



Debt Affordability Committee

FY2019 1st meeting

September 12, 2017



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-FY18.
- The DAC recommendation is due by December 15.
- This recommendation is advisory and does not bind the administration to any level of debt issuance.



Debt Affordability Committee Members

Name	Position
Howard Merkowitz, Deputy Comptroller	Designee of Comptroller
Jennifer Sullivan, Assistant Secretary for Administration & Finance	Designee of Administration & Finance Secretary
Sue Perez, Deputy Treasurer	Designee of State Treasurer
Michael Butler, Town of Dedham	Treasurer's appointee #1
TBD	Treasurer's Appointee #2
Catherine Walsh, Northeastern University	Governor's Appointee
Michelle Ho, Deputy CFO for Capital Programs	Designee of Transportation Secretary
<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, June 2017
 - *“The commonwealth's financial best practices are generally very strong...The commonwealth also conducts a debt affordability analysis and reports its audited financial results on a timely basis;”*
Moody's Report, June 2017
 - *“Conservative budgeting, ongoing economic and revenue monitoring...support the Commonwealth's fiscal flexibility...Net tax-supported debt and pension liabilities are high for a state but represent only a moderate burden on resources”*
Fitch Report, June 2017



Importance of Debt Affordability Reviews

- For FY17 and FY18, the debt service line items represent a significant portion of the overall budget
 - \$2.53 billion expended in FY17 for general and special obligation debt and Contract Assistance
 - 6.2% of the Commonwealth's operating budget
 - \$2.63 billion budgeted in FY18 for general and special obligation debt and Contract Assistance
 - 6.2% 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



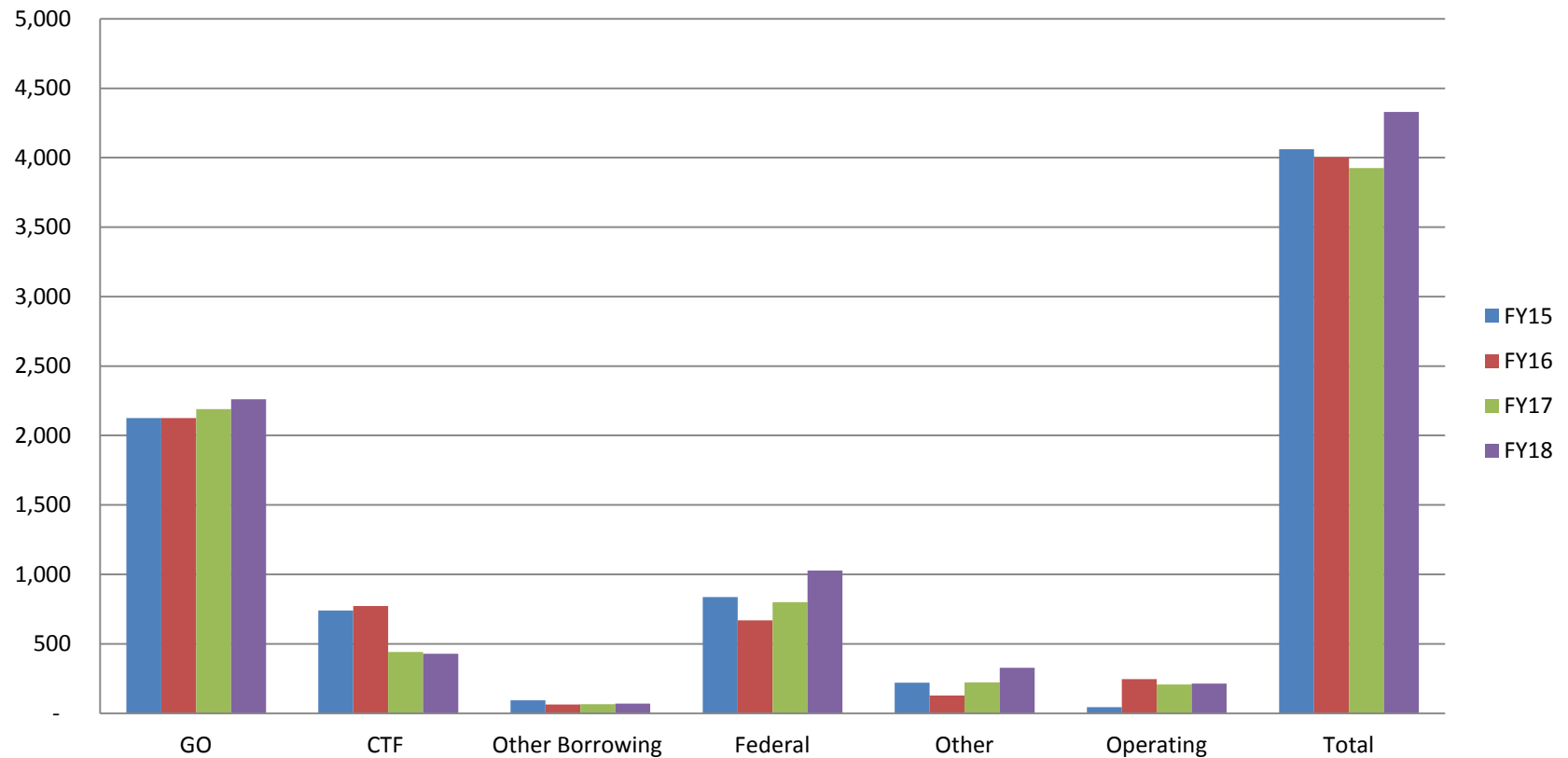
Bond Cap and other Capital Funding Sources

- 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



FY18 Capital Plan: Sources of Funds

**Budgeted Funding Sources FY15-FY18
(\$ million)**





Debt Affordability Committee: Charge

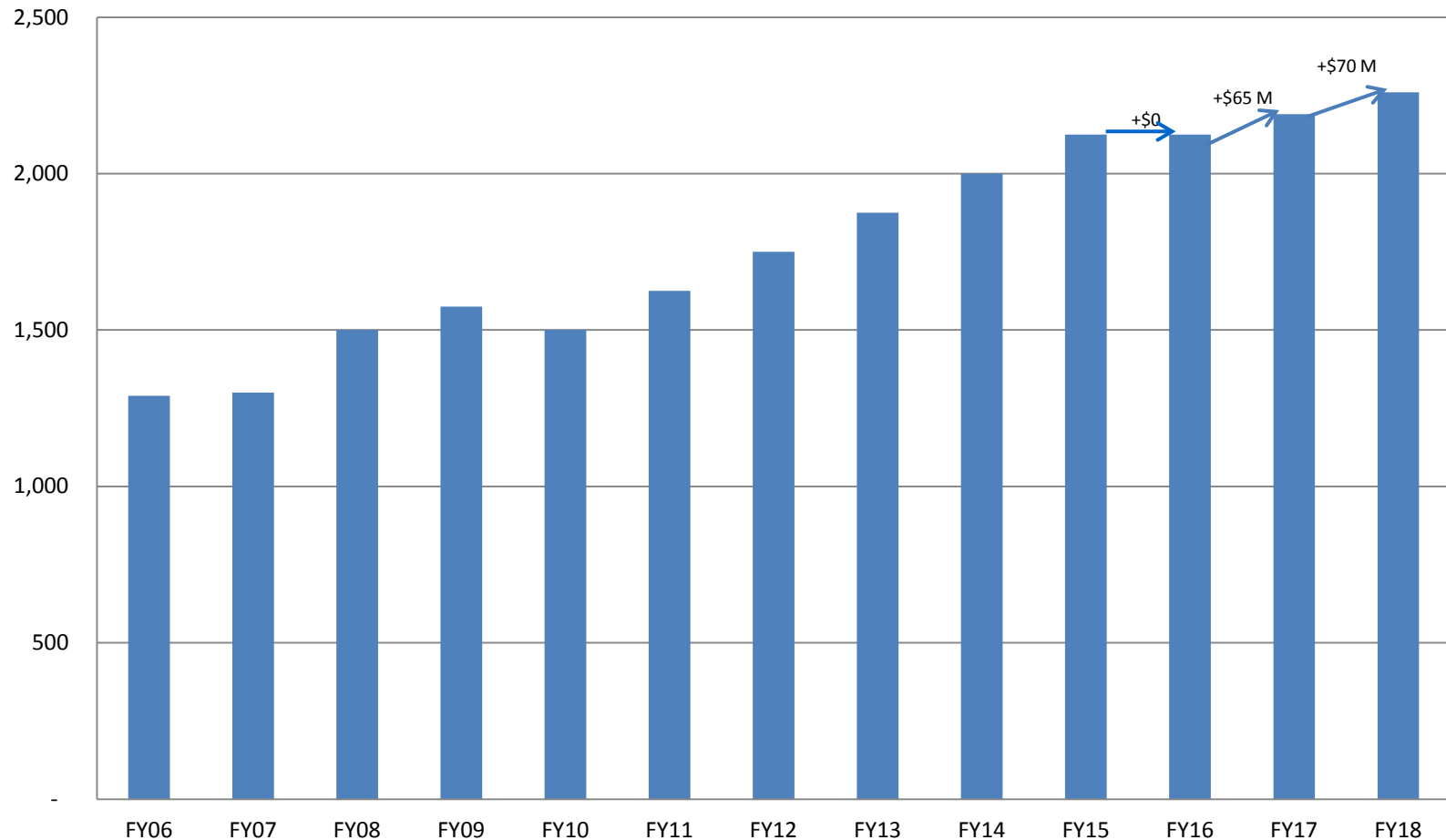
Statute charges DAC with examining multiple factors affecting the prudent level of bond-cap issuance, including:

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 in the 2015 and 2016 DAC deliberations



Published Bond Cap FY06-FY18

Budgeted Bond Cap Spending (\$B)





Debt Affordability Committee: past recommendations continued

Year (FY Rec)	Recommended \$B	Enacted - \$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



Debt Affordability Committee: 2017 Workplan

- Meeting #1: Introduction (September 12)
 - DAC roles and responsibilities
 - Presentation of model
 - Debt portfolio
- Meeting #2: Model in Practice (Approx. October 15)
 - Model presented in more detail
 - Presentations on assumptions
 - Massachusetts debt in context of other states
 - Discussion on assumptions and improvements to model
- Meeting #3: Debt Affordability Recommendation Discussion (approx. November 15)
 - Revised Debt Affordability Model
 - Discuss/adopt model and report
 - Discuss recommended debt affordability level for fiscal year 2019
- Meeting #4: Debt Affordability Recommendation Discussion (approx. December 1)
 - Vote on final recommendation to Governor for fiscal year 2019



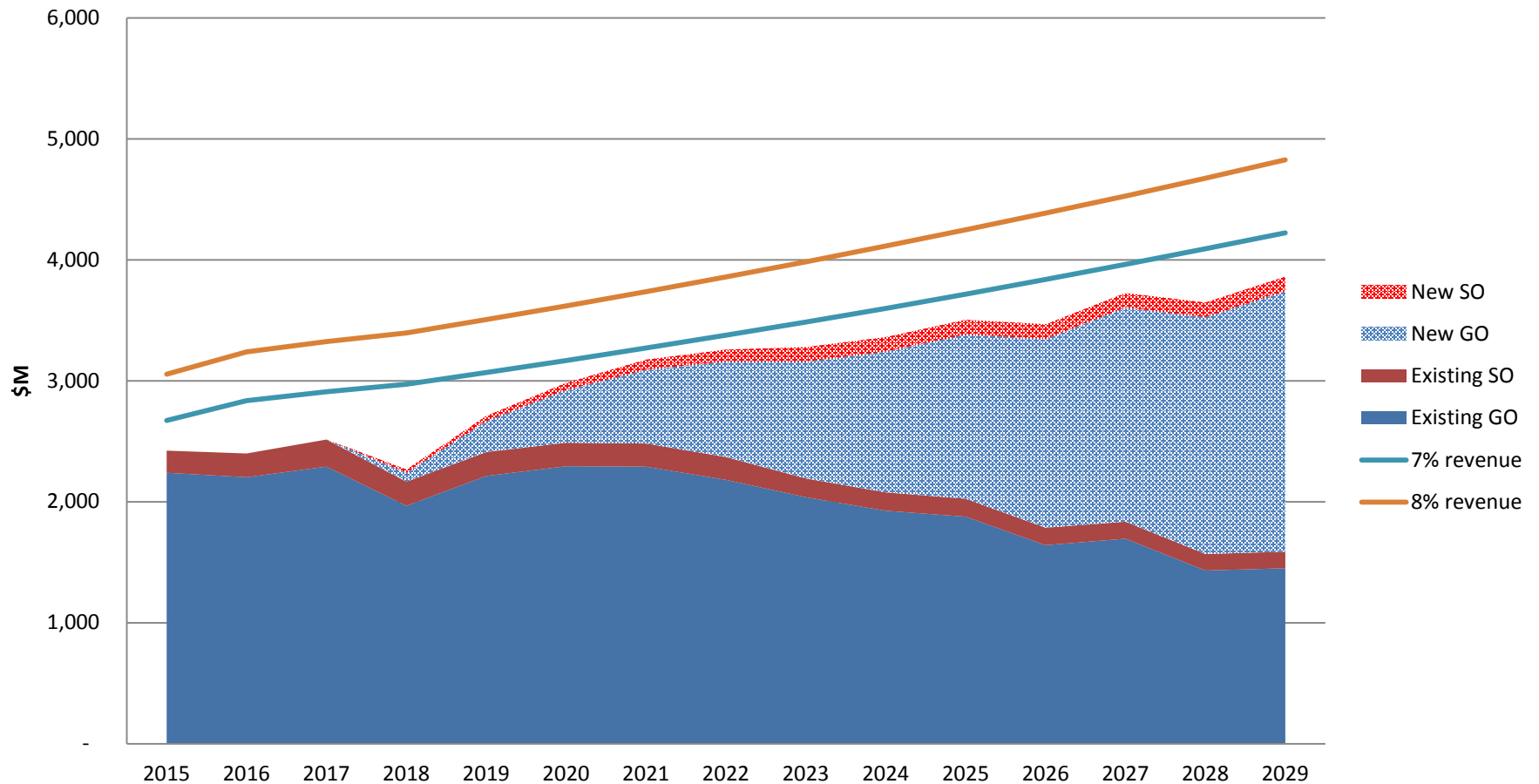
Debt Affordability Model: 8% Test

- 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 FY18-22 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

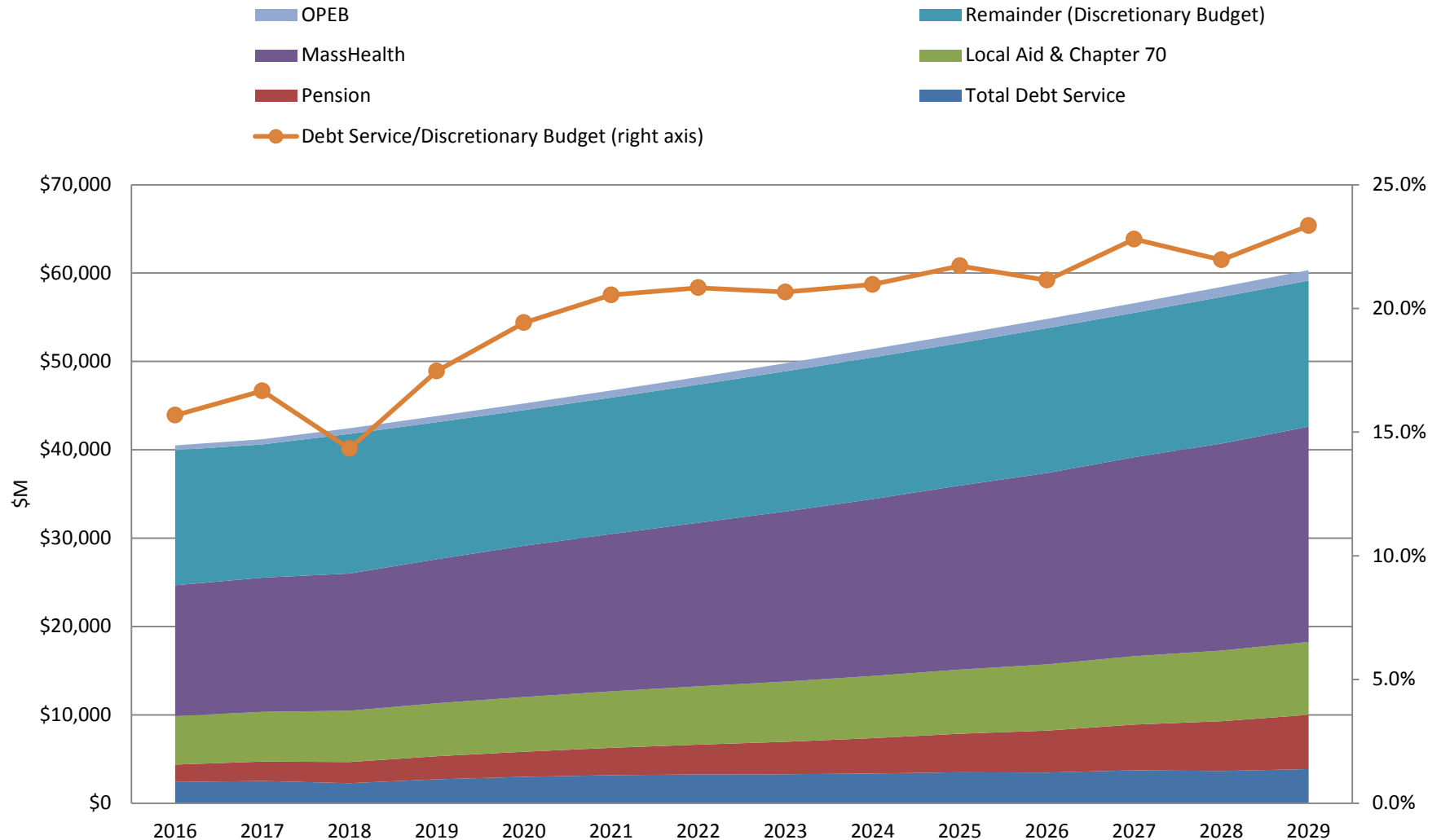
Projected DS FY15-FY29





Debt Service and Discretionary Spending

Debt Service and the Discretionary Budget





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	Working Assumption	Rationale
10 year interest rate	3.0% +10 bps /year	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	"
30 year interest rate	4.4% + 10 bps/year	"
Debt Service	Level debt service (equal payments until maturity)+Contract Assistance	Abstracts past serial issuance, proceeds vs. par, doesn't push off estimated impact
Bond cap issuance	\$2.260 B/year through 2022, 3% thereafter	Current capital plan
ABP issuance	\$485 M over 3 years	Remainder of authorization. Split between GANS/CTF
Special Obligation Issuance	\$1.8 B thru FY22	Remaining amount needed to execute REP plan within bond constraints. \$2.6 B total program
Self-Supporting Issuance	\$70M/year, \$50 M after 2020	Based on recent spending levels

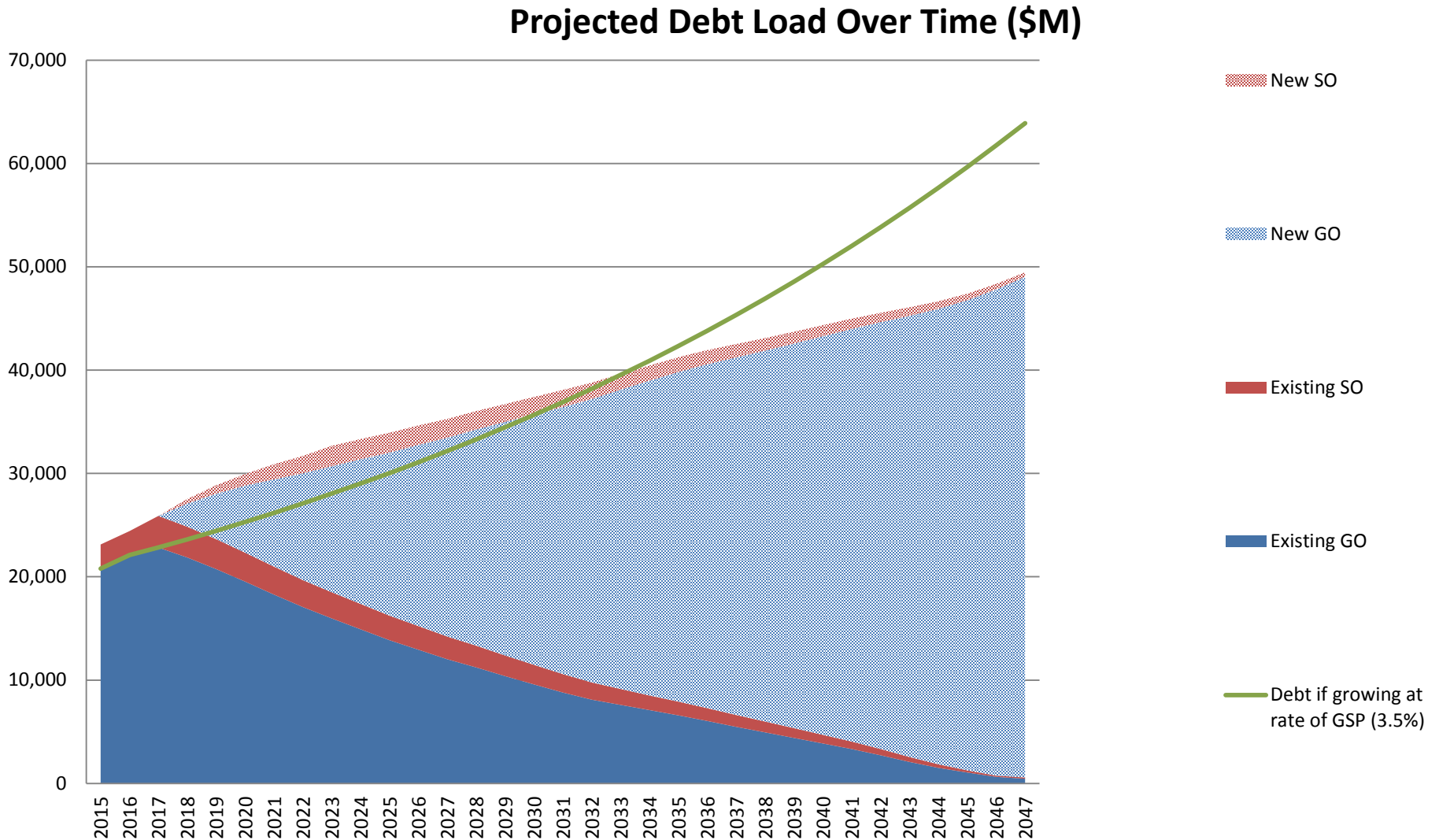


Assumptions: Budget

Measure	Assumption	Rationale
Revenue Growth	3.25% increase a year	FY07-FY17 CAGR 3.71% all sources; less since FY15
Other than Pension Employment Benefits OPEB)	Increase ~7%/year through FY25, 4% thereafter	Actuary's (AON) projection through FY25
Pension	8.95% increase in transfer a year from FY18 until final amortization FY36; normal cost thereafter	New funding schedule based on most recent valuation implemented in FY18
MassHealth	5% growth through FY20, 4% thereafter	Somewhat aggressive growth rate assumptions – 8.2% annual growth rate FY09-FY16, ameliorated thereafter with policy stability
Local Aid & Chapter 70	3.25%	Tied to revenue growth
Existing Debt Service	Paid down at current schedule	Best working assumption, though refinancing will likely smooth repayment (August 25, 2017 DBC run)



Debt Load: Direct Debt Overview





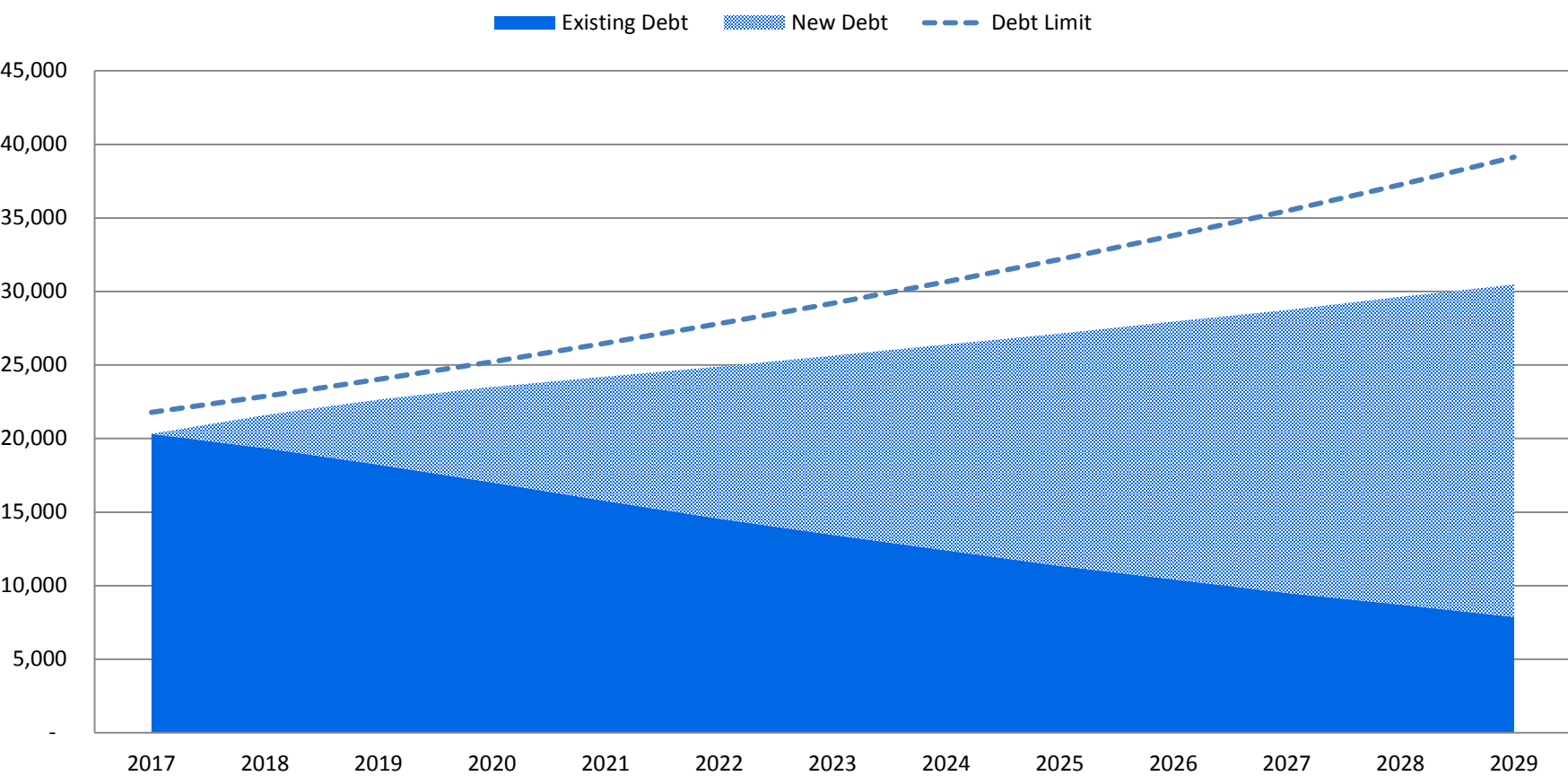
Statutory Debt Limit

- The commonwealth may not issue debt exceeding the statutory debt limit.
- Statutory debt limit is \$22.9 B for FY18 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 (GO debt only) Projection (\$M)





Other Debt-Like Obligations: Contract Assistance

Contract Assistance	Description	FY18 Cost (\$M)
Clean Water Trust	Supports subsidized loans to municipalities for waste and drinking water projects	\$55.4
I-Cubed	Debt service on MDFA bonds issued through I-Cubed program	10.2
Social Innovation Fund	Contractual success payments to providers in Pay-for-Success program	10.9
Metropolitan Highway System	Maintains coverage ratios for legacy toll-funded credits	125.0
Total		\$201.6

- Affordability analysis treats Contract Assistance as equivalent to general obligation debt service

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	\$5,655	1% of state sales tax + \$160 M, fares, assessments, state appropriation
Mass. School Building Authority	5,624	1% of state sales tax
Massachusetts Clean Water Trust	3,654	Interest income on loans to municipalities paid out of water rate fees, contract assistance
MassDOT: Legacy Turnpike <u>Debt</u>	<u>1,882</u>	<u>Tolls, \$125 M/year contract assistance</u>
<i>subtotal</i>	<i>\$16,185</i>	



Debt of component units – self supporting

Authority	Outstanding Debt (\$M)	Revenue Source
Massachusetts Water Resource Authority	5,687	Rate revenues from 61 Metro Boston communities
MassHousing	3,479	Working capital and bond funds
UMass Building Authority	2,829	Campus resources (tuition and fees), fees from revenue generating buildings
Mass. State College Building Authority	1,360	Fees from revenue generating buildings
Steamship Authority	74	Passenger fares
<u>MassDevelopment</u>	<u>7</u>	<u>Property and interest income</u>
<i>Subtotal, self supporting component units</i>	<i>\$13,436</i>	
<i>Total, Named Authorities</i>	<i>\$30,251</i>	
TOTAL: Direct Debt + Authorities	\$54,990	