



Debt Affordability Committee

FY2020 1st meeting

October 30, 2018



Debt Affordability Committee

- The Debt Affordability Committee (DAC) is charged with submitting to the Governor and the General Court the Committee's recommendation for the fiscally prudent amount of new Commonwealth General Obligation debt that can be issued in the following fiscal year.
- The DAC is codified in MGL Ch. 29 §60B. The DAC was created in the FY13 budget and has released its debt affordability recommendations for FY15-FY19.
- The DAC recommendation is due by Saturday, December 15.
- This recommendation is advisory and does not bind the administration to any level of debt issuance.



Debt Affordability Committee Members

Name	Position
Bill McNamara, Assistant Secretary	Designee of Administration & Finance Secretary
Sue Perez, Deputy Treasurer	Designee of State Treasurer
Howard Merkowitz, Deputy Comptroller	Designee of Comptroller
Michelle Ho, Director of Capital Planning	Designee of Transportation Secretary
Catherine Walsh, Northeastern University	Governor's Appointee
Michael Butler, Town of Dedham	Treasurer's Appointee
<u>Non Voting Members</u>	
House and Senate Chairs and Ranking Members of Bonding and Ways & Means Committees	



Importance of Debt Affordability Reviews

- An annual debt affordability review acts as a primary tool for maintenance of a set of strong financial management practices
- Specifically, a periodic analysis of the affordability of debt levels provides key internal benefits to the Commonwealth
 - Ensures that the financing costs as a percentage of the operating budget are kept at manageable levels
 - Forces the setting of priorities due to the limited nature of available funds
- The reviews are also viewed as a responsible practice and credit positive by rating agencies and internal credit analysts
 - *“Strong financial, debt, and budget management policies, including annualized formal debt affordability statements, and multiyear capital investment planning;”*
S&P Report, August 2018
 - *“The commonwealth's governance policies and practices are strong... The commonwealth also conducts a debt affordability analysis and reports its audited financial results on a timely basis.”*
Moody's Report, August 2018
 - *“Massachusetts' 'AA+' reflects considerable economic resources, strong budget controls and a record of careful financial management. The Commonwealth carries a long-term liability burden that is well above average for a U.S. state but remains a moderate burden on resources.”*
Fitch Report, August 2018



Importance of Debt Affordability Reviews

- The debt service line items represent a significant portion of the overall budget
 - \$2.60 billion expended in FY18 for general and special obligation debt and Contract Assistance
 - 6.1% of the Commonwealth's operating budget
 - \$2.72 billion budgeted in FY19 for general and special obligation debt and Contract Assistance
 - 6.0% of the Commonwealth's operating budget
- The debt service line items are a non-discretionary long term obligation, but the future cost of debt service is more under Commonwealth control than other long-term obligations
 - Close management aids in the prevention of structural imbalances within the budget
 - Annual planning provides a roadmap that allows for funding of necessary projects through the use of efficient and strategic amortization of the debt profile
- While the Commonwealth's control of debt issuance provides up-front flexibility, once debt is issued, it becomes the Commonwealth's most binding financial obligation, with each issuance imposing costs for up to 30 years
- The use of forecasting and a reasoned imposition of policy/statutory limits on additional debt are the most effective means of controlling the growth of long term, fixed obligations



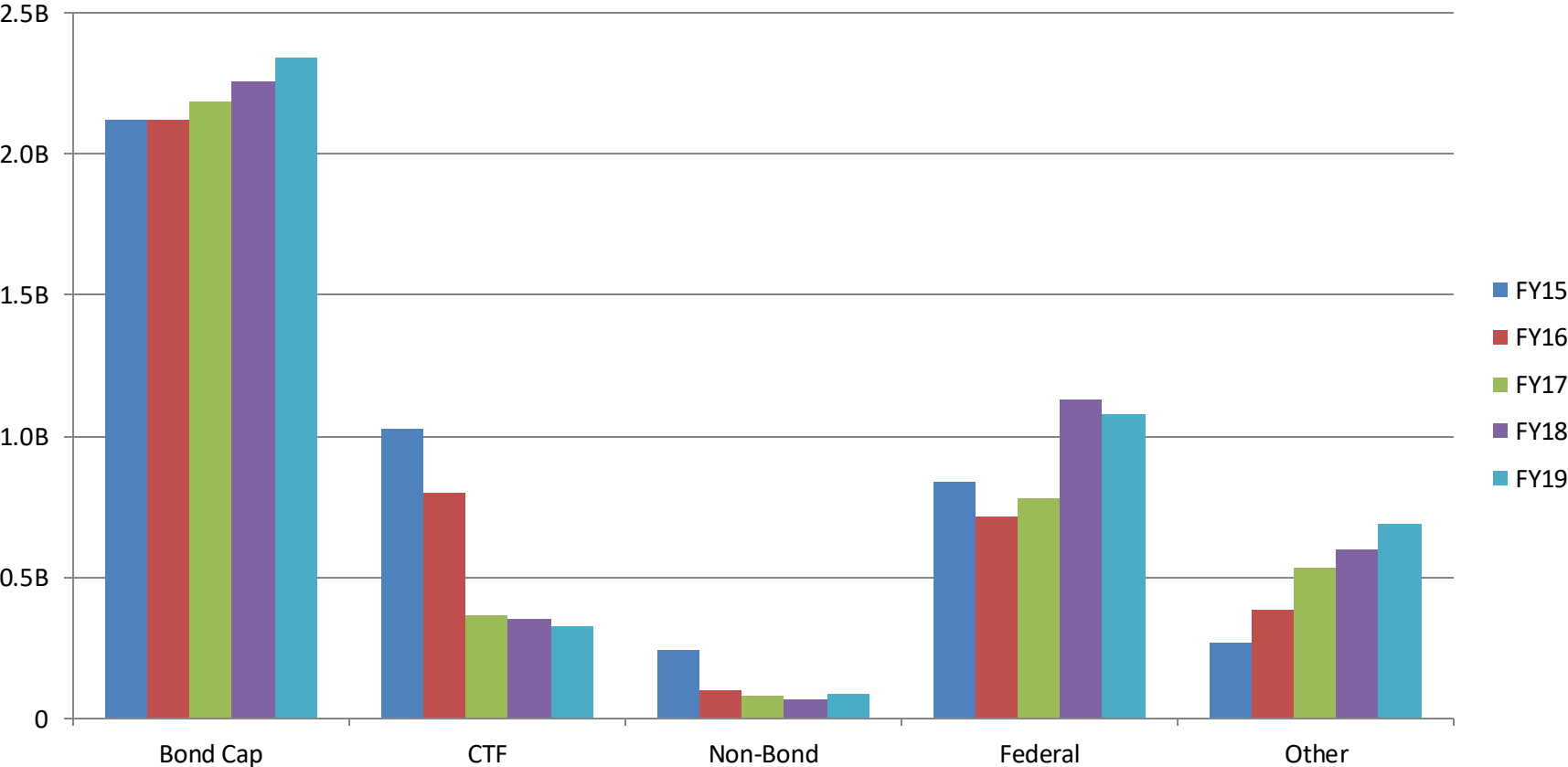
Bond Cap and other Capital Funding Sources

- DAC only makes a formal recommendation as to the affordable level of *bond cap* spending.
- Bond cap is set by the administration, and refers to the total amount of General Obligation bonds subject to the debt limit issued in a fiscal year to support capital spending.
- Bond cap is the principal, but not only, source of funding for the Commonwealth's capital plan. Other sources include:
 - Self-supporting/Project Financed Debt: projects where savings or revenue are anticipated to cover debt service, including the Clean Energy Investment Program (CEIP) and selected IT projects
 - Accelerated Bridge Program (ABP) debt covered by the Commonwealth Transportation Fund (CTF) revenues and federal grants, excluded from the statutory debt limit
 - Rail Enhancement Program (REP) covered by the CTF, excluded from the statutory debt limit
 - Federal grants and reimbursements
 - Funds from other state component units such as University of Massachusetts Building Authority or private sources
 - Operating pay-as-you-go capital, including toll revenue



Sources of Funds

FY15-FY19 Capital Plan Sources of Funds





Debt Affordability Committee: Charge

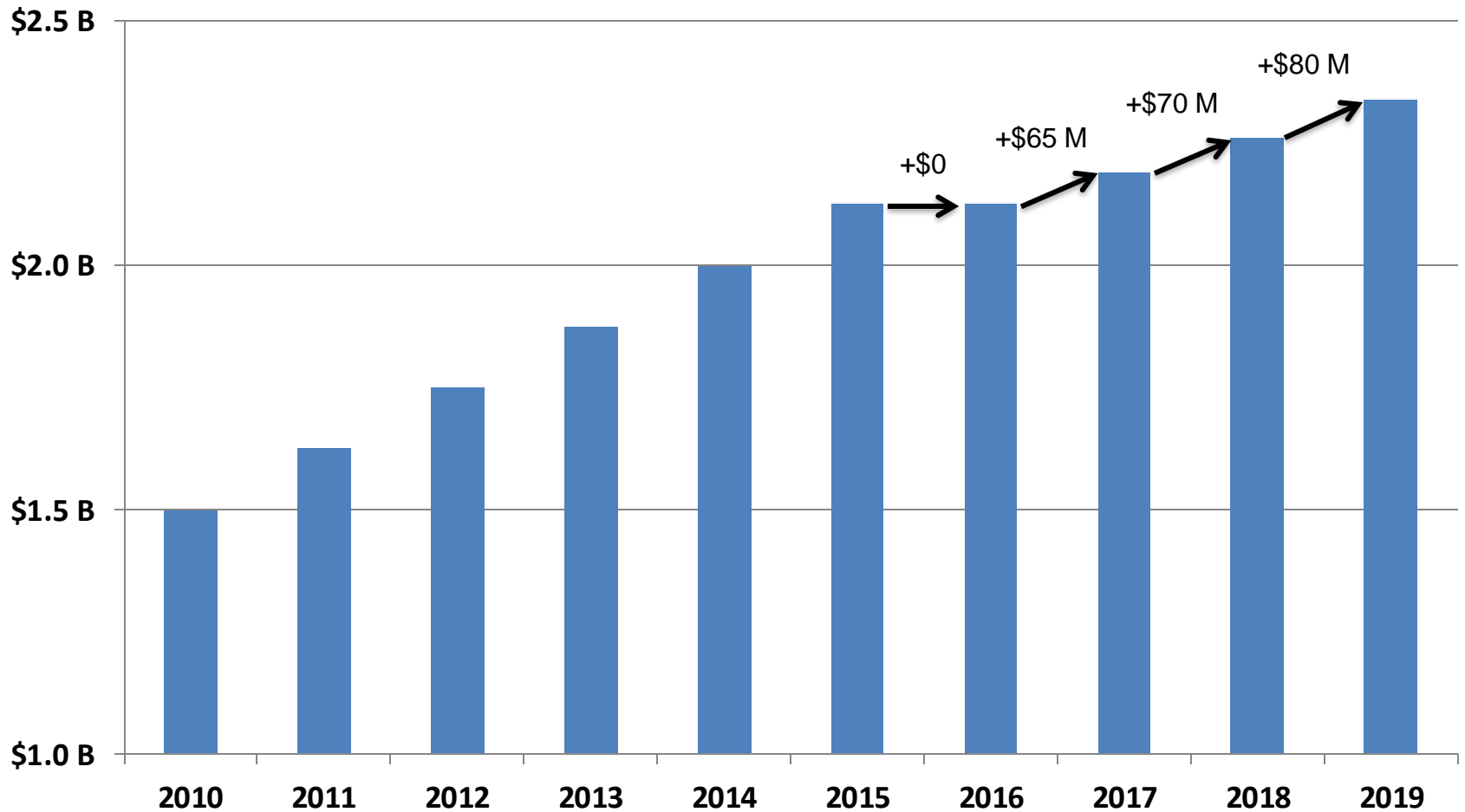
Statute charges DAC with examining multiple factors affecting the prudent level of bond-cap issuance, including:

1. Outstanding debt
2. State's capital program
3. Debt service projections for next 10 years
4. Bond ratings and credit rating agency criteria
5. Marketability of state bonds
6. Pertinent debt ratios and their comparison with other states
7. Composition of Commonwealth debt: fixed rate vs. variable rate
8. Debt of Commonwealth component units
 - The 2014 DAC also recommended that the committee take other long term obligations including pension and OPEB liabilities into account; this has been included future deliberations



Published Bond Cap FY10-FY19

Administrative Bond Cap





Debt Affordability Committee: past recommendations

Year (FY Rec)	Recommended (\$B)	Implemented (\$B)	Notes
2013 (FY15)	2.125	2.125	Recommended 3 part test: debt service targeted at 7% of revenue, stay within debt limit, bond cap not to increase by >\$125 M/year
2014 (FY16)	2.250	2.125	Administration elected to freeze bond cap at FY15 level, due to fiscal pressure
2015 (FY17)	2.190	2.190	Committee recommended \$65 M (3.1%) increase to bond cap, approximately in line with projected revenue growth
2016 (FY18)	2.260	2.260	Committee recommended \$70 M (3.2%) increase to bond cap, approximately in line with projected revenue growth
2017 (FY19)	2.340	2.340	Committee recommended \$80 M (3.5%) increase to bond cap, approximately in line with projected revenue growth



Debt Affordability Committee: 2018 Workplan

- Meeting #1: Introduction (October 30)
 - DAC roles and responsibilities
 - History of Debt Affordability Committee
 - Debt portfolio
- Meeting #2: Model in Practice (November 14)
 - Model presentation
 - Presentations on assumptions
 - Massachusetts debt in context of other states
 - Discussion of improvements to model
- Meeting #3: Debt Affordability Recommendation Discussion (December 4)
 - Revised Debt Affordability Model
 - Discussion/adoption of model and report
 - Discussion of recommended debt affordability level for fiscal year 2020
- Meeting #4: Debt Affordability Recommendation Discussion (December 10)
 - Vote on final recommendation to Governor for fiscal year 2020



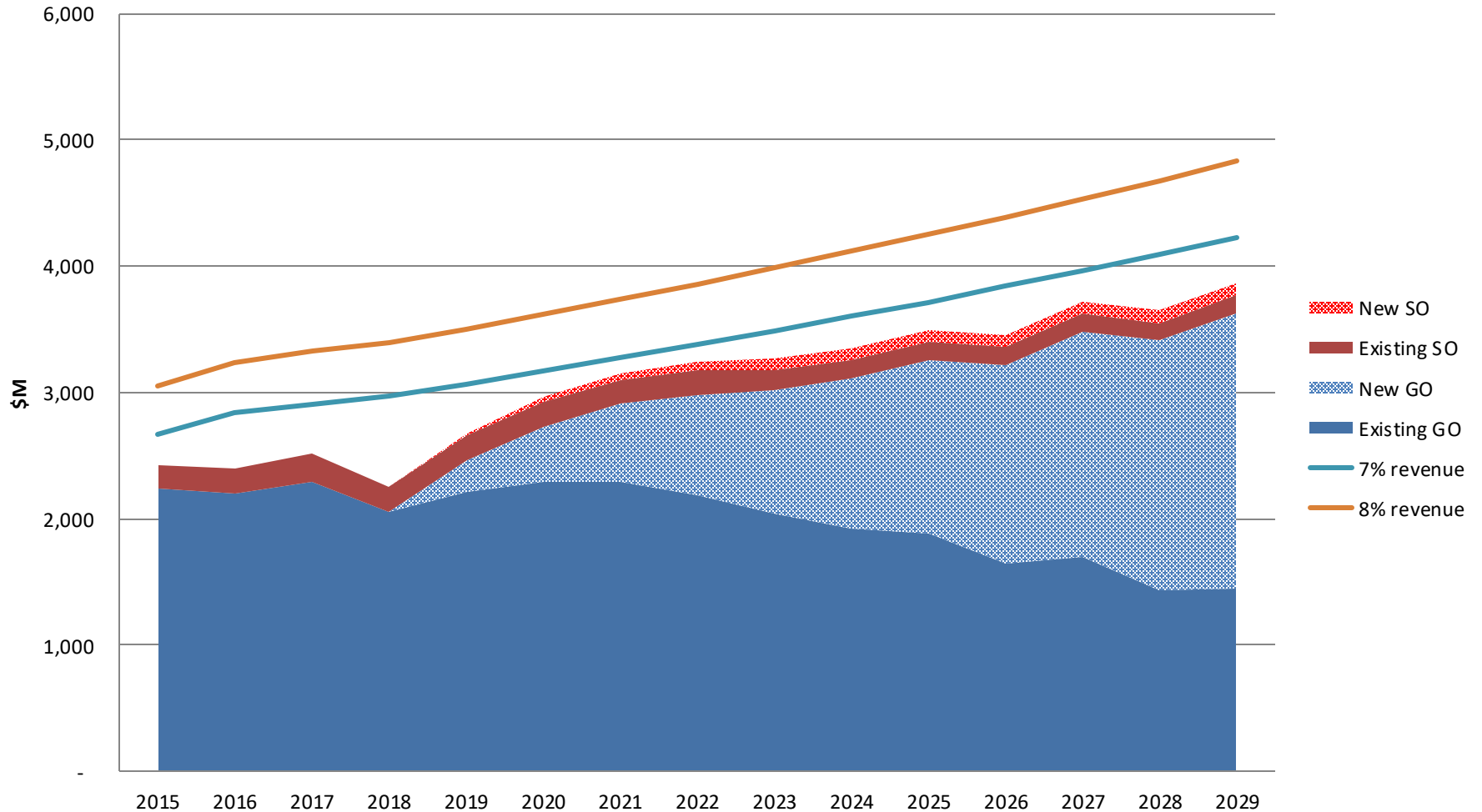
Debt Affordability Model: 8% Test

- A&F internally models the costs of issuance against projected revenue, using lessons learned and feedback from prior years' committee deliberations
- Model starts with existing debt schedule and layers on projected issuance based on the FY19-23 capital plan.
- A&Fs “first cut” metric is the 8% of budgeted revenues test:
 - Debt Service on direct Commonwealth debt cannot exceed 8% of budgeted revenues in a fiscal year.
 - Budgeted Revenues excludes the sales tax transfer to the MBTA and MSBA, but includes pension payments.
 - Direct debt includes all debt issued by the Commonwealth and backed by budgeted tax revenue. It includes debt such as ABP that is excluded from the debt limit but does not include debt of component units with dedicated revenues such as the MBTA or School Building Authority.



8% Test: One View

Projected Debt Service FY15-FY29





Assumptions

- The two following charts represent the assumptions used in developing the debt affordability analysis. These include projected
 - Interest rates
 - Level and type of issuance
 - Revenue growth
 - Non discretionary spending trends
- All assumptions can be changed to “stress-test” the affordability of different levels of issuance under different economic and spending scenarios



Assumptions: Issuance

Measure	2017 Assumption	2018 Assumption	Rationale
10 year interest rate	3.0% +10 bps/year	Discuss: 3.0% is conservative; recent history has been ~2.6%	Conservative, slightly higher than today's rates. Interest rate increases programmed for 15 years (ending in 2033)
20 year interest rate	3.8% +10 bps/year	Discuss: ~3.4%	"
30 year interest rate	4.4% +10 bps/year	Discuss: ~3.7%	"
Debt Service	Level debt service and Contract Assistance	Unchanged	Abstracts past serial issuance, proceeds vs. par, doesn't push off estimated impact
Bond cap issuance	\$2.260 B/year through 2022, 3% thereafter	\$2.340 B/year through 2023, 3% thereafter	Current capital plan
ABP issuance	\$485 M over 3 years	Unchanged	Remainder of authorization. Split between GANS/CTF
REP issuance	\$1.8 B thru FY22	Unchanged	Remaining amount needed to execute REP plan within bond constraints. \$2.6 B total program
Self-Supporting Issuance	\$70M/year, \$50 M after 2020	Unchanged	Based on recent spending levels



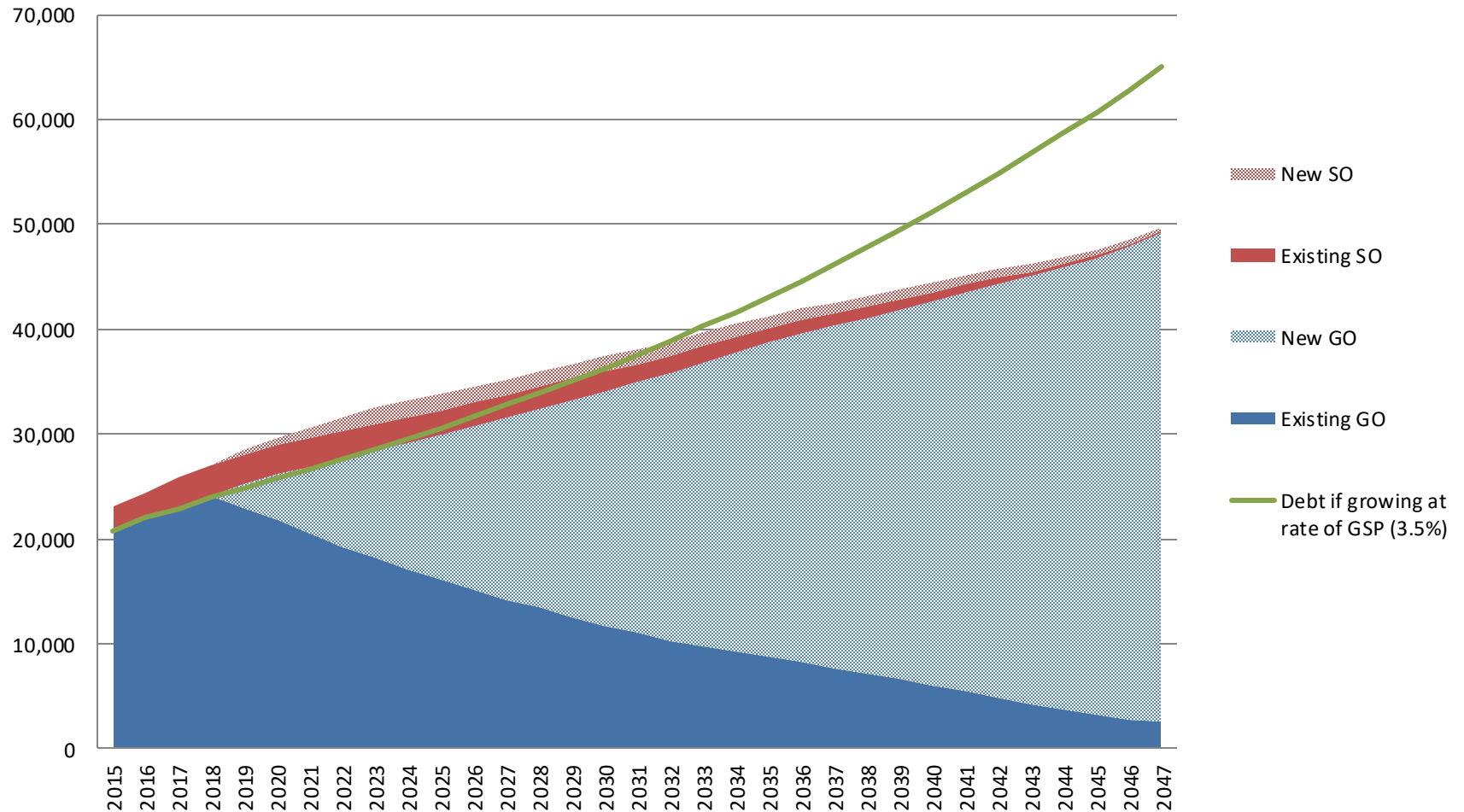
Assumptions: Budget

Measure	2017 Assumption	2018 Assumption	Rationale
Revenue Growth	3.25% increase a year	Discuss: 5-year CAGR of 4.8%; 10-year 2.9%; 15-year 4.2%	FY07-FY17 CAGR 3.71% all sources; less since FY15
OPEB	Increase ~7%/year through FY25, 4% thereafter	Unchanged	Actuary's (AON) projection through FY25
Pension	8.95% increase in transfer a year from FY18 until final amortization FY36; normal cost thereafter	Unchanged	New funding schedule based on most recent valuation implemented in FY18
MassHealth	5% growth through FY20, 4% thereafter	Unchanged	Somewhat aggressive growth rate assumptions – 8.2% annual growth rate FY09-FY16, ameliorated thereafter with policy stability
Local Aid & Chapter 70	3.25%	Discuss	Tied to revenue growth
Existing Debt Service	Paid down at current schedule	Unchanged	Best working assumption, though refinancing will likely smooth repayment



Debt Load: Direct Debt Overview

Projected Debt Load Over Time (\$M)





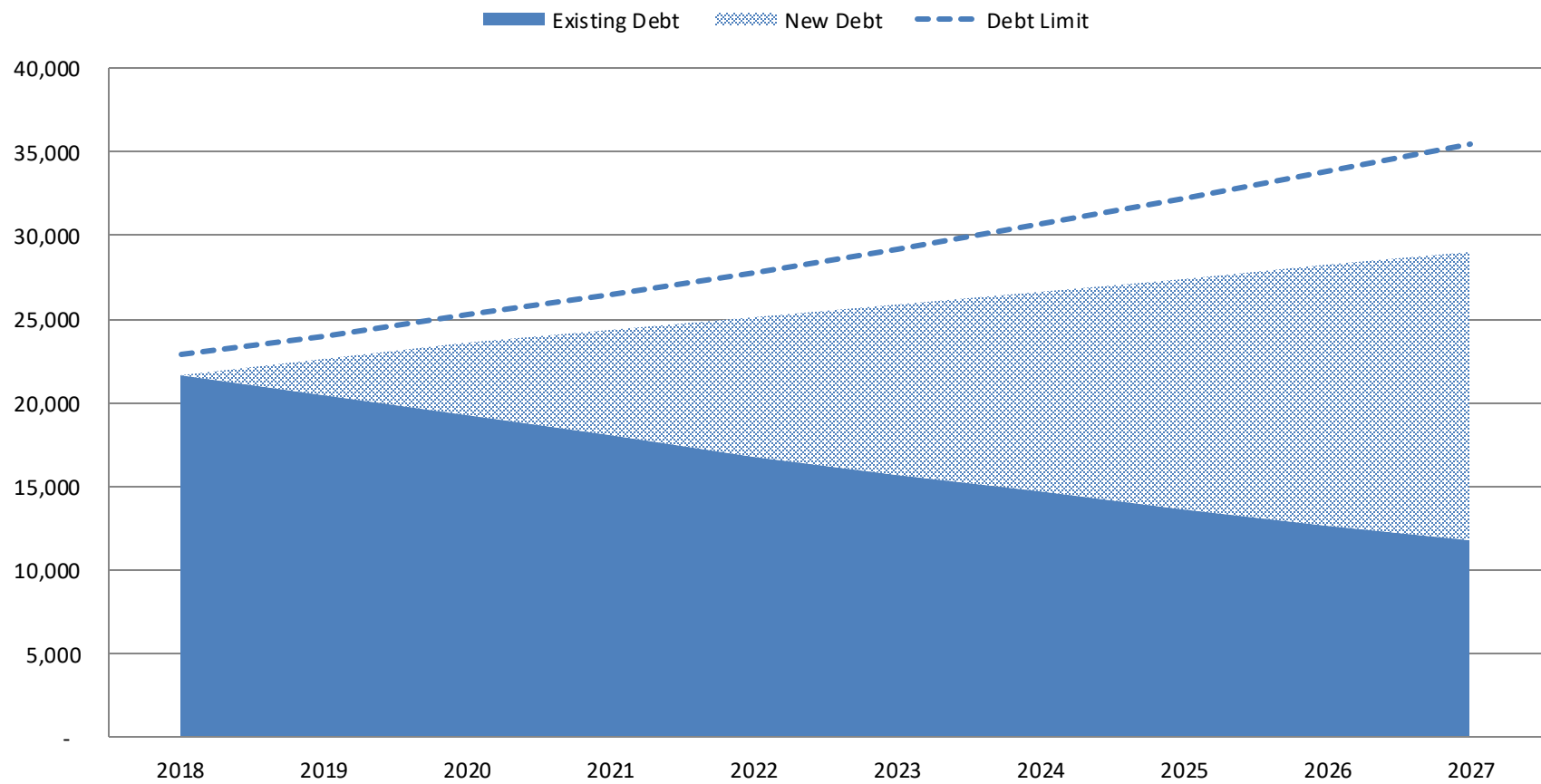
Statutory Debt Limit

- The commonwealth may not issue debt exceeding the statutory debt limit.
- Statutory debt limit is \$24.0 B for FY19 and increases 5% annually.
- The statutory debt limit can only be amended by the legislature.
- Certain types of debt backed by specific revenues, including ABP and Rail Enhancement Program debt, are excluded by statute from the debt limit calculation.
- The legislature excluded Rail Enhancement Program from the debt limit in 2016. The debt limit now only applies to general obligation debt.



Statutory Debt Limit Projection

Statutory Debt Limit Projection (\$M)





Other Debt-Like Obligations: Contract Assistance

Contract Assistance	Description	FY19 Cost (\$M)
Metropolitan Highway System	Maintains coverage ratios for legacy toll-funded credits	125.0
Clean Water Trust	Supports subsidized loans to municipalities for waste and drinking water projects	63.4
I-Cubed	Debt service on MDFA bonds issued through I-Cubed program	13.6
Social Innovation Fund	Contractual success payments to providers in Pay-for-Success programs	9.1
Total		\$211.1

Other Debt-Like Obligations: Component Units and Authorities



- In addition to Commonwealth issued debt, some of which is excluded from statutory debt limit, the state contains multiple public authorities that also issue debt.
- While not direct obligations of the Commonwealth, the rating agencies take into account these authorities' debt load when evaluating Commonwealth debt.
 - Authorities draw on same economic base as Commonwealth debt
 - Some authorities viewed by rating agencies as implicitly guaranteed by Commonwealth
- Authorities listed on succeeding slides in rough order from tax-supported (closest to state obligation) to direct fee supported.

Debt of component units: Direct Commonwealth Support – taxes and contract assistance



Authority	Outstanding Debt (\$M)	Revenue Source
Mass. Bay Transit Authority	\$5,728	Greater of the statutory floor and 1% of all taxed sales. Also, fares, assessments, state appropriation
Mass. School Building Authority	5,828	1% of all taxed sales
Massachusetts Clean Water Trust	3,654	Interest income on loans to municipalities paid out of water rate fees, contract assistance
MassDOT: Legacy Turnpike Debt	<u>1,841</u>	<u>Tolls, \$125 M/year contract assistance</u>
<i>Subtotal</i>	<i>\$17,051</i>	



Debt of component units – self supporting

Authority	Outstanding Debt (\$M)	Revenue Source
Massachusetts Water Resource Authority	5,337	Rate revenues from 61 Metro Boston communities
MassHousing	4,220	Working capital and bond funds
UMass Building Authority	2,871	Campus resources (tuition and fees), fees from revenue generating buildings
Mass. State College Building Authority	1,230	Fees from revenue generating buildings
Steamship Authority	82	Passenger fares
<u>MassDevelopment</u>	<u>6.7</u>	<u>Property and interest income</u>
<i>Subtotal, self supporting component units</i>	<i>\$13,717</i>	
<i>Total, Named Authorities</i>	<i>\$30,798</i>	