rating agencies simply measure the state level of debt. Moody's and Fitch acknowledge Massachusetts' investments in municipalities and "notch up" our rating, but S&P does not.

Ms. Connors then recapped the main levers available to improve credit ratings: continuing to increase pension contributions, to transfer capital gains to pensions and retiree benefits, and (when available) to appropriate surpluses to the same; and reducing total debt by decreasing the capital budget. She intends to update the summary with feedback from this meeting. Mr. Benison requested that we emphasize that the full set of policy tradeoffs is beyond this Committee's scope. Ms. Perez asked to confirm that the Committee has now been tasked by the Legislature with opining on how to reduce debt service (in addition to total debt) and noted that we can show them what improvements have already been accomplished. She also thought it was important to note that Commonwealth capital spending has been used to leverage federal aid, and the impact on total capital dollars available that would result from reducing the capital budget.

Ms. Connors then moved on to the next item on the agenda, the DAC Model Inputs Review. She 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 on the FY24 bond cap limit. For revenue growth we look at the 10- and 20-year compound annual growth rate history and conservatively take the lowest such levels. For forward rates, we look at spreads between 10-, 20-, and 30-year municipal bonds with AAA and AA ratings and apply these to adjust Moody’s projections of 20-year forward rates. She observed that the current forward rate curve looks different from last year, with a peak expected in 2023. Ms. Walsh asked what scenarios the Committee typically considers, and Ms. Connors responded that we review a baseline, a conservative, and a stress test.

With no further business, the meeting was formally adjourned (motion by Ms. Ho, seconded, vote unanimous) at 2:05 pm.

The next DAC meeting is scheduled for Friday, November 18th, 2022, at 1:00 pm.