

**REFUNDING ISSUE - BOOK-ENTRY-ONLY**

*In the opinion of Locke Lord LLP, Bond Counsel, based on an analysis of existing law and assuming, among other matters, compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under the Internal Revenue Code of 1986. Interest on the Bonds will not be included in computing the alternative minimum taxable income of individuals or, except as described herein, corporations. Under existing law, interest on the Bonds and any profit made on the sale thereof are exempt from Massachusetts personal income taxes and the Bonds are exempt from Massachusetts personal property taxes. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. See "TAX EXEMPTION" herein.*



**THE COMMONWEALTH OF MASSACHUSETTS**

**\$346,370,000**

**General Obligation Refunding Bonds  
2018 Series B**

**Dated: Date of Delivery**

**Due: As shown on the inside cover hereof**

*The General Obligation Refunding Bonds, 2018 Series B (the "Bonds") will be issued by means of a book-entry-only system evidencing ownership and transfer of the Bonds on the records of The Depository Trust Company, New York, New York ("DTC"), and its participants. Details of payment of the Bonds are more fully described in this Official Statement. The Bonds will bear interest from their date of delivery and interest will be payable on January 1, 2019 and semiannually thereafter on January 1 and July 1 and at maturity, calculated on the basis of a 360-day year of twelve 30-day months. The Bonds are not subject to redemption prior to maturity.*

The Bonds will constitute general obligations of The Commonwealth of Massachusetts (the "Commonwealth"), and the full faith and credit of the Commonwealth will be pledged to the payment of the principal of and interest on the Bonds. However, for information regarding the statutory limit on state tax revenue growth, see "SECURITY FOR THE BONDS" (herein) and the Information Statement (described herein) under the heading "COMMONWEALTH REVENUES – Limitations on Tax Revenues."

The Bonds are offered when, as and if issued and received by the Underwriters, and subject to the unqualified approving opinion as to legality of Locke Lord LLP, Boston, Massachusetts, Bond Counsel. Certain legal matters will be passed upon for the Commonwealth by Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., Boston, Massachusetts, Disclosure Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, McCarter & English, LLP, Boston, Massachusetts. PFM Financial Advisors LLC is acting as financial advisor to the Commonwealth in connection with the issuance of the Bonds. The Bonds are expected to be available for delivery at DTC in New York, New York, on or about May 16, 2018.

**Goldman Sachs & Co. LLC**

**Morgan Stanley  
BofA Merrill Lynch**

**Jefferies**

**Siebert Cisneros Shank & Co., LLC  
Citigroup**

**Barclays**

May 9, 2018

# THE COMMONWEALTH OF MASSACHUSETTS

**\$346,370,000**

## **General Obligation Refunding Bonds 2018 Series B**

**Dated: Date of Delivery**

**Due: as shown below**

| <u>Maturity</u> | <u>Amount</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>CUSIP<br/>Number*</u> |
|-----------------|---------------|----------------------|--------------|--------------------------|
| July 1, 2019    | \$30,000,000  | 5.00%                | 1.74%        | 57582RSX5                |
| July 1, 2020    | 3,175,000     | 3.00                 | 1.90         | 57582RSZ0                |
| July 1, 2020    | 26,825,000    | 5.00                 | 1.90         | 57582RSY3                |
| July 1, 2021    | 3,285,000     | 3.00                 | 1.98         | 57582RTA4                |
| July 1, 2021    | 16,715,000    | 5.00                 | 1.98         | 57582RTB2                |
| July 1, 2022    | 2,455,000     | 4.00                 | 2.07         | 57582RTD8                |
| July 1, 2022    | 17,545,000    | 5.00                 | 2.07         | 57582RTC0                |
| July 1, 2023    | 20,000,000    | 5.00                 | 2.16         | 57582RTE6                |
| July 1, 2024    | 20,000,000    | 5.00                 | 2.28         | 57582RTF3                |
| July 1, 2025    | 20,000,000    | 5.00                 | 2.38         | 57582RTG1                |
| July 1, 2026    | 25,000,000    | 5.00                 | 2.44         | 57582RTH9                |
| July 1, 2027    | 25,000,000    | 5.00                 | 2.51         | 57582RTJ5                |
| July 1, 2028    | 42,425,000    | 5.00                 | 2.57         | 57582RTK2                |
| July 1, 2029    | 45,395,000    | 5.00                 | 2.68         | 57582RTL0                |
| July 1, 2030    | 48,550,000    | 5.00                 | 2.77         | 57582RTM8                |

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\* CUSIP is a registered trademark of the American Bankers Association. CUSIP data herein is provided by CUSIP Global Services, managed on behalf of the American Bankers Association by S&P Global Market Intelligence. The CUSIP numbers are included solely for the convenience of owners of the Bonds, and the Commonwealth is not responsible for the selection or the correctness of the CUSIP numbers printed herein. CUSIP numbers assigned to securities may be changed during the term of such securities based on a number of factors, including, but not limited to, the refunding or defeasance of such securities or the use of secondary market financial products.

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No dealer, broker, salesperson or other person has been authorized by The Commonwealth of Massachusetts or the Underwriters of the Bonds to give any information or to make any representations, other than those contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by either of the foregoing. This Official Statement does not constitute an offer to sell or a solicitation of any offer to buy, nor shall there be any sale of the Bonds offered hereby by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information set forth herein or included by reference herein has been furnished by the Commonwealth and includes information obtained from other sources which are believed to be reliable, but is not guaranteed as to accuracy or completeness and is not to be construed as a representation by the Underwriters of the Bonds or, as to information from other sources, the Commonwealth. The information and expressions of opinion herein or included by reference herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth, or its agencies, authorities or political subdivisions, since the date hereof, except as expressly set forth herein.

THE UNDERWRITERS HAVE PROVIDED THE FOLLOWING SENTENCE FOR INCLUSION IN THIS OFFICIAL STATEMENT: THE UNDERWRITERS HAVE REVIEWED THE INFORMATION IN THIS OFFICIAL STATEMENT IN ACCORDANCE WITH, AND AS PART OF, THEIR RESPECTIVE RESPONSIBILITIES TO INVESTORS UNDER THE FEDERAL SECURITIES LAWS AS APPLIED TO THE FACTS AND CIRCUMSTANCES OF THIS TRANSACTION, BUT THE UNDERWRITERS DO NOT GUARANTEE THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION.

IN CONNECTION WITH THIS OFFERING THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL ON THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

**THE COMMONWEALTH OF MASSACHUSETTS**



**CONSTITUTIONAL OFFICERS**

**Charles D. Baker ..... Governor**  
**Karyn E. Polito ..... Lieutenant Governor**  
**William F. Galvin ..... Secretary of the Commonwealth**  
**Maura T. Healey ..... Attorney General**  
**Deborah B. Goldberg ..... Treasurer and Receiver-General**  
**Suzanne M. Bump ..... Auditor**

**LEGISLATIVE OFFICERS**

**Harriette L. Chandler ..... Acting President of the Senate**  
**Robert A. DeLeo ..... Speaker of the House**

# OFFICIAL STATEMENT

## THE COMMONWEALTH OF MASSACHUSETTS

**\$346,370,000**

### **General Obligation Refunding Bonds 2018 Series B**

#### INTRODUCTION

This Official Statement (including the cover page and Appendices A through D attached hereto) provides certain information in connection with the issuance by The Commonwealth of Massachusetts (the “Commonwealth”) of its \$346,370,000 aggregate principal amount of General Obligation Refunding Bonds, 2018 Series B (the “Bonds”). The Bonds will be general obligations of the Commonwealth, and the full faith and credit of the Commonwealth will be pledged to the payment of the principal of and interest on the Bonds. However, for information regarding the statutory limit on state tax revenue growth, see “SECURITY FOR THE BONDS” and the Information Statement (described below) under the heading “COMMONWEALTH REVENUES – Limitations on Tax Revenues.”

The Bonds are being issued to refund certain general obligation bonds, as set forth in “THE BONDS – Plan of Finance” and in Appendix D – Table of Refunded Bonds.

#### **Purpose and Content of Official Statement**

This Official Statement describes the terms and use of proceeds of, and security for, the Bonds. This introduction is subject in all respects to the additional information contained in this Official Statement, including Appendices A through D. All descriptions of documents contained herein are only summaries and are qualified in their entirety by reference to each such document.

Specific reference is made to the Commonwealth’s Information Statement dated March 22, 2018 (the “Information Statement”), which is attached hereto as Appendix A. The Information Statement has been filed with the Municipal Securities Rulemaking Board (the “MSRB”) through its Electronic Municipal Market Access (“EMMA”) system. Subsequent filings by the Commonwealth to the EMMA system, prior to the sale of the Bonds, of continuing disclosure documents identified as “other financial/operating data” are hereby deemed to be included by reference in the Information Statement. The Information Statement contains certain fiscal, budgetary, financial and other general information concerning the Commonwealth. Exhibit A to the Information Statement contains certain economic information concerning the Commonwealth. Exhibit B to the Information Statement contains the financial statements of the Commonwealth for the fiscal year ended June 30, 2017, prepared on a statutory basis. Exhibit C to the Information Statement contains the financial statements of the Commonwealth for the fiscal year ended June 30, 2017, prepared on a GAAP basis. Specific reference is made to said Exhibits A, B and C, which are incorporated by reference and copies of which have been filed with EMMA. The financial statements are also available at the home page of the Comptroller of the Commonwealth located at <http://www.mass.gov/comptroller> by clicking on “Financial Reports” under the “Publications and Reports” tab. In addition, the financial statements are also posted on the Commonwealth’s investor website at [www.massbondholder.com](http://www.massbondholder.com).

Appendix B attached hereto contains the proposed form of legal opinion of Bond Counsel with respect to the Bonds. Appendix C attached hereto contains the proposed form of the Commonwealth’s continuing disclosure undertaking to be included in the form of the Bonds to facilitate compliance by the Underwriters of the Bonds with the requirements of paragraph (b)(5) of Rule 15c2-12 of the Securities and Exchange Commission. Appendix D attached hereto contains a listing of the bonds to be refunded with the proceeds of the Bonds.

## THE BONDS

### General

The Bonds will mature on the dates and in the aggregate principal amounts, and shall bear interest at the rates per annum (calculated on the basis of a 360-day year of twelve 30-day months), as set forth on the inside cover page of this Official Statement. The Bonds will be dated their date of delivery and will bear interest from such date. Interest on the Bonds will be payable semiannually on January 1 and July 1 of each year, and at maturity, commencing January 1, 2019, until the principal amount is paid. The record date for the Bonds will be the 15th day of the month immediately preceding each interest payment date. The Commonwealth will act as its own paying agent with respect to the Bonds. The Commonwealth reserves the right to appoint from time to time a paying agent or agents or bond registrar for the Bonds.

*Book-Entry-Only System.* The Bonds will be issued by means of a book-entry-only system, with one bond certificate for each maturity immobilized at The Depository Trust Company, New York, New York (“DTC”). The certificates will not be available for distribution to the public and will evidence ownership of the Bonds in principal amounts of \$5,000 or integral multiples thereof. Transfers of ownership will be effected on the records of DTC and its participants pursuant to rules and procedures established by DTC and its participants. Interest and principal due on the Bonds will be paid in federal funds to DTC or its nominee as registered owner of the Bonds. As long as the book-entry-only system remains in effect, DTC or its nominee will be recognized as the owner of the Bonds for all purposes, including notices and voting. The Commonwealth will not be responsible or liable for maintaining, supervising or reviewing the records maintained by DTC, its participants or persons acting through such participants. See “BOOK-ENTRY-ONLY SYSTEM.”

*Redemption.* The Bonds are not subject to redemption prior to maturity.

### Plan of Finance

The Bonds are being issued pursuant to the provisions of Section 53A of Chapter 29 of the Massachusetts General Laws for the purpose of refunding the bonds set forth in Appendix D (the “Refunded Bonds”). The net proceeds of the Bonds will be applied as described in the following paragraphs.

The Commonwealth, upon the delivery of the Bonds, will enter into a refunding escrow agreement (the “Escrow Agreement”) with an escrow agent to be selected for the Refunded Bonds. Such Escrow Agreement will provide for the deposit of a portion of the net proceeds of the Bonds equal to the aggregate principal amount of the Refunded Bonds with such escrow agent, to be applied immediately upon receipt to purchase non-callable direct obligations of, or obligations the payment of the principal of and interest on which are unconditionally guaranteed by, the United States of America, obligations of certain federal agencies specified in Section 49 of Chapter 29 of the Massachusetts General Laws or of any agency or corporation which has been created pursuant to an act of Congress of the United States as an agency or instrumentality of the United States of America, repurchase agreements with banks in respect of any such obligations or advance-refunded or defeased bonds that are secured by such obligations (the “Escrow Obligations”). Such Escrow Agreement will require that maturing principal of and interest on the Escrow Obligations held under such Escrow Agreement, be held in trust in such account and paid to the Commonwealth solely for the payment of the principal of the Refunded Bonds subject to such Escrow Agreement. Interest due on the Refunded Bonds prior to and on each redemption date of the Refunded Bonds will be paid directly by the Commonwealth.

The Escrow Obligations held under the Escrow Agreement as described above will mature at such times and earn interest in such amounts such that they will produce sufficient monies, together with interest payments by the Commonwealth, to pay principal of and interest due on the Refunded Bonds to and including their respective redemption dates, each as set forth in Appendix D.

## SECURITY FOR THE BONDS

The Bonds will be general obligations of the Commonwealth to which its full faith and credit will be pledged for the payment of principal and interest when due. However, it should be noted that Chapter 62F of

the Massachusetts General Laws imposes a state tax revenue growth limit and does not exclude principal and interest payments on Commonwealth debt obligations from the scope of the limit. This statute is subject to amendment or repeal by the Legislature. Currently, actual tax revenue growth is below the statutory limit. See the Information Statement under the heading “COMMONWEALTH REVENUES – Limitations on Tax Revenues.”

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including the Bonds, and all claims with respect thereto. However, the property of the Commonwealth is not generally subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires a legislative appropriation. Enforcement of a claim for payment of principal or interest on the Bonds may also be subject to the provisions of federal or state statutes, if any, hereafter enacted extending the time for payment or imposing other constraints upon enforcement, insofar as the same may be constitutionally applied. The United States Bankruptcy Code is not applicable to the Commonwealth. Under Massachusetts law, the Bonds have all of the qualities and incidents of negotiable instruments under the Uniform Commercial Code. The Bonds are not subject to acceleration.

### **LITIGATION**

No litigation is pending or, to the knowledge of the Attorney General, threatened against or affecting the Commonwealth seeking to restrain or enjoin the issuance, sale or delivery of the Bonds or in any way contesting or affecting the validity of the Bonds.

There are pending in courts within the Commonwealth various suits in which the Commonwealth is a defendant. In the opinion of the Attorney General, no litigation is pending or, to the Attorney General’s knowledge, threatened which is likely to result, either individually or in the aggregate, in final judgments against the Commonwealth that would materially affect its financial condition. For a description of certain litigation affecting the Commonwealth, see the Information Statement under the heading “LEGAL MATTERS.”

### **BOOK-ENTRY-ONLY SYSTEM**

The Depository Trust Company, New York, New York, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond will be issued for each maturity of similar tenor set forth on the inside cover page hereof, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Commonwealth as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

**THE COMMONWEALTH WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATION TO THE DIRECT PARTICIPANTS, THE INDIRECT PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR BY ANY DIRECT OR INDIRECT PARTICIPANT, THE PAYMENT OF OR THE PROVIDING OF NOTICE TO THE DIRECT PARTICIPANTS, THE INDIRECT PARTICIPANTS OR THE BENEFICIAL OWNERS OR WITH RESPECT TO ANY OTHER ACTION TAKEN BY DTC AS BOND OWNER.**

The principal of and interest and premium, if any, on the Bonds will be paid to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC, as registered owner of the Bonds. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commonwealth, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with municipal securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of the principal of and interest and premium, if any, to Cede & Co.

(or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commonwealth, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

The Commonwealth cannot give any assurances that Direct Participants or others will distribute payments of principal of and interest on the Bonds paid to DTC or its nominee, as the registered owner, to the Beneficial Owners, or that they will do so on a timely basis or that DTC will serve and act in a manner described in this document.

Beneficial Owners of the Bonds will not receive or have the right to receive physical delivery of such Bonds and will not be or be considered to be the registered owners thereof. So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the holders or registered owners of the Bonds shall mean Cede & Co. and shall not mean the Beneficial Owners of the Bonds, except as otherwise expressly provided herein.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth. Under such circumstances, in the event that a successor depository is not obtained, Bonds will be delivered and registered as designated by the Beneficial Owners. The Beneficial Owner, upon registration of Bonds held in the Beneficial Owner's name, will become the Bondowner. Bond certificates are required to be printed and delivered.

The Commonwealth may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In such event, Bond certificates will be printed, delivered and registered as designated by the Beneficial Owners.

**THE INFORMATION IN THIS SECTION CONCERNING DTC AND DTC'S BOOK-ENTRY-ONLY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE COMMONWEALTH BELIEVES TO BE RELIABLE, BUT THE COMMONWEALTH TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF.**

#### **RATINGS**

The Bonds have been assigned long-term ratings of "AA+" (stable outlook), "Aa1" (stable outlook) and "AA" (stable outlook) by Fitch Ratings, Moody's Investors Service, Inc. and S&P Global Ratings, respectively.

Such ratings reflect only the respective views of such organizations, and an explanation of the significance of such ratings may be obtained from the rating agency furnishing the same. There is no assurance that a rating will continue for any given period of time or that a rating will not be revised or withdrawn entirely by any or all of such rating agencies, if, in its or their judgment, circumstances so warrant. Any downward revision or withdrawal of a rating could have an adverse effect on the market prices of the Bonds.

#### **UNDERWRITING**

The Underwriters, represented by Goldman Sachs & Co. LLC, have agreed, subject to certain conditions, to purchase all of the Bonds from the Commonwealth at a discount from the initial offering prices of the Bonds equal to approximately 0.248615% of the aggregate principal amount of the Bonds. The Underwriters may offer and sell the Bonds to certain dealers and others (including dealers depositing Bonds into investment trusts) at prices lower than the public offering prices (or yields higher than the offering yields) stated on the inside cover page hereof. The principal offering prices (or yields) set forth on the inside cover page hereof may be changed from time to time after the initial offering by the Underwriters.

The Commonwealth intends to use a portion of the proceeds from the Bonds to redeem the Refunded Bonds. To the extent an Underwriter or an affiliate thereof is an owner of Refunded Bonds, such

Underwriter or its affiliate, as applicable, would receive a portion of the proceeds from the issuance of the Bonds contemplated herein in connection with such Refunded Bonds being redeemed by the Commonwealth.

In addition, certain of the Underwriters have entered into distribution agreements with other broker-dealers (that have not been designated by the Commonwealth as Underwriters) for the distribution of the Bonds at the original issue prices. Such agreements generally provide that the relevant Underwriter will share a portion of its underwriting compensation or selling concession with such broker-dealers.

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include sales and trading, commercial and investment banking, advisory, investment management, investment research, principal investment, hedging, market making, brokerage and other financial and non-financial activities and services. Certain of the underwriters and their respective affiliates have provided, and may in the future provide, a variety of these services to the Commonwealth and to persons and entities with relationships with the Commonwealth, for which they received or will receive customary fees and expenses. Under certain circumstances, the underwriters and their affiliates may have certain creditor and/or other rights against the Commonwealth and its affiliates in connection with such activities.

In the ordinary course of their various business activities, the underwriters and their respective affiliates, officers, directors and employees may purchase, sell or hold a broad array of investments and actively trade securities, derivatives, loans, commodities, currencies, credit default swaps and other financial instruments for their own account and for the accounts of their customers, and such investment and trading activities may involve or relate to assets, securities and/or instruments of the Commonwealth (directly, as collateral securing other obligations or otherwise) and/or persons and entities with relationships with the Commonwealth. The underwriters and their respective affiliates may also communicate independent investment recommendations, market color or trading ideas and/or publish or express independent research views in respect of such assets, securities or instruments and may at any time hold, or recommend to clients that they should acquire, long and/or short positions in such assets, securities and instruments.

#### **TAX EXEMPTION**

In the opinion of Locke Lord LLP, Bond Counsel (“Bond Counsel”), based upon an analysis of existing laws, regulations, rulings, and court decisions, and assuming, among other matters, compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”). Bond Counsel is of the further opinion that interest on the Bonds will not be included in computing the alternative minimum taxable income of Bondholders who are individuals or, except as described herein, corporations. Bond Counsel expresses no opinion regarding any other federal tax consequences arising with respect to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

For taxable years that began before January 1, 2018, interest on the Bonds owned by a corporation (other than an S corporation, a qualified mutual fund, a real estate investment trust, a real estate mortgage investment conduit, or a financial asset securitization investment trust) will be included in such corporation’s adjusted current earnings for purposes of computing the alternative minimum taxable income of such corporation. The alternative minimum tax on corporations has been repealed for taxable years beginning on or after January 1, 2018.

The Code imposes various requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Bonds. Failure to comply with these requirements may result in interest on the Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Bonds. The Agency and the Institution have covenanted to comply with such requirements to ensure that interest on the Bonds will not be included in federal gross income. The opinion of Bond Counsel assumes compliance with these covenants.

Bond Counsel is also of the opinion that, under existing law, interest on the Bonds and any profit on the sale of the Bonds are exempt from Massachusetts personal income taxes and that the Bonds are exempt from Massachusetts personal property taxes. Bond Counsel expresses no opinion regarding any other

Massachusetts tax consequences arising with respect to the Bonds. Prospective Bondowners should be aware, however, that the Bonds are included in the measure of Massachusetts estate and inheritance taxes, and the Bonds and the interest thereon are included in the measure of certain Massachusetts corporate excise and franchise taxes. Bond Counsel has not opined as to the taxability of the Bonds or the income therefrom under the laws of any state other than Massachusetts. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix B hereto.

To the extent the issue price of any maturity of the Bonds is less than the amount to be paid at maturity of such Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Bonds), the difference constitutes “original issue discount,” the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Bonds which is excluded from gross income for federal income tax purposes and is exempt from Massachusetts personal income taxes. For this purpose, the issue price of a particular maturity of the Bonds is the reasonably expected initial offering price to the public or the first price at which a substantial amount of such maturity of the Bonds is sold to the public, as applicable. The original issue discount with respect to any maturity of the Bonds accrues daily over the term to maturity of such Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Bonds. Bondowners should consult their own tax advisors with respect to the tax consequences of ownership of Bonds with original issue discount, including the treatment of purchasers who do not purchase such Bonds in the original offering to the public at the reasonably expected initial offering price to the public, or, if applicable, the first price at which a substantial amount of such Bonds is sold to the public.

Bonds purchased, whether at original issuance or otherwise, for an amount greater than the stated principal amount to be paid at maturity of such Bonds, or, in some cases, at the earlier redemption date of such Bonds (“Premium Bonds”), will be treated as having amortizable bond premium for federal income tax purposes and Massachusetts personal income tax purposes. No deduction is allowable for the amortizable bond premium in the case of obligations, such as the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, a Bondowner’s basis in a Premium Bond will be reduced by the amount of amortizable bond premium properly allocable to such Bondowner. Holders of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

Prospective Bondowners should be aware that certain requirements and procedures contained or referred to in the relevant documents may be changed and certain actions may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) after the date of issuance of the Bonds may adversely affect the value of, or the tax status of interest on, the Bonds.

Legislation affecting tax-exempt obligations is regularly considered by the United States Congress and may also be considered by the Massachusetts legislature. Court proceedings may also be filed, the outcome of which could modify the tax treatment of obligations such as the Bonds. There can be no assurance that legislation enacted or proposed, or actions by a court, after the date of issuance of the Bonds will not have an adverse effect on the tax status of interest on the Bonds or the market value or marketability of the Bonds. These adverse effects could result, for example, from changes to federal or state income tax rates, changes in the structure of federal or state income taxes (including replacement with another type of tax), or repeal (or reduction in the benefit) of the exclusion of interest on the Bonds from gross income for federal or state income tax purposes for all or certain taxpayers.

For example, H.R. 1, signed into law on December 22, 2017, reduces the corporate tax rate, modifies individual tax rates, eliminates many deductions, and raises the income threshold above which the individual alternative minimum tax is invoked, among other things. These changes may increase, reduce or otherwise change the financial benefits of owning state and local government bonds. Additionally, Bondowners should be aware that future legislative actions (including federal income tax reform) may

retroactively change the treatment of all or a portion of the interest on the Bonds for federal income tax purposes for all or certain taxpayers. In all such events, the market value of the Bonds may be affected and the ability of Bondowners to sell their Bonds in the secondary market may be reduced. The Bonds are not subject to special mandatory redemption, and the interest rates on the Bonds are not subject to adjustment, in the event of any such change in the tax treatment of interest on the Bonds. Prospective Bondowners are urged to consult their own tax advisors with respect to any such legislation, interpretation or development.

Although Bond Counsel is of the opinion that interest on the Bonds is excluded from gross income for federal income tax purposes and is exempt from Massachusetts personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the Bonds may otherwise affect a Bondowner's federal or state tax liability. Among other possible consequences of ownership or disposition of, or the accrual or receipt of interest on, the Bonds, the Code requires recipients of certain social security and certain railroad retirement benefits to take into account receipts or accruals of interest on the Bonds in determining the portion of such benefits that are included in gross income. The nature and extent of these other tax consequences will depend upon the particular tax status of the Bondowner or the Bondowner's other items of income, deduction or exclusion. Bond Counsel expresses no opinion regarding any such other tax consequences, and Bondowners should consult with their own tax advisors with respect to such consequences.

### **OPINIONS OF COUNSEL**

The unqualified approving opinion as to the legality of the Bonds will be rendered by Locke Lord LLP of Boston, Massachusetts, Bond Counsel to the Commonwealth. The proposed form of the opinion of Bond Counsel relating to the Bonds is attached hereto as Appendix B. Certain legal matters will also be passed upon by Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C. of Boston, Massachusetts, as Disclosure Counsel to the Commonwealth. Certain legal matters will be passed upon for the Underwriters by their counsel, McCarter & English, LLP, of Boston, Massachusetts.

### **CONTINUING DISCLOSURE**

In order to assist the Underwriters in complying with paragraph (b)(5) of Rule 15c2-12, the Commonwealth will undertake in the Bonds to provide annual reports and notices of certain events. A description of this undertaking is set forth in Appendix C attached hereto.

For information concerning the Commonwealth's compliance with its undertakings under Rule 15c2-12 and the availability of certain other financial information from the Commonwealth, see the Information Statement under the heading "CONTINUING DISCLOSURE."

### **FINANCIAL ADVISOR**

PFM Financial Advisors LLC ("PFM") serves as financial advisor to the Commonwealth for debt management and other financial matters. PFM has acted as independent financial advisor to the Commonwealth with respect to the Bonds. PFM is not obligated to undertake, and has not undertaken, either to make an independent verification of or to assume responsibility for, the accuracy, completeness, or fairness of the information contained in this Official Statement and the appendices hereto. PFM is an independent financial advisory firm and is not engaged in the business of underwriting, trading or distributing securities.

### **MISCELLANEOUS**

Any provisions of the constitution of the Commonwealth, of all general and special laws and of other documents set forth or referred to in this Official Statement are only summarized, and such summaries do not purport to be complete statements of any of such provisions. Only the actual text of such provisions can be relied upon for completeness and accuracy.

This Official Statement contains certain forward-looking statements that are subject to a variety of risks and uncertainties that could cause actual results to differ from the projected results, including without limitation general economic and business conditions, conditions in the financial markets, the financial condition of the Commonwealth and various state agencies and authorities, receipt of federal grants, litigation, arbitration, force majeure events and various other factors that are beyond the control of the Commonwealth and its various agencies and authorities. Because of the inability to predict all factors that may affect future decisions, actions, events or financial circumstances, what actually happens may be different from what is set forth in such forward-looking statements. Forward-looking statements are indicated by use of such words as “may,” “will,” “should,” “intends,” “expects,” “believes,” “anticipates,” “estimates” and others.

All estimates and assumptions in this Official Statement have been made on the best information available and are believed to be reliable, but no representations whatsoever are made that such estimates and assumptions are correct. So far as any statements in this Official Statement involve any matters of opinion, whether or not expressly so stated, they are intended merely as such and not as representations of fact. The various tables may not add due to rounding of figures.

The Commonwealth has prepared the prospective financial information set forth in this Official Statement in connection with its budgeting and appropriations processes. This prospective financial information was not prepared with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of the Commonwealth, was prepared on a reasonable basis, reflects the best currently available estimates and judgments, and presents, to the best knowledge and belief of the offices of the Commonwealth identified in this Official Statement as the sources of such information, the currently expected course of action and the currently expected future budgeted revenues and expenditures of the Commonwealth. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this Official Statement are cautioned not to place undue reliance on the prospective financial information.

Neither the Commonwealth’s independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with, the prospective financial information.

The information, estimates and assumptions and expressions of opinion in this Official Statement are subject to change without notice. Neither the delivery of this Official Statement nor any sale made pursuant to this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth or its agencies, authorities or political subdivisions since the date of this Official Statement, except as expressly stated.

#### **AVAILABILITY OF OTHER INFORMATION**

Questions regarding this Official Statement or requests for additional financial information concerning the Commonwealth should be directed to Susan E. Perez, Deputy Treasurer, Office of the Treasurer and Receiver-General, 3 Center Plaza, Suite 430, Boston, Massachusetts 02108, telephone (617) 367-3900, x. 816, or Jennifer Sullivan, Assistant Secretary for Capital Finance, Executive Office for Administration and Finance, State House, Room 373, Boston, Massachusetts 02133, telephone (617) 727-2040. Questions regarding legal matters relating to this Official Statement and the Bonds should be directed to Walter J. St. Onge, III, Locke Lord LLP, 111 Huntington Avenue, Boston, Massachusetts 02199, telephone (617) 239-0389.

**THE COMMONWEALTH OF MASSACHUSETTS**

By           /s/ Deborah B. Goldberg            
Deborah B. Goldberg  
*Treasurer and Receiver-General*

By           /s/ Michael J. Heffernan            
Michael J. Heffernan  
*Secretary of Administration and Finance*

May 9, 2018

**THE  
COMMONWEALTH  
OF  
MASSACHUSETTS**



**INFORMATION STATEMENT**

**Dated March 22, 2018**

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**THE COMMONWEALTH OF MASSACHUSETTS**



**CONSTITUTIONAL OFFICERS**

**Charles D. Baker .....Governor**  
**Karyn E. Polito ..... Lieutenant Governor**  
**William F. Galvin ..... Secretary of the Commonwealth**  
**Maura Healey ..... Attorney General**  
**Deborah B. Goldberg ..... Treasurer and Receiver-General**  
**Suzanne M. Bump ..... Auditor**

**LEGISLATIVE OFFICERS**

**Harriette L. Chandler ..... President of the Senate**  
**Robert A. DeLeo ..... Speaker of the House**

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**THE COMMONWEALTH OF MASSACHUSETTS**

**INFORMATION STATEMENT**

**March 22, 2018**

This Information Statement, together with its Exhibits (included by reference as described below), is furnished by The Commonwealth of Massachusetts (the Commonwealth). It contains certain fiscal, financial and economic information concerning the Commonwealth and its ability to meet its financial obligations. This Information Statement contains information only through its date, or as otherwise provided for herein, and should be read in its entirety.

The ability of the Commonwealth to meet its obligations will be affected by future social, environmental and economic conditions, among other things, as well as by legislative policies and the financial condition of the Commonwealth. Many of these conditions are not within the control of the Commonwealth.

Exhibit A to this Information Statement is the Statement of Economic Information as of January 10, 2018. Exhibit A sets forth certain economic, demographic and statistical information concerning the Commonwealth.

Exhibits B and C, respectively, are the Commonwealth's Statutory Basis Financial Report for the year ended June 30, 2017 and the Commonwealth's Comprehensive Annual Financial Report (reported in accordance with generally accepted accounting principles (GAAP)) for the year ended June 30, 2017.

Specific reference is made to Exhibits A, B and C, copies of which are attached hereto and have also been filed with the Municipal Securities Rulemaking Board (MSRB) through its Electronic Municipal Market Access System (EMMA). The financial statements are also available at the home page of the Comptroller of the Commonwealth located at <http://www.macomptroller.org> by clicking on "Financial Reports" on the Comptroller's homepage.

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## THE GOVERNMENT

The government of the Commonwealth is divided into three branches: the Executive, the bicameral Legislature and the Judiciary.

### Executive Branch

*Governor.* The Governor is the chief executive officer of the Commonwealth. Other elected members of the executive branch are the Lieutenant Governor (elected with the Governor), the Treasurer and Receiver-General (State Treasurer), the Secretary of the Commonwealth (State Secretary), the Attorney General and the State Auditor. All are elected to four-year terms. The terms of the current office holders began in January, 2015.

The Executive Council, also referred to as the “Governor’s Council,” consists of eight members who are elected to two-year terms in even-numbered years. The Executive Council is responsible for the confirmation of certain gubernatorial appointments, particularly judges, and must approve all warrants prepared by the Comptroller for payment by the State Treasurer.

Also within the Executive Branch are certain independent offices, each of which performs a defined function, such as the Board of Library Commissioners, the Office of Campaign and Political Finance, the Office of the Comptroller, the Office of the Inspector General and the State Ethics Commission.

*Governor’s Cabinet.* The Governor’s Cabinet, which assists the Governor in administration and policy making, comprises the secretaries who head the eight Executive Offices, which are the Executive Office for Administration and Finance, the Executive Office of Health and Human Services, the Executive Office of Public Safety and Security, the Executive Office of Housing and Economic Development, the Executive Office of Labor and Workforce Development, the Executive Office of Energy and Environmental Affairs, the Executive Office of Education, and the Executive Office of Technology Services and Security. In addition, the Secretary of Transportation, who is the chief executive of the Massachusetts Department of Transportation (MassDOT) and chairs MassDOT’s board of directors, is a member of the Governor’s Cabinet. (MassDOT has a legal existence separate from the Commonwealth but houses several departments of state government.) Cabinet secretaries and executive department chiefs, including the Secretary of Transportation, serve at the pleasure of the Governor. Most other agencies are grouped under one of the eight Executive Offices for administrative purposes.

The Governor’s chief fiscal officer is the Secretary of Administration and Finance. The activities of the Executive Office for Administration and Finance fall within five broad categories: (i) administrative and fiscal supervision, including supervision of the implementation of the Commonwealth’s operating budget and capital investment plan, and monitoring of all agency expenditures during the fiscal year; (ii) enforcement of the Commonwealth’s tax laws and collection of tax revenues through the Department of Revenue; (iii) human resource management, including administration of the state personnel system, civil service system and employee benefit programs, and negotiation of collective bargaining agreements with certain of the Commonwealth’s public employee unions; (iv) capital facilities management, including coordinating and overseeing the construction, management and leasing of all state facilities; and (v) administration of general services, including procurement management services. The Secretary of Administration and Finance serves on numerous state boards and commissions.

*State Treasurer.* The State Treasurer has four primary statutory responsibilities: (i) oversight of the collection of all state revenues by state agencies, including tax revenues remitted by the Department of Revenue (other than small amounts of funds held by certain agencies); (ii) the management of both short-term and long-term investment of Commonwealth funds (other than the state employee and teacher pension funds), including all cash receipts; (iii) the disbursement of Commonwealth moneys and oversight of reconciliation of the state’s accounts; and (iv) the issuance of most debt obligations of the Commonwealth, including notes, commercial paper and long-term bonds.

In addition to these responsibilities, the State Treasurer chairs the Massachusetts Lottery Commission, the State Board of Retirement, the Pension Reserves Investment Management Board, the Massachusetts Clean Water Trust, and the Massachusetts School Building Authority, and appoints the members of the Alcoholic Beverages Control Commission. The State Treasurer also serves as a member of numerous other state boards and commissions.

*State Auditor.* The State Auditor is charged with improving the efficiency of state government by auditing the administration and expenditure of public funds and reporting the findings to the public. The State Auditor reviews the activities and operations of approximately 750 state entities and potentially thousands of private contractors doing business with the Commonwealth. See “COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS.”

*Attorney General.* The Attorney General represents the Commonwealth in all legal proceedings in both the state and federal courts, including defending the Commonwealth in actions in which a state law or executive action is challenged. The Attorney General also brings actions to enforce environmental and consumer protection statutes, among others, and represents consumer interests in public utility rate-setting proceedings and in proceedings before the Division of Insurance and other administrative bodies. The Attorney General works in conjunction with the general counsel of the various state agencies and executive departments to coordinate and monitor all pending litigation.

*State Secretary.* The Secretary of the Commonwealth is responsible for collection and storage of public records and archives, securities regulation, state elections, administration of state lobbying laws, and the registration of and reporting by corporations.

*State Comptroller.* Accounting policies and practices, publication of official financial reports, and oversight of fiscal management functions are the responsibility of the Comptroller. The Comptroller also administers the Commonwealth’s annual state single audit and manages the state accounting system. The Comptroller serves as a member of the Massachusetts Lottery Commission, the Inspector General Council, the Records Conservation Board, and the State Retiree Benefits Trust. The Comptroller is appointed by the Governor for a term coterminous with the Governor’s and may be removed by the Governor only for cause. The annual financial reports of the Commonwealth, single audit reports, and any rules and regulations promulgated by the Comptroller must be reviewed by an advisory board. This board is chaired by the Secretary of Administration and Finance and includes the State Treasurer, the Attorney General, the State Auditor, the Court Administrator of the Trial Court, and two persons with relevant experience appointed by the Governor for three-year terms.

The Commonwealth’s annual reports include financial statements on the statutory basis of accounting (the Statutory Basis Financial Report, or SBFR) and financial statements on a GAAP basis (the Comprehensive Annual Financial Report, or CAFR). The Statutory Basis Financial Report for the year ended June 30, 2017, attached hereto as Exhibit B, was reviewed, and the Comprehensive Annual Financial Report for the year ended June 30, 2017, attached hereto as Exhibit C, was audited, by KPMG LLP, as stated in its reports appearing therein. KPMG LLP has not been engaged to perform, and has not performed, since the respective dates of its reports included herein, any procedures on the financial statements addressed in such reports, nor has it performed any procedures relating to the official statement of which this Information Statement is a part. See “COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS.”

## **Legislative Branch**

The Legislature (formally called the General Court) is the bicameral legislative body of the Commonwealth, consisting of a Senate of 40 members and a House of Representatives of 160 members. Members of both the Senate and the House are elected to two-year terms in even-numbered years. The Legislature meets every year. The joint rules of the House and Senate require all formal business to be concluded by the end of July in even-numbered years and by the third Wednesday in November in odd-numbered years.

All enacted bills are presented to the Governor for approval or veto. The Legislature may override the Governor’s veto of any bill by a two-thirds roll-call vote of each house. The Governor also has the power to return a bill to the chamber of the Legislature in which it originated with a recommendation that certain amendments be made; such a bill is then before the Legislature and is subject to amendment or re-enactment by each branch, at which point the Governor has no further right to return the bill a second time with a recommendation to amend but may still veto the bill. The House of Representatives must originate any bill that imposes a tax. Once a tax bill is originated by the House and forwarded to the Senate for consideration, the Senate may amend it.

## **Judicial Branch**

The judicial branch of state government is composed of the Supreme Judicial Court, the Appeals Court and the Trial Court. The Supreme Judicial Court has original jurisdiction over certain cases and hears appeals from both the Appeals Court, which is an intermediate appellate court, and in some cases, directly from the Trial Court. The Supreme Judicial Court is authorized to render advisory opinions on certain questions of law to the Governor, the Legislature and the Governor's Council. Judges of the Supreme Judicial Court, the Appeals Court and the Trial Court are appointed by the Governor, with the advice and consent of the Governor's Council, to serve until the mandatory retirement age of 70 years.

## **Independent Authorities and Agencies**

The Legislature has established a number of independent authorities and agencies within the Commonwealth, the budgets of which are not included in the Commonwealth's annual budget. The Governmental Accounting Standards Board (GASB) Statements No. 14 and No. 34, as amended by Statement No. 61, *The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34*, articulate standards for determining significant financial or operational relationships between the primary government and its independent entities. In fiscal 2017, the Commonwealth had significant operational or financial relationships, or both, as defined by GASB Statements No. 14 and No. 34, as amended by Statement No. 61, with 40 of these authorities. A discussion of these entities and the relationship to the Commonwealth is included in footnote 1 to the fiscal 2017 Basic Financial Statements in the CAFR, attached hereto as Exhibit C.

## **Local Government**

The Commonwealth has 351 incorporated cities and towns that exercise the functions of local government, which include public safety, fire protection and public construction. Cities and towns or regional school districts established by them also provide elementary and secondary education. Cities are governed by several variations of the mayor-and-council or manager-and-council form. Most towns place executive power in a board of three or five selectmen elected to one- or three-year terms and retain legislative powers in the voters themselves, who assemble in periodic open or representative town meetings. Various local and regional districts exist for schools, water and wastewater administration, and certain other governmental functions.

Municipal revenues consist of taxes on real and personal property, distributions from the Commonwealth under a variety of programs and formulas, local receipts (including motor vehicle excise taxes, local option taxes, fines, licenses and permits, charges for utility and other services, and investment income) and appropriations from other available funds (including general and dedicated reserve funds). See "COMMONWEALTH EXPENDITURES – Local Aid."

The cities and towns of the Commonwealth are also organized into 14 counties, but county government has been abolished in seven of those counties. The county governments that remain are responsible principally for the operation of courthouses and registries of deeds. Where county government has been abolished, the functions, duties and responsibilities of the government have been transferred to the Commonwealth, including all employees, assets, valid liabilities and debts.

## **Initiative Petitions**

Under the Massachusetts constitution, legislation may be enacted in the Commonwealth pursuant to a voter initiative process. Initiative petitions which have been certified by the Attorney General as to proper form and as to which the requisite number of voter signatures has been collected are submitted to the Legislature for consideration. If the Legislature fails to enact the measure into law as submitted, the petitioner may place the initiative on the ballot for the next statewide general election by collecting additional voter signatures. If approved by a majority of the voters at the general election, the petition becomes law 30 days after the date of the election. Initiative petitions so approved by the voters do not constitute constitutional amendments and may be subsequently amended or repealed by the Legislature. Initiative petitions may not make appropriations.

On September 6, 2017, the Attorney General certified an initiative petition that, if approved, would reduce the sales tax rate in Massachusetts from 6.25% to 5% and institute an annual sales tax holiday weekend. See

“COMMONWEALTH REVENUES – State Taxes; *Sales and Use Tax*.” On December 6, 2017, the sponsors of the petition submitted signatures to the Secretary of the Commonwealth, which the Secretary certified as being sufficient on December 21, 2017. Accordingly, as described above, the petition has been submitted to the Legislature for consideration, and if the Legislature takes no action, the sponsors will have the opportunity to place the petition on the November, 2018 ballot by collecting further signatures in the summer of 2018.

Constitutional amendments also may be initiated by citizens, but they follow a longer adoption process, which includes gaining at least 25% of the votes of the House of Representatives and Senate jointly assembled in constitutional convention in two successive biennial legislative sessions before being decided by the voters.

On September 2, 2015, the Attorney General certified a petition to amend the state constitution to provide for an additional tax on certain income. See “COMMONWEALTH REVENUES – State Taxes; *Income Tax*.” On December 18, 2015, the Secretary of State certified that the petitioners had collected sufficient signatures for the petition to be transmitted to the Legislature. On May 18, 2016, the members of the Legislature jointly assembled in constitutional convention agreed to the amendment by a vote of 135-57. On June 14, 2017, the members of the Legislature jointly assembled in constitutional convention agreed to the amendment a second time, by a vote of 134-55. Opponents of the petition have filed a lawsuit in the Supreme Judicial Court claiming that the Attorney General’s certification of the petition in 2015 was unconstitutional. If the measure survives the legal challenge, it will appear on the ballot at the November, 2018 statewide election.

*[Remainder of page intentionally left blank.]*

## COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS

### Operating Fund Structure

The Commonwealth's operating fund structure satisfies the requirements of state finance law and is in accordance with GAAP, as defined by GASB. The General Fund and other funds that are appropriated in the annual state budget receive most of the non-bond and non-federal grant revenues of the Commonwealth. These funds are referred to in this Information Statement as the "budgeted operating funds" of the Commonwealth. Budgeted operating funds are created and repealed from time to time through the enactment of legislation, and existing funds may become inactive when no appropriations are made from them. Budgeted operating funds do not include the capital projects funds of the Commonwealth, into which the proceeds of Commonwealth bonds are deposited. See "Capital Investment Process and Controls" below.

Two of the budgeted operating funds account for most of the Commonwealth's appropriated spending: the General Fund and the Commonwealth Transportation Fund (formerly the Highway Fund), from which approximately 98.7% of the budgeted operating fund outflows in fiscal 2017 were made. The remaining approximately 1.3% of budgeted operating fund outflows occurred in other operating funds: the Commonwealth Stabilization Fund, the Intragovernmental Service Fund, the Inland Fisheries and Game Fund, the Marine Recreational Fisheries Development Fund, the Public Safety Training Fund, the Community First Trust Fund, the Gaming Local Aid Fund and the Local Aid Stabilization Fund. There were also 17 budgeted funds which were authorized by law but had no activity in fiscal 2017: the Collective Bargaining Reserve Fund, the Tax Reduction Fund, the Dam Safety Trust Fund, the International Educational and Foreign Language Grant Program Fund, the Education Fund, the Gaming Economic Development Fund, the Massachusetts Tourism Fund, the Temporary Holding Fund, the Substance Abuse Prevention and Treatment Fund, the Children and Families Protection Fund, the Home and Community-based Services Policy Lab Fund, the Regional Water Entity Reimbursement Fund, the Local Capital Projects Fund, the Manufacturing Fund, the Community College Fund, the Agricultural Resolve and Security Fund, and the Marijuana Regulation Fund.

At the end of a fiscal year, undesignated balances in the budgeted operating funds, unless excluded by law, are used to calculate the consolidated net surplus. Under state finance law, balances in the Stabilization Fund, the Tax Reduction Fund, the Inland Fisheries and Game Fund, the Marine Recreational Fisheries Fund, the Public Safety Training Fund, the Community First Trust Fund, and the Local Aid Stabilization Fund are excluded from the consolidated net surplus calculation.

### Overview of Operating Budget Process

Generally, funds for the Commonwealth's programs and services must be appropriated by the Legislature. The process of preparing a budget begins with the executive branch early in the fiscal year preceding the fiscal year for which the budget will take effect. The legislative budgetary process begins in late January (or, in the case of a newly elected Governor, not later than early March) with the Governor's budget submission to the Legislature for the fiscal year commencing in the ensuing July. The Massachusetts constitution requires that the Governor recommend to the Legislature a budget which contains a statement of all proposed expenditures of the Commonwealth for the upcoming fiscal year, including those already authorized by law, and of all taxes, revenues, loans and other means by which such expenditures are to be defrayed. State finance law requires the Legislature and the Governor to approve a balanced budget for each fiscal year, and the Governor may approve no supplemental appropriation bills that would result in an unbalanced budget. However, this is a statutory requirement that may be superseded by an appropriation act.

The House Committee on Ways and Means considers the Governor's budget recommendations and, with revisions, proposes a budget to the full House of Representatives. Once approved by the House, the budget is considered by the Senate Committee on Ways and Means, which in turn proposes a budget, with revisions, to be considered by the full Senate. In recent years, the legislative budget review process has included joint hearings by the Ways and Means Committees of the Senate and the House. After Senate action, a legislative conference committee develops a joint budget recommendation for consideration by both houses of the Legislature, which upon adoption is sent to the Governor. Under the Massachusetts constitution, the Governor may veto the budget in whole or disapprove or reduce specific line items (line item veto). The Legislature may override the Governor's veto or

specific line-item vetoes by a two-thirds roll-call vote of both the House and Senate. The annual budget legislation, as finally enacted, is known as the general appropriations act.

In years in which the general appropriations act is not approved by the Legislature and the Governor before the beginning of the applicable fiscal year, the Legislature and the Governor generally approve a temporary budget under which funds for the Commonwealth's programs and services are appropriated based upon the level of appropriations from the prior fiscal year budget.

State finance law requires the Commonwealth to monitor revenues and expenditures during a fiscal year. For example, the Comptroller publishes a quarterly report of planned and actual revenues. See "COMMONWEALTH REVENUES – Tax Revenue Forecasting." Department heads are required to notify the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means of any anticipated decrease in estimated revenues for their departments from the federal government or other sources or if it appears that any appropriation will be insufficient to meet all expenditures required in the fiscal year by any law, rule, regulation or order not subject to administrative control. The Secretary of Administration and Finance must notify the Governor and the House and Senate Committees on Ways and Means whenever the Secretary determines that revenues will be insufficient to meet authorized expenditures. The Secretary of Administration and Finance is then required to compute projected deficiencies and, under Section 9C of Chapter 29 of the General Laws, the Governor is required to reduce allotments, to the extent lawfully permitted to do so, or submit proposals to the Legislature to raise additional revenues or to make appropriations from the Stabilization Fund to cover such deficiencies. The Supreme Judicial Court has ruled that, under current law, the Governor's authority to reduce allotments of appropriated funds extends only to appropriations of funds to state agencies under the Governor's control.

### **Cash and Budgetary Controls**

The Commonwealth has in place controls designed to ensure that (i) sufficient cash is available to meet the Commonwealth's obligations, (ii) state expenditures are consistent with periodic allotments of annual appropriations, and (iii) moneys are expended consistently with statutory and public purposes. Two independently elected Executive Branch officials, the State Treasurer and the State Auditor, conduct the cash management and audit functions, respectively. Regarding periodic allotments, at the beginning of each fiscal year the Executive Office for Administration and Finance schedules the rate at which agencies will have access to funds included in their appropriation through a published periodic allotment calendar. Under state finance law, monthly appropriation allotments are ordinarily one-twelfth of the annual amount, but the Executive Office for Administration and Finance may provide for greater or lesser monthly allotments in appropriate cases. This calendar is reviewed regularly, and depending on the fiscal climate, the Executive Office for Administration and Finance may choose to adjust the allotment schedule in order to tighten spending controls. In some cases agencies may request an ad hoc allotment in order to gain access to funds faster than the existing periodic allotment schedule would allow (*e.g.*, exceptional cases where unique payment concerns must be considered); such requests are carefully reviewed by the Executive Office for Administration and Finance before they are approved. The Comptroller conducts the expenditure control function.

### **Capital Investment Process and Controls**

Capital expenditures are primarily financed with debt proceeds and federal grants. Authorization for capital spending requires approval by the Legislature, and the issuance of debt must be approved by a two-thirds roll-call vote of each house of the Legislature. The state constitution requires the Governor to recommend the terms of the authorized debt. The State Treasurer issues authorized debt at the request of the Governor, and the Governor, through the Secretary of Administration and Finance, controls the amount of capital expenditures through the allotment of funds pursuant to such authorizations. The Executive Office for Administration and Finance establishes a capital investment plan on or before July 1 each year pursuant to state law. The capital investment plan is an administrative guideline and is subject to amendment from time to time. See "COMMONWEALTH CAPITAL INVESTMENT PLAN."

The Comptroller has established various funds to account for financial activity related to the acquisition or construction of capital assets. In addition, accounting procedures and financial controls have been instituted to limit agency capital spending to the levels approved by the Governor. Capital spending is tracked against the capital

investment plan on both a cash and encumbrance accounting basis on the state's accounting system, and federal reimbursements are budgeted and monitored against anticipated receipts.

### **Cash Management Practices of State Treasurer**

The State Treasurer is responsible for ensuring that all Commonwealth financial obligations are met on a timely basis. The Massachusetts constitution requires that all payments by the Commonwealth (other than debt service) be made pursuant to a warrant approved by the Governor's Council. The Comptroller prepares certificates which, with the advice and consent of the Governor's Council and approval of the Governor, become the warrant to the State Treasurer. Once the warrant is approved, the State Treasurer's office disburses the money. The warrant requirement under state finance law does not apply to debt service appropriations.

The Cash Management Division of the State Treasurer's office utilizes approximately 900 operating accounts to track cash collections and disbursements for the Commonwealth. The Division relies primarily upon electronic receipt and disbursement systems.

The State Treasurer, in conjunction with the Executive Office for Administration and Finance, is required to submit quarterly cash flow projections for the then current fiscal year to the House and Senate Committees on Ways and Means on or before the last day of August, November, February and May. The projections must include estimated sources and uses of cash, together with the assumptions from which such estimates were derived and identification of any cash flow gaps. See "FISCAL 2018 AND FISCAL 2019 – Cash Flow." The State Treasurer's office, in conjunction with the Executive Office for Administration and Finance, is also required to develop quarterly and annual cash management plans to address any gap identified by the cash flow projections and variance reports. The State Treasurer's office oversees the issuance of short-term debt to meet cash flow needs, including the issuance of commercial paper and revenue anticipation notes. See "LONG-TERM LIABILITIES – General Obligation Debt."

Cash that is not needed for immediate funding needs is invested in the Massachusetts Municipal Depository Trust. The State Treasurer serves as trustee of the Trust and has sole authority pertaining to rules, regulations and operations of the Trust. The Trust has two investment options: a short-term liquidity vehicle or "cash portfolio" structured similarly to a money market fund and a short-term bond fund. For additional detail on the Massachusetts Municipal Depository Trust, see "FISCAL 2018 AND FISCAL 2019 – Cash Flow."

### **Fiscal Control, Accounting and Reporting Practices of the Comptroller**

The Comptroller is responsible for oversight of fiscal management functions, establishment of accounting policies and practices, and publication of official financial reports. The Comptroller maintains the Massachusetts Management Accounting and Reporting System (MMARS), the centralized state accounting system that is used by all state agencies and departments for processing of all financial transactions. The University of Massachusetts, the state universities and the community colleges process only some transactions on MMARS, and the independent state authorities do not use the system. MMARS provides a ledger-based system of revenue and expenditure accounts enabling the Comptroller to control obligations and expenditures effectively and to ensure that appropriations are not exceeded during the course of the fiscal year. The Commonwealth's statewide accounting system also has various modules for receivables, payables, capital assets and other processes management.

*Expenditure Controls.* The Comptroller requires that the amount of all obligations under purchase orders, contracts and other commitments for the expenditures of moneys be recorded as encumbrances. Once encumbered, these amounts are not available to support additional spending commitments. As a result of these encumbrances, spending agencies can use MMARS to determine at any given time the amount of their appropriations available for future commitments.

The Comptroller is responsible for compiling expenditure requests into the certificates for approval by the Governor's Council. The Council approves an estimated warrant giving the Treasurer authority to issue payments up to the amount on the warrant, as long as those payments are otherwise determined by the Comptroller to comply with state finance law. In preparing these certificates, which become the warrant, the Comptroller's office has systems in place to ensure that the necessary moneys for payment have been both appropriated by the Legislature and allotted by the Governor in each account and sub-account. By law, certain obligations may be placed upon the warrant even if the supporting appropriation or allotment is insufficient. These obligations include debt service,

which is specifically exempted by the state constitution from the warrant requirement, and Medicaid payments, which are mandated by federal law.

Although state finance law generally does not create priorities among types of payments to be made by the Commonwealth in the event of a cash shortfall, the Comptroller has developed procedures, in consultation with the State Treasurer and the Executive Office for Administration and Finance, for prioritizing payments based upon state finance law and sound fiscal management practices.

*Internal Controls.* The Comptroller establishes internal control policies and procedures in accordance with state finance law. Agencies are required to adhere to such policies and procedures. All unaccounted-for variances, losses, shortages or thefts of funds or property must be reported to the State Auditor, who is authorized to investigate and recommend corrective action.

*Statutory Basis of Accounting.* In accordance with state law, the Commonwealth adopts its budget and maintains financial information on a statutory basis of accounting. Under the statutory basis, tax and departmental revenues are accounted for on a modified cash basis by reconciling revenue to actual cash receipts confirmed by the State Treasurer. Certain limited revenue accruals are also recognized, including receivables from federal reimbursements with respect to paid expenditures; a provision in the fiscal 2018 budget requires that the Comptroller record in fiscal 2018 on the statutory basis certain sales tax revenues received in July, 2018, that under Massachusetts General Law and the Comptroller's revenue recognition policy would normally be recorded as fiscal 2019 revenue. The result of this provision is that thirteen months of such sales tax revenue would be recorded in fiscal 2018. The fiscal 2018 sales revenue estimate includes \$125 million to account for this provision. The provision does not currently extend past fiscal 2018; if the provision is not extended beyond fiscal 2018, only eleven months of such sales tax revenue would be recorded in fiscal 2019 on a statutory basis. Expenditures are measured on a modified cash basis, including actual cash disbursements and encumbrances for goods or services received prior to the end of a fiscal year.

For certain programs, such as Medicaid, expenditures are recognized under the statutory basis of accounting only to the extent of disbursements supported by current-year appropriations. Some prior year services billed after the start of a fiscal year have been paid from the new fiscal year's appropriation, in an amount determined by the specific timing of billings and the amount of prior year funds that remained after June 30 to pay the prior year's accrued billings, though this practice may vary from year to year.

*GAAP Basis of Accounting.* The Comptroller also prepares Commonwealth financial statements on a GAAP basis. In addition to the primary government, certain independent authorities and agencies of the Commonwealth are included as component units within the Commonwealth's reporting entity.

GAAP employs an economic resources management focus and a current financial resources management focus as two bases for accounting and reporting. Under the economic resources management focus (also called the "government-wide perspective") revenues and expenses (different from expenditures) are presented similarly to private-sector entities. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met. Capital assets, including infrastructure assets net of depreciation, and the long-term portion of all liabilities are reported on the statement of net position.

Under the current financial resources management focus of GAAP (also called the "fund perspective"), the primary emphasis is to demonstrate inter-period equity. Revenues are reported in the period in which they become both measurable and available. Revenues are considered available when they are expected to be collected within the current period or soon enough thereafter to be used to pay liabilities of the current period.

Significant revenues susceptible to accrual include income, sales and use, corporation and other taxes, federal revenues (including both grants and reimbursements) and reimbursements for the use of materials and services. Tax accruals, which include the estimated amounts due to the Commonwealth on previous filings, over- and under-withholdings, estimated payments on income earned and tax refunds and abatements payable, are all recorded as adjustments to statutory basis tax revenues.

Major expenditure accruals are recorded for the cost of Medicaid claims that have been incurred but not paid, claims and judgments and workers' compensation claims incurred but not reported and contract assistance and amounts due to municipalities and state authorities. See Exhibit C – Comprehensive Annual Financial Report for the year ended June 30, 2017; Page 3 and Notes to the Basic Financial Statements.

### **Audit Practices of State Auditor**

The State Auditor is mandated under state law to conduct an audit at least once every three years of the accounts of all departments, offices, commissions, institutions and activities of the Commonwealth. This audit encompasses hundreds of state entities, including the court system and independent authorities. The State Auditor also has the authority to audit federally aided programs and vendors and their subcontractors under contract with the Commonwealth as well as to conduct special audit projects. Further, the State Auditor upon a ratified majority vote by the board of selectmen or school committee, may, in the Auditor's discretion, audit the accounts, programs, activities and other public functions of a town, district, regional school district, city or county. The State Auditor conducts both compliance and performance audits in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States.

Within the State Auditor's office is the Division of Local Mandates, which evaluates proposed and actual legislation to determine the financial impact on the Commonwealth's cities and towns. In accordance with state law, the Commonwealth is required to reimburse cities and towns for any costs incurred through mandated programs established after the passage of Proposition 2½, the statewide tax limitation enacted by the voters in 1980, unless expressly exempted from those provisions, and the State Auditor's financial analysis is used to establish the amount of reimbursement due to the Commonwealth's cities and towns. See "COMMONWEALTH EXPENDITURES – Local Aid; *Property Tax Limits.*"

Also within the State Auditor's office is the Bureau of Special Investigations, which is charged with the responsibility of investigating fraud within public assistance programs.

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## COMMONWEALTH REVENUES

This section contains a description of the major categories of Commonwealth revenues. See “COMMONWEALTH EXPENDITURES” for a description of the major categories of Commonwealth expenditures. All percentages and amounts for fiscal 2018 and fiscal 2019 are projected.

In order to fund its programs and services, the Commonwealth collects a variety of taxes and receives revenues from other non-tax sources, including the federal government and various fees, fines, court revenues, assessments, reimbursements, interest earnings and transfers from its non-budgeted funds, which are deposited in the General Fund, the Commonwealth Transportation Fund (formerly the Highway Fund) and other budgeted operating funds. Revenues deposited in such funds are referred to as budgeted operating revenues in this Information Statement. In fiscal 2017, on a statutory basis, approximately 57.0% of the Commonwealth’s budgeted operating revenues and other financing sources were derived from state taxes. In addition, the federal government provided approximately 26.0% of such revenues, with the remaining 17.0% provided from departmental revenues and transfers from non-budgeted funds.

The Commonwealth’s executive and legislative branches establish the Commonwealth’s budget using the statutory basis of accounting, which differs from a GAAP basis. See “SELECTED FINANCIAL DATA – Statutory Basis Distribution of Budgetary Revenues and Expenditures” and “- GAAP Basis.”

### State Taxes

The major components of state taxes are the income tax, which accounted for approximately 57.2% of total tax revenues in fiscal 2017, the sales and use tax, which accounted for approximately 24.2% of total budgeted tax revenues in fiscal 2017, and the corporations and other business and excise taxes (including taxes on insurance companies and financial institutions), which accounted for approximately 10.0% of total budgeted tax revenues in fiscal 2017. Other tax and excise sources accounted for the remaining 8.6% of total budgeted tax revenues in fiscal 2017.

The Governor annually files a “tax expenditure budget” that provides a list, description and revenue estimate of various tax credits, deductions and exemptions that represent departures from the basic provisions of the state tax code. See “Tax Credits and Other Incentives” below.

On December 22, 2017, President Trump signed into law Public Law 115-97, making major changes to the federal Internal Revenue Code, most of which are effective in the 2018 tax year, including extensive changes to federal personal income taxes, corporate income taxes, and estate taxes, and the deductibility of various taxes and interest costs. The Commonwealth’s income tax system interacts with the federal system in numerous ways, and the changes to the federal Internal Revenue Code could have significant flow-through effects on the Commonwealth’s tax system and revenues. The Department of Revenue is in the process of reviewing the implications of the federal changes for the Commonwealth’s tax revenues and tax administration; however, the deemed repatriation of foreign earnings is estimated to have a positive revenue impact for the Commonwealth of \$65 million in fiscal 2019 for budgeting purposes.

*Income Tax.* The Commonwealth assesses personal income taxes at flat rates, according to classes of income, after specified deductions and exemptions. A rate of 5.3% was applied to most types of income from January 1, 2002 to January 1, 2012. Under current law, the state personal income tax rate on most classes of taxable income is scheduled to be reduced gradually to 5.0%, contingent upon “baseline” state tax revenue growth (*i.e.*, revenue growth after factoring out the impact of tax law and administrative processing changes). Pursuant to this law, the state income tax rate on most classes of taxable income has been gradually reduced from 5.3% to its current rate of 5.1%. In order to trigger a reduction, baseline revenues are measured for fiscal year-over-fiscal year growth of at least 2.5 percentage points more than the rate of inflation, as measured by the consumer price index for all urban consumers in Boston. Inflation-adjusted baseline revenues must also demonstrate positive growth for consecutive three-month periods, beginning in August and ending in November, in comparison with the same three-month periods in the prior calendar year. If these triggers are met, the personal income tax rate on most classes of taxable income is reduced by 0.05% on the following January 1. The state income tax rate on most classes of taxable income was reduced from 5.15% to 5.10%, effective January 1, 2016, as a result of satisfying these triggers.

On August 30, 2017, the Department of Revenue certified that the fiscal 2017 inflation-adjusted baseline tax revenue growth over fiscal 2016 was 0.059%, and, therefore, the 2.5% fiscal 2017 growth threshold needed to trigger a further tax rate reduction effective January 1, 2018 was not met.

In the tax year following that in which the personal income tax rate is reduced to 5.0%, the charitable deduction, which was in effect for tax year 2000 but subsequently suspended, will be restored.

The following table shows the Department of Revenue’s estimated impacts on income tax revenue of the state income tax rate reductions described above in fiscal years 2013 through 2018, inclusive.

**Impact of Income Tax Rate Reductions (millions)**

| <u>Decrease from:</u> | <u>Fiscal 2013</u> | <u>Fiscal 2014</u> | <u>Fiscal 2015</u> | <u>Fiscal 2016</u> | <u>Fiscal 2017</u> | <u>Fiscal 2018 (1)</u> |
|-----------------------|--------------------|--------------------|--------------------|--------------------|--------------------|------------------------|
| 5.3% to 5.25%         | \$114              | \$119              | \$124              | \$130              | \$136              | \$142                  |
| 5.25% to 5.20%        | -                  | 65                 | 133                | 138                | 145                | 151                    |
| 5.20% to 5.15%        | -                  | -                  | 70                 | 145                | 152                | 158                    |
| 5.15% to 5.10%        | -                  | -                  | -                  | 74                 | 152                | 159                    |

Source: Department of Revenue.

(1) Income tax revenue impact in fiscal 2018 is projected and subject to change.

On September 2, 2015, the Attorney General certified an initiative petition to amend the state constitution to provide for an additional tax of 4.0% on that portion of annual taxable income in excess of \$1 million for tax years beginning on or after January 1, 2019. The \$1 million figure would be adjusted annually for inflation. See “THE GOVERNMENT – Initiative Petitions.”

*Capital Gains Component of the Income Tax.* The tax rate on gains from the sale of capital assets held for one year or less and from the sale of collectibles is 12%. The tax rate on gains from the sale of capital assets owned more than one year is currently 5.10% (effective January 1, 2016), and is equal to the state personal income tax rate. The 5.10% rate could further decline through the statutory mechanism for adjusting the personal income tax rate described above. Current state finance law provides for tax revenues collected from capital gains income during a fiscal year that exceed a specified threshold to be transferred to the Commonwealth’s Stabilization Fund, with 5% of the amount so deposited then transferred to the State Retiree Benefits Trust Fund and an additional 5% transferred to the Commonwealth’s Pension Liability Fund. Each quarter, the Department of Revenue certifies the amount of tax revenues estimated to have been collected during the preceding quarter from capital gains income, and, once the threshold has been exceeded, the excess is transferred to the Commonwealth Stabilization Fund. The final certification of capital gains tax revenues is done in November following the end of the fiscal year, but no adjustment is made to Stabilization Fund transfers if the final amount of capital gains taxes certified differs from the amount certified in the preceding July. The threshold is subject to annual adjustment to reflect the average annual rate of growth in U. S. gross domestic product over the preceding five years and is certified annually by the Department of Revenue each December for the ensuing fiscal year as part of the consensus revenue process. On December 28, 2016, the Department of Revenue certified that the fiscal 2018 capital gains tax collections threshold is approximately \$1.169 billion. On December 22, 2017, the Department of Revenue certified that the fiscal 2019 capital gains tax collections threshold is approximately \$1.212 billion.

In fiscal years 2015 and 2016, the Commonwealth temporarily suspended the requirement to transfer capital gains tax collections above the threshold to the Stabilization Fund, with all capital gains tax collections to remain in the General Fund.

The fiscal 2017 capital gains tax collections threshold had been determined to be approximately \$1.128 billion. The fiscal 2017 budget included language requiring the Comptroller to transfer all capital gains tax collections above \$1.278 billion to the Stabilization Fund in fiscal 2017. On July 21, 2017, the Department of Revenue certified that fiscal 2017 tax revenues collected from capital gains income were \$1.19 billion, therefore resulting in no transfer of capital gains tax revenues to the Stabilization Fund in fiscal 2017 under this provision. On November 30, 2017, the Department of Revenue certified that fiscal 2017 tax revenues collected from capital gains

income were \$1.185 billion. On October 27, 2017, the Department of Revenue certified that tax revenues estimated to have been collected during the first period of fiscal 2018 (July 1, 2017 through September 30, 2017) from capital gains income were \$179.1 million.

*Sales and Use Tax.* The sales tax rate imposed on retail sales of certain tangible property (including retail sales of meals) transacted in the Commonwealth and a corresponding use tax rate on the storage, use or other consumption of like tangible properties brought into the Commonwealth is 6.25%. Food, clothing, prescribed medicine, materials and produce used in food production, machinery, materials, tools and fuel used in certain industries and property subject to other excises (except for cigarettes) are exempt from sales taxation. The sales and use tax is also applied to sales of electricity, gas and steam for certain nonresidential use and to nonresidential and a portion of residential use of telecommunications services.

Certain sales tax receipts are required to be credited to the Convention Center Fund. The Convention Center Fund is not included in the calculation of revenues for budgeted operating funds. See “LONG-TERM LIABILITIES—Special Obligation Debt; *Convention Center Fund.*”

A portion of the Commonwealth’s receipts from the sales tax (other than the tax on meals) is dedicated through non-budgeted special revenue funds to the Massachusetts Bay Transportation Authority (MBTA) and the Massachusetts School Building Authority (MSBA). The amount dedicated to the MSBA is the amount raised by a 1% sales tax (not including meals). The amount dedicated to the MBTA is a comparable amount, subject to an inflation-adjusted floor, plus \$160 million annually. Effective commencing in fiscal 2015, the \$160 million adjustment was integrated into the inflation-adjusted floor, which was reset at \$970.6 million. The floor grows by the allowable base revenue growth (lesser of sales tax growth or inflation, but not greater than 3% and not less than 0%) thereafter.

The Commonwealth’s receipts from the sales tax on account of motor vehicle sales (net of amounts required to be credited to the Convention Center Fund or dedicated to the MBTA or MSBA) are dedicated to the Commonwealth Transportation Fund.

On September 6, 2017, the Attorney General certified an initiative petition that, if approved, would reduce the sales tax rate in Massachusetts from 6.25% to 5%. See “THE GOVERNMENT – Initiative Petitions.” The Governor has also filed legislation that would establish an annual sales tax holiday weekend.

*Business Corporations Tax.* Business corporations doing business in the Commonwealth, other than banks and other financial institutions, insurance companies, railroads and safe deposit companies, are subject to an excise that has a property measure and an income measure. The value of Massachusetts tangible property (not taxed locally) or net worth allocated to the Commonwealth is taxed at \$2.60 per \$1,000 of value. The net income assigned to Massachusetts, which is based on net income for federal taxes, is taxed at 8.0%. The minimum tax is \$456.

In general, corporations apportion their income to Massachusetts based on the proportion of payroll, property and sales within the Commonwealth, with sales being double-weighted. This general rule does not apply to manufacturing companies or to mutual fund service corporations. The net income of such entities is apportioned only by the percentage of their Massachusetts sales.

*Financial Institutions Tax.* Financial institutions (which include commercial and savings banks) are subject to an excise tax. The net income assigned to Massachusetts is taxed at 9.0%. In general, financial institutions apportion their income to Massachusetts based on the proportion of receipts, payroll and property within the Commonwealth.

*Insurance Taxes.* Life insurance companies are subject to a 2% tax on gross premiums. Property and casualty insurance companies are subject to a 2.28% tax on gross premiums. Domestic property and casualty insurance companies also pay a 1% tax on gross investment income.

*Other Taxes.* Other tax revenues are derived by the Commonwealth from excise taxes on motor fuels, cigarettes and other tobacco products, alcoholic beverages, deeds, and hotel/motel room occupancy, as well as taxes on estates, among other tax sources. On November 8, 2016, voters approved an initiative petition that, among other things, imposes an excise tax, in addition to the regular sales tax, on retail sales of recreational marijuana and

marijuana products, which that petition legalized. Legislation approved by the Governor on December 30, 2016 delayed the effective date of the new tax, and the first tax collections are now expected to occur in fiscal 2019. Legislation approved by the Governor on July 28, 2017 increased the maximum combined state and local tax rate on recreational marijuana from 12% to 20%.

*Tax Credits and Other Incentives.* Massachusetts law provides for a variety of tax credits that may be applied against corporate excise or personal income taxes due, as applicable under relevant law. These credits are designed as benefits for specified economic activities as a means to encourage such business in the state. Certain of these credits, to the extent not used to reduce a current tax liability, may be carried forward, transferred or refunded, as specified in the applicable statute. In addition, certain statutory provisions may also provide an exemption from sales and use taxes for qualifying expenditures, or other specified tax benefits.

The Governor annually publishes a “tax expenditure budget” that provides a list, description and revenue estimate of various tax credits, deductions and exemptions that represent departures from the basic provisions of the state tax code. A summary of the tax expenditure budget published on January 24, 2018 appears below.

**Fiscal 2019 Tax Expenditure Budget Summary (in millions)**

| <u>Tax Type</u>                     | <b>Fiscal 2015</b> | <b>Fiscal 2016</b> | <b>Fiscal 2017</b> | <b>Fiscal 2018</b> | <b>Fiscal 2019</b> |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Personal Income Tax                 | \$6,721.0          | \$7,090.0          | \$7,397.2          | \$7,754.2          | \$8,283.9          |
| Corporate and Other Business Excise | 1,826.4            | 2,039.0            | 2,089.9            | 2,129.6            | 2,158.8            |
| Sales and Use Tax                   | <u>4,686.3</u>     | <u>4,557.3</u>     | <u>4,705.0</u>     | <u>4,903.8</u>     | <u>5,085.9</u>     |
| <b>Total</b>                        | <b>\$13,233.7</b>  | <b>\$13,686.3</b>  | <b>\$14,192.1</b>  | <b>\$14,787.6</b>  | <b>\$15,528.6</b>  |

Under legislation approved June 16, 2008, in support of the life sciences industry, up to \$25 million per year in tax incentives is available to certified life sciences companies over a 10-year period, commencing January 1, 2009 and ending on December 31, 2018, for an aggregate amount of \$250 million. The Department of Revenue estimates that this program resulted in revenue reductions of \$16.5 million in fiscal 2013, \$16.5 million in fiscal 2014, \$12.9 million in fiscal 2015, \$15.9 million in fiscal 2016, and \$16.9 million in fiscal 2017. The Massachusetts Life Sciences Center board has approved \$20 million in tax incentives that are expected to be utilized in fiscal 2018. The Governor has filed legislation that would extend the availability of these tax credits until December 31, 2028.

**Tax Revenue Forecasting**

Under state law, on or before October 15 of each year, the Secretary of Administration and Finance is required to submit to the Governor and to the House and Senate Committees on Ways and Means estimates of revenues available to meet appropriations and other needs in the current fiscal year and the following fiscal year.

On or before January 15 of each year (January 31 in the first year of a new Governor), the Secretary is required to develop jointly with the House and Senate Committees on Ways and Means a consensus tax revenue forecast for the following fiscal year. State finance law requires that the consensus tax revenue forecasts be net of the amounts necessary to fully fund the pension system according to the applicable funding schedule, and to fulfill statutory commitments to the MBTA and the MSBA. These amounts are to be transferred without further appropriation from the General Fund. See “Sales and Use Tax,” above and “PENSION AND OPEB FUNDING.”

An additional component of the consensus revenue process is the requirement that the consensus tax revenue forecast joint resolution include a benchmark for the estimated growth rate of Massachusetts potential gross state product, or PGSP. Health care cost control legislation requires that the Secretary and the House and Senate Committees on Ways and Means include a PGSP growth benchmark for the ensuing calendar year. PGSP is a measure of the “full employment” output of the Commonwealth’s economy. The PGSP growth benchmark is used by the Massachusetts Health Policy Commission to establish the Commonwealth’s health care cost growth benchmark. See “COMMONWEALTH EXPENDITURES – Medicaid and the Health Connector; *Health Care Cost Containment.*”

The following table compares actual budgeted tax revenues to consensus tax revenue forecasts for fiscal 2013 to 2017. Figures for fiscal 2018 and 2019 are projected. The figures include sales tax receipts dedicated to the MBTA and the MSBA and amounts transferred to the state pension system.

### Tax Revenue Forecasting (in millions)

|  | <u>Fiscal 2013</u> | <u>Fiscal 2014</u> | <u>Fiscal 2015</u> | <u>Fiscal 2016</u> | <u>Fiscal 2017</u> | <u>Projected Fiscal 2018</u> | <u>Projected Fiscal 2019</u> |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|------------------------------|------------------------------|
| Consensus forecast   | \$21,950           | \$22,334           | \$24,337           | \$25,479           | \$26,860           | \$27,072                     | \$27,594                     |
| GAA estimate of tax-related settlements and judgments exceeding \$10 million | -                  | -                  | 204                | 100                | 125                | 125                          |                              |
| <b>Total taxes per enacted budget</b>  | <u>\$22,011</u>    | <u>\$22,797</u>    | <u>\$24,591</u>    | <u>\$25,711</u>    | <u>\$26,356</u>    | <u>\$26,604</u> (3)          |                              |
| October revision   | 21,496 (2)         | -                  | -                  | -                  | 26,056             | -                            |                              |
| January revision   | -                  | 23,200             | 24,325             | 25,751             | -                  | 26,761 (3)(4)                |                              |
| <b>Actual budgeted operating tax revenues (1)</b>                            | <u>\$22,123</u>    | <u>\$23,370</u>    | <u>\$24,932</u>    | <u>\$25,425</u>    | <u>\$25,662</u>    |                              |                              |
| Actual revenues as a percentage of consensus forecast                        | 101%               | 105%               | 102%               | 99.8%              | 95.5%              |                              |                              |
| Actual revenues as a percentage of total taxes per enacted budget            | 101%               | 103%               | 102%               | 98.7%              | 98.5%              |                              |                              |

SOURCE: Executive Office for Administration and Finance; actual budgeted operating tax revenues, Office of the Comptroller.

- (1) Actual revenues include tax-related settlements exceeding \$10 million each.
- (2) Revised on December 4, 2012.
- (3) See discussion below. The Executive Office for Administration and Finance currently projects that tax-related settlements and judgments exceeding \$10 million each will be \$100 million in fiscal 2018.
- (4) Revised on January 12, 2018, including \$100 million for tax-related settlements and judgments exceeding \$10 million each.

On January 12, 2017, a fiscal 2018 consensus tax revenue estimate of \$27.072 billion was agreed upon by the Secretary of Administration and Finance and the chairs of the House and Senate Committees on Ways and Means. The fiscal 2018 consensus tax revenue estimate represents revenue growth of 3.9% from the fiscal 2017 estimate of \$26.056 billion. The \$27.072 billion figure included allocations of \$2.395 billion for pension funding, \$1.007 billion in dedicated sales tax receipts for the MBTA, \$841 million in dedicated sales tax receipts for the MSBA and \$22.9 million for the Workforce Training Fund. The total amount of off-budget allocations was \$4.368 billion. Accordingly, after taking into account these off-budget allocations the Secretary and Committee chairs agreed that \$22.704 billion would be the maximum amount of tax revenue available for the fiscal 2018 budget and they based their respective budget recommendations on that number. On July 17, 2017, the Governor approved the fiscal 2018 budget, which assumed total tax revenues of \$26.504 billion (excluding tax-related settlements and judgments), based on the consensus estimate of \$27.072 billion adjusted down by \$749 million (including a \$35 million reduction on account of a change in the return filing deadline for corporate and business taxpayers and an \$83 million increase from the personal Part B tax rate reduction not triggering, as assumed in the consensus update), and up by \$181 million for the incremental impact of various tax law changes. On January 12, 2018, the Secretary of Administration and Finance revised the Fiscal Year 2018 state tax revenue estimate upward by \$157 million, from \$26.504 billion to \$26.661 billion, to reflect strong year-to-date performance in the category of income tax withholding.

On December 6, 2017, the Secretary of Administration and Finance and the House and Senate Ways and Means Committees conducted a hearing on state tax revenue estimates for fiscal 2019. The Commissioner of Revenue provided a forecast that fiscal 2019 tax revenue collections will be \$27.374 billion to \$27.582 billion,

reflecting actual growth of 3.3% to 4.1%, and baseline growth of 4.1% to 4.9% from the fiscal 2018 benchmark, which represents growth of \$0.870 billion to \$1.078 billion over the fiscal 2018 benchmark. The Commissioner also provided a hybrid forecast of 27.392 billion for fiscal 2019, reflecting actual growth of 3.4%, and baseline growth of 4.2% from the fiscal 2018 benchmark, which represents an actual growth of \$0.888 billion over the fiscal 2018 benchmark.

The Secretary of Administration and Finance and the Committees on Ways and Means also heard public testimony from economists and state budget experts from Northeastern University, the Massachusetts Taxpayers Foundation and the Beacon Hill Institute, who provided a range of forecasts for fiscal 2019 tax revenue collections, from \$27.581 billion to \$28.697 billion.

On January 12, 2018, a fiscal 2019 consensus tax revenue estimate of \$27.594 billion was agreed upon by the Secretary of Administration and Finance and the chairs of the House and Senate Committees on Ways and Means. The fiscal 2019 consensus tax revenue estimate represents revenue growth of 3.5% from the revised fiscal 2018 estimate of \$26.661 billion certified by the Secretary also on January 12, 2018. The \$27.594 billion figure for fiscal 2019 includes allocations of \$2.609 billion for pension funding, \$1.032 billion in dedicated sales tax receipts for the MBTA, \$858.9 million in dedicated sales tax receipts for the MSBA, and \$24.0 million for the Workforce Training Fund. The total amount of off-budget allocations was \$4.612 billion. Accordingly, after taking into account these off-budget allocations the Secretary and Committee chairs agreed that \$22.982 billion would be the maximum amount of tax revenue available for the fiscal 2019 budget. The consensus tax revenue estimate for fiscal 2019 assumes that another income tax trigger will go into effect on January 1, 2019, lowering the state personal income tax rate on most classes of taxable income to 5.05% from 5.10%, but does not take into account any potential effects from certain pending initiative petitions regarding the income tax and the sales and use tax. See, “THE GOVERNMENT – Initiative Petitions,” and “COMMONWEALTH REVENUES – State Taxes; *Income Tax*” and “*Sales and Use Tax*.”

The Secretary of Administration and Finance and the chairs of the House and Senate Committees on Ways and Means also agreed upon a potential gross state product (PGSP) estimate of 3.6% for calendar 2019, which is identical to the PGSP figure that was adopted for calendar 2016 through 2018. The PGSP growth benchmark is to be used by the Health Policy Commission to establish the Commonwealth’s health care cost growth benchmark. See “COMMONWEALTH EXPENDITURES – Medicaid and the Health Connector; *Health Care Cost Containment*.”

### Fiscal 2017 and Fiscal 2018 Tax Revenues

*Fiscal 2017.* Tax revenues for fiscal 2017 totaled approximately \$25.662 billion, including \$58.0 million in one-time tax-related settlements and judgments, exceeding \$10 million each, an increase of approximately \$237 million, or 0.9%, over fiscal 2016. The following table shows the tax collections for fiscal 2017 and the change from tax collections in the prior year, both in dollars and as a percentage. The table also notes the amount of tax collections during the fiscal year that are dedicated to the MBTA and the MSBA.

| <b>Fiscal 2017 Tax Collections (in millions)</b> |                          |                               |                          |                       |                       |  |
|--|--------------------------|-------------------------------|--------------------------|-----------------------|-----------------------|--|
| <u>Month</u>                                     | <u>Tax Collections</u>   | <u>Change from Prior Year</u> | <u>Percentage Change</u> | <u>MBTA Portion</u>   | <u>MSBA Portion</u>   | <u>Tax Collections: Net of MBTA and MSBA</u> |
| July   | \$1,705.4                | \$34.3                        | 2.1%                     | \$84.8                | \$71.5                | \$1,549.0                                    |
| August   | 1,737.0                  | 8.6                           | 0.5                      | 79.9                  | 66.6                  | 1,590.6                                      |
| September  | 2,756.9                  | 205.4                         | 8.0                      | 83.3                  | 67.7                  | 2,605.9                                      |
| October  | 1,792.3                  | 128.8                         | 7.7                      | 83.4                  | 70.0                  | 1,638.8                                      |
| November   | 1,490.4                  | (182.7)                       | (10.9)                   | 75.9                  | 62.5                  | 1,352.0                                      |
| December   | 2,489.6                  | 62.6                          | 2.6                      | 88.8                  | 65.9                  | 2,334.8                                      |
| January  | 2,720.2                  | 131.4                         | 5.1                      | 96.3                  | 82.9                  | 2,540.9                                      |
| February   | 1,172.4                  | (100.8)                       | (7.9)                    | 72.0                  | 58.7                  | 1,041.7                                      |
| March  | 2,290.2                  | 18.4                          | 0.8                      | 79.8                  | 59.9                  | 2,150.5                                      |
| April  | 2,854.3                  | (92.4)                        | (3.1)                    | 78.9                  | 65.6                  | 2,709.9                                      |
| May  | 1,921.1                  | 56.6                          | 3.0                      | 82.9                  | 69.6                  | 1,768.5                                      |
| June   | 2,732.1                  | (33.1)                        | (1.2)                    | 86.2                  | 75.8                  | 2,570.0                                      |
| <b>Total (1)</b>                                 | <b><u>\$25,661.7</u></b> | <b><u>\$237.2</u></b>         | <b><u>0.9%</u></b>       | <b><u>\$992.2</u></b> | <b><u>\$816.8</u></b> | <b><u>\$23,852.7</u></b>                     |

SOURCE: Executive Office for Administration and Finance.

(1) Totals may not add due to rounding.

The tax revenue increase of approximately \$237 million from fiscal 2016 to fiscal 2017 is attributable, in large part, to an increase of approximately \$542.8 million, or 4.8%, in withholding collections and an increase of approximately \$156.5 million, or 2.6%, in sales and use tax collections, which were partly offset by a decrease of approximately \$148.6 million, or 5.5%, in corporate and business tax collections, a decrease of approximately \$135.0 million, or 5.4% in income tax cash estimated payments, a decrease of approximately \$101.9 million, or 5.0%, in income tax payments with bills and returns, and a net decrease of approximately \$60.7 million, or 2.7%, in all other taxes. Fiscal 2017 tax collections, without tax-related settlements, were approximately \$452 million below the benchmarks associated with the revised fiscal 2017 tax revenue estimate of \$26.056 billion.

On July 6, 2017, the Department of Revenue and the Office of the Attorney General jointly certified that fiscal 2017 tax-related settlement and judgment payments totaled \$58.0 million and non-tax related settlement and judgment payments totaled \$53.6 million.

*Fiscal 2018.* The fiscal 2018 General Appropriations Act was based on estimated tax collections of \$26.504 billion, including revenues dedicated to the MBTA, the MSBA and the Workforce Training Fund, excluding large tax-related settlements and judgments. As indicated above, the fiscal 2018 estimate was revised upward to \$26.661 billion on January 12, 2018. Preliminary tax revenues (including large tax-related settlements) for the first eight months of fiscal 2018, ended February 28, 2018, totaled \$17.171 billion, an increase of approximately \$1.307 billion, or 8.2%, over the same period in fiscal 2017.

The table on the following page shows the tax collections for the first eight months of fiscal 2018 and the change from tax collections in the same period in the prior year, both in dollars and as a percentage. The table also notes the amount of tax collections during the fiscal year that are dedicated to the MBTA and the MSBA.

*[Remainder of page intentionally left blank.]*

**Fiscal 2018 Tax Collections (in millions)**

| <u>Month</u>     | <u>Tax Collections</u>   | <u>Change from Prior Year</u> | <u>Percentage Change</u> | <u>MBTA Portion</u>   | <u>MSBA Portion</u>   | <u>Tax Collections: Net of MBTA and MSBA</u> |
|------------------|--------------------------|-------------------------------|--------------------------|-----------------------|-----------------------|--|
| July             | \$1,797.1                | \$91.7                        | 5.4%                     | \$83.5                | \$70.2                | \$1,643.4                                    |
| August           | 1,711.9                  | (25.2)                        | (1.4)                    | 82.8                  | 69.4                  | 1,559.7                                      |
| September        | 2,837.0                  | 80.1                          | 2.9                      | 85.4                  | 68.3                  | 2,683.3                                      |
| October          | 1,835.0                  | 42.7                          | 2.4                      | 84.1                  | 70.8                  | 1,680.1                                      |
| November         | 1,735.8                  | 245.4                         | 16.5                     | 81.7                  | 68.3                  | 1,585.9                                      |
| December         | 3,007.5                  | 517.9                         | 20.8                     | 86.0                  | 70.2                  | 2,851.3                                      |
| January          | 2,967.6                  | 247.5                         | 9.1                      | 96.0                  | 82.6                  | 2,789.0                                      |
| February (1)     | 1,279.1                  | 106.8                         | 9.1                      | 76.4                  | 63.1                  | 1,139.6                                      |
| <b>Total (2)</b> | <b><u>\$17,171.0</u></b> | <b><u>\$1,306.9</u></b>       | <b><u>8.2%</u></b>       | <b><u>\$675.8</u></b> | <b><u>\$562.9</u></b> | <b><u>\$15,932.3</u></b>                     |

SOURCE: Executive Office for Administration and Finance.

(1) Figures are preliminary.

(2) Totals may not add due to rounding.

The year-to-date tax revenue increase of approximately \$1.307 billion through February, 2018 from the same period in fiscal 2017 is attributable, in large part, to an increase of approximately \$434.0 million, or 5.5%, in withholding collections, an increase of approximately \$655.9 million, or 40.4%, in income tax estimated payments, an increase of approximately \$60.4 million, or 18.3%, in income tax payments with bills and returns, an increase of approximately \$32.7 million, or 3.0%, in corporate and business tax collections, an increase of approximately \$147.1 million, or 3.5%, in sales and use tax collections, and a net increase of approximately \$46.8 million, or 3.2%, in all other taxes, which were partly offset by an increase of approximately \$69.7 million, or 9.5%, in income tax cash refunds. Year-to-date collections from one-time tax related settlements and judgments exceeding \$10 million each totaled \$11.0 million. Excluding these payments, year-to-date fiscal 2018 tax collections through February, 2018 were approximately \$725 million above the year-to-date benchmark associated with the revised fiscal 2018 tax revenue estimate of \$26.661 billion.

A provision in the fiscal 2018 budget requires that the Comptroller record in fiscal 2018 on the statutory basis certain sales tax revenues received in July, 2018, that under Massachusetts General Law and the Comptroller’s revenue recognition policy would normally be recorded as fiscal 2019 revenue. The result of this provision is that 13 months of such sales tax revenue will be recorded in fiscal 2018. The Governor’s proposed budget for fiscal 2019 includes a proposal to extend this accounting treatment for two fiscal years. See “COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS – Fiscal Control, Accounting and Reporting Practices of the Comptroller; *Statutory Basis of Accounting.*”

**Federal and Other Non-Tax Revenues**

Federal revenues are collected through reimbursements for the federal share of entitlement programs such as Medicaid and through block grants for programs such as Transitional Assistance to Needy Families (TANF). The amount of federal reimbursements to be received is determined by state expenditures for these programs. The Commonwealth receives reimbursement for approximately 50% of its spending for Medicaid programs. Block grant funding for TANF is received quarterly and is contingent upon a maintenance-of-effort spending level determined annually by the federal government. Federal reimbursements for fiscal 2017 were \$10.858 billion and are projected to be \$11.482 billion in fiscal 2018.

Departmental and other non-tax revenues are derived from a large number of sources, including but not limited to fees and assessments for services, licenses, and reimbursements. For fiscal 2017, departmental and other non-tax revenues were \$4.382 billion. The largest budgeted departmental revenues, assessments and miscellaneous revenues in fiscal 2017 included \$1.259 billion in drug rebates, recoveries and other fees, \$819 million in reimbursements from cities, towns and non-state entities for retiree benefits, \$599 million for Registry of Motor Vehicles fees, fines and assessments, and \$255 million from filing, registration and other fees paid to the Secretary of State’s office. Departmental and other non-tax revenues are projected to be \$4.740 billion in fiscal 2018.

*Lottery Revenues.* For the budgeted operating funds, inter-fund transfers include transfers of net operating revenues from the State Lottery and Gaming Fund and the Arts Lottery Fund and reimbursements for the budgeted costs of the State Lottery Commission, which accounted for transfers from the Lottery of \$1.050 billion, \$1.069

billion, \$1.086 billion, \$1.092 billion, and \$1.136 billion in fiscal 2013 through 2017, respectively. Under state law, the net balance in the State Lottery and Gaming Fund, as determined by the Comptroller on each September 30, December 31, March 31 and June 30, is to be used to fund monthly local aid payments to cities and towns.

The following table shows Lottery revenues and profits for fiscal 2018.

**Fiscal 2018 Monthly Lottery Revenues and Profits (in thousands) (1)**

| <u>Month</u>      | <u>Revenues</u>    | <u>Prizes</u>      | <u>Subtotal<br/>Operating<br/>Expenses</u> | <u>Operating<br/>Revenues</u> | <u>Administrative<br/>Expenses</u> | <u>Net Profit before<br/>Distributions</u> |
|-------------------|--------------------|--------------------|--|-------------------------------|------------------------------------|--|
| July              | \$402,164          | \$278,909          | \$23,114                                   | \$100,141                     | \$3,387                            | \$96,754                                   |
| August            | 514,130            | 369,704            | 29,314                                     | 115,112                       | 6,666                              | 108,447                                    |
| September         | 376,517            | 268,338            | 21,550                                     | 86,629                        | 9,787                              | 76,842                                     |
| October           | 384,068            | 284,551            | 21,941                                     | 77,576                        | 5,317                              | 72,259                                     |
| November          | 483,127            | 354,155            | 27,765                                     | 101,208                       | 5,581                              | 95,626                                     |
| December          | 419,352            | 289,148            | 23,972                                     | 106,231                       | 7,832                              | 98,399                                     |
| January           | 490,545            | 373,314            | 28,251                                     | 88,980                        | 7,746                              | 81,234                                     |
| February          | 403,965            | 306,392            | 23,187                                     | 74,385                        | 5,782                              | 68,603                                     |
| March             | -                  | -                  | -  | -                             | -                                  | -  |
| April             | -                  | -                  | -  | -                             | -                                  | -  |
| May               | -                  | -                  | -  | -                             | -                                  | -  |
| June              | -                  | -                  | -  | -                             | -                                  | -  |
| <b>Total</b>      | <b>\$3,473,868</b> | <b>\$2,524,511</b> | <b>\$199,094</b>                           | <b>\$750,262</b>              | <b>\$52,098</b>                    | <b>\$698,164</b>                           |
| YTD prize accrual | -                  | 25,460             | -  | (25,460)                      | -                                  | (25,460)                                   |
| <b>Adj Totals</b> | <b>\$3,473,868</b> | <b>\$2,549,972</b> | <b>\$199,094</b>                           | <b>\$724,802</b>              | <b>\$52,098</b>                    | <b>\$672,704</b>                           |

Source: State Lottery Commission; Monthly values from the State Lottery Commission Statement of Operations.  
(1) Preliminary and subject to change.

A five-year history of Lottery revenues and profits is shown in the following table as well as current projections for fiscal 2018.

**Lottery Revenues and Profits  
(in thousands)**

| Fiscal Year | Revenues    | Net Operating<br>Revenues | Net Profits |
|-------------|-------------|---------------------------|-------------|
| 2018 (1)    | \$5,163,153 | \$1,070,272               | \$ 968,756  |
| 2017        | 5,097,765   | 1,136,203                 | 1,039,697   |
| 2016        | 5,233,931   | 1,092,130                 | 989,411     |
| 2015        | 5,014,535   | 1,086,469                 | 985,879     |
| 2014        | 4,863,373   | 1,069,958                 | 974,562     |
| 2013        | 4,850,482   | 1,050,128                 | 955,801     |

Source: State Lottery Commission

(1) Fiscal 2018 figures are projected. These numbers are under review and may be adjusted. Minor adjustments to Lottery revenues are reported several times a year based upon trends.

*Tobacco Settlement.* In November, 1998, the Commonwealth joined with other states in a master settlement agreement that resolved the Commonwealth’s and other states’ litigation against the cigarette industry. Under the agreement, cigarette companies have agreed to make both annual payments (in perpetuity) and five initial payments (for calendar 1999 to 2003, inclusive) to the settling states. Each payment amount is subject to applicable adjustments, reductions and offsets, including upward adjustments for inflation and downward adjustments for decreased domestic cigarette sales volume.

The Commonwealth’s allocable share of the base amounts payable under the master settlement agreement is approximately 4.04%, which equals more than \$8.962 billion through fiscal 2024, subject to adjustments, reductions and offsets. However, since fiscal 2006 certain amounts have been withheld from each year’s payments by tobacco manufacturers who claim that because of certain developments they are entitled to reduce such payments under the master settlement agreement. Those withheld amounts ranged from \$21 million to \$35 million to the Commonwealth in the period from 2006 through 2012, inclusive. A smaller amount has been withheld for 2013 through 2016, inclusive. The Commonwealth believes it is due the full amount and is pursuing its claim to unreduced payments. See “LEGAL MATTERS – Other Revenues.” The Commonwealth was also awarded \$414.3 million from a separate Strategic Contribution Fund established under the master settlement agreement to reward certain states’ particular contributions to the national tobacco litigation effort. This additional amount, also subject to a number of adjustments, reductions and offsets, was payable in equal annual installments during the years 2008 through 2017, inclusive. Massachusetts received its final Strategic Contribution Fund payment in April, 2017.

From fiscal 2003 through fiscal 2012, all payments received by the Commonwealth pursuant to the master settlement agreement were deposited in the General Fund. Since fiscal 2012, state law has stipulated that a portion of annual tobacco settlement revenues be deposited into the State Retiree Benefit Trust Fund. See “PENSION AND OPEB FUNDING – Other Post-Employment Benefit Obligations (OPEB).”

The following table sets forth the tobacco settlement amounts received by the Commonwealth to date.

**Payments Received Pursuant to the Tobacco Master Settlement Agreement (in millions) (1)**

| <u>Fiscal Year</u> | <u>Initial Payments</u> | <u>Annual Payments</u> | <u>Total Payments</u> |
|--------------------|-------------------------|------------------------|-----------------------|
| 2000               | \$186.6 (2)             | \$139.6                | \$326.2(2)            |
| 2001               | 78.2                    | 164.2                  | 242.4                 |
| 2002               | 82.8                    | 221.7                  | 304.5                 |
| 2003               | 86.4                    | 213.6                  | 300.0                 |
| 2004               | -                       | 253.6                  | 253.6                 |
| 2005               | -                       | 257.4                  | 257.4                 |
| 2006               | -                       | 236.3                  | 236.3                 |
| 2007               | -                       | 245.4                  | 245.4                 |
| 2008               | -                       | 288.5                  | 288.5                 |
| 2009               | -                       | 315.2                  | 315.2                 |
| 2010               | -                       | 263.7                  | 263.7                 |
| 2011               | -                       | 248.7                  | 248.7                 |
| 2012               | -                       | 253.6                  | 253.6                 |
| 2013               | -                       | 253.5                  | 253.5                 |
| 2014               | -                       | 282.1                  | 282.1                 |
| 2015               | -                       | 245.8                  | 245.8                 |
| 2016               | -                       | 257.6                  | 257.6                 |
| 2017               | -                       | 254.5                  | 254.5                 |
| <b>Total</b>       | <u>\$434.0</u>          | <u>\$4,395.0</u>       | <u>\$4,829.0</u>      |

SOURCE: Office of the Comptroller.

(1) Amounts are approximate. Totals may not add due to rounding.

(2) Payments received for both 1999 and 2000.

*Settlements and Judgments.* State finance law provides that any one-time settlement or judgment amounting to \$10 million or more is to be deposited in the Stabilization Fund to the extent that the total of all such one-time settlements and judgments in a fiscal year exceeds the average of such totals for the five preceding fiscal years. The amount of such one-time settlements and judgments totaled approximately \$133.8 million in fiscal 2013, \$436.5 million in fiscal 2014, \$226.1 million in fiscal 2015, \$155.3 million in fiscal 2016, and \$111.6 million in fiscal 2017. The threshold applicable in fiscal 2018 is \$213 million (average of fiscal 2013 through fiscal 2017).

In fiscal 2013 and fiscal 2014, projected tax-related settlements or judgments exceeding \$10 million were included as part of the consensus revenue estimate. Beginning in fiscal 2015, such settlements or judgments have been counted separately from the consensus revenue estimate in the General Appropriations Act.

On March 2, 2018, the Commissioner of Revenue and the Attorney General certified that the Commonwealth had received \$36.6 million in one-time settlement and judgment payments exceeding \$10 million (\$25.6 million of which were non-tax-related and \$11.0 million tax-related) during the first eight months of fiscal 2018. The next certification, which will be issued in early May, will reflect such one-time settlement and judgment payments received through April 30, 2018. The Executive Office for Administration and Finance estimates that the settlement and judgment payments will be below the fiscal 2018 threshold described above.

*Gaming.* On November 22, 2011, the Governor approved legislation that authorized the licensing of up to three regional resort casinos (one per region) and one slot facility (up to 1,250 slots) in the Commonwealth. The legislation established an appointed, independent state Gaming Commission to oversee the implementation of the law and the regulation of the resultant gaming facilities. The legislation also provided that licensing fees collected by the Gaming Commission are to be applied to a variety of one-time state and local purposes, and gaming revenues received by the Commonwealth are to be applied to various funds created by the legislation. The legislation stipulates that initial licensing fees, which are set by the Gaming Commission, must be at least \$85 million per casino (a “Category 1” license) and \$25 million for the slot facility (a “Category 2” license). According to the Gaming Commission, aggregate state tax revenues from gaming licenses are expected to total approximately \$300 million per year once the facilities are operational.

The Gaming Commission entered into agreements with the Category 1 licensees in two of the three regions, pursuant to which the licensees each received a license effective on November 7, 2014. The \$85 million license fees were paid by each licensee in November, 2014. The facility in Springfield (Region B) is expected to be operational in calendar 2018; the facility in Everett (Region A) is expected to be operational in calendar 2019.

In March, 2016, the Mashpee Wampanoag tribe announced that it would commence construction of a tribal resort casino in the third region (Region C), based upon the assumed power of the U. S. Secretary of the Interior to take land into trust for the tribe. On April 28, 2016, the Gaming Commission voted to deny an application for a Category 1 license in Region C. On July 28, 2016, in the case of *Littlefield v. the U. S. Department of the Interior*, the U. S. District Court held that the Secretary of the Interior lacked the authority to take land into trust for the Mashpee Wampanoag tribe and remanded the matter back to the Secretary of the Interior for further proceedings consistent with the opinion as well as the declaratory judgment entered. The U.S. Bureau of Indian Affairs filed a motion for reconsideration, which was denied by the District Court, and the Mashpee Wampanoag filed a motion to intervene, which was granted. In December, 2016, the U. S. Department of the Interior and the Mashpee Wampanoag each filed a notice of appeal to the U. S. Court of Appeals for the First Circuit. On April 24, 2017, the Mashpee Wampanoag filed an assent to motion to stay briefing pending the revised decision from the Department of the Interior. On May 8, 2017, the Department of the Interior moved to withdraw its appeal. The Department of the Interior has not issued a revised decision, but instead has requested further briefing from the parties. The Mashpee Wampanoag have asked the Court of Appeals to stay the matter further pending a decision from the Department of the Interior, and the Court has agreed to the requested stay. The Gaming Commission will continue to monitor this matter.

The Category 2 slot facility opened on June 24, 2015. In fiscal 2017, the facility generated approximately \$158.3 million in gross gaming revenue, resulting in \$63.4 million in budgetary fund taxes collected by the Commonwealth.

Various municipalities have filed suit contesting certain aspects of the Gaming Commission’s issuance of the Region A Category 1 license. Certain of these claims have been dismissed, either voluntarily or by order of the Superior Court. The Gaming Commission currently is defending the remaining intervenor claim filed by Mohegan Sun and the appeals filed by the City of Revere and the individuals who filed an open meeting law claim as part of the City of Revere litigation. That claim and those appeals were argued before the Supreme Judicial Court in November, 2016. On March 10, 2017, the Supreme Judicial Court issued a decision affirming Mohegan Sun’s intervenor claim, reversing the Superior Court’s dismissal of the open meeting law claim, and remanding the case to the Superior Court for further proceedings. Briefing on Mohegan Sun’s intervenor claim was completed in January,

2018, with arguments before the Superior Court to follow later in 2018. Discovery on the open meeting law claim is continuing. The Gaming Commission is proceeding with its defense of these claims.

On November 14, 2016, the Gaming Commission was sued for tortious interference with respect to the plaintiff's agreement to sell property to the licensee for the Region A Category 1 facility. The plaintiff is requesting damages as determined at trial. On April 7, 2017, the Gaming Commission filed a motion to dismiss the suit, which was granted by the Superior Court on June 7, 2017; however, the plaintiff filed an amended complaint while the Superior Court was in the process of issuing its decision. The Superior Court's decision stands, and the Gaming Commission filed a motion to dismiss the claims in the amended complaint. The Gaming Commission's motion to dismiss was argued in October, 2017. The Superior Court denied the Gaming Commission's motion in part and asked for further briefing on a jurisdictional issue from both parties. In lieu of a briefing on the jurisdictional issue, the case was transferred by agreement of the parties from Suffolk County to Middlesex County. The case is scheduled to be reargued on March 23, 2018. The Gaming Commission is proceeding with its defense of this claim.

In January, 2018, the Gaming Commission instituted an investigation into certain public allegations related to the former chief executive officer of the parent company of the Region A Category I license. This investigation is ongoing.

### Limitations on Tax Revenues

Chapter 62F of the General Laws establishes a state tax revenue growth limit for each fiscal year equal to the average positive rate of growth in total wages and salaries in the Commonwealth, as reported by the federal government, during the three calendar years immediately preceding the end of such fiscal year. The growth limit is used to calculate "allowable state tax revenue" for each fiscal year. Chapter 62F also requires that allowable state tax revenues be reduced by the aggregate amount received by local governmental units from any newly authorized or increased local option taxes or excises. Any excess in state tax revenue collections for a given fiscal year over the prescribed limit, as determined by the State Auditor, is to be applied as a credit against the then-current personal income tax liability of all taxpayers in the Commonwealth in proportion to the personal income tax liability of all taxpayers in the Commonwealth for the immediately preceding tax year. The law does not exclude principal and interest payments on Commonwealth debt obligations from the scope of its tax limit. However, the preamble contained in Chapter 62F provides that "although not specifically required by anything contained in this chapter, it is assumed that from allowable state tax revenues as defined herein the Commonwealth will give priority attention to the funding of state financial assistance to local governmental units, obligations under the state governmental pension systems and payment of principal and interest on debt and other obligations of the Commonwealth."

The following table sets forth the Commonwealth's net state tax revenues and allowable state tax revenues, as defined in Chapter 62F, for fiscal 2013 through fiscal 2017.

|      | <u>Net State Tax Revenues</u> | <u>Allowable State Tax Revenues</u> | <u>Net State Tax Revenues (under)<br/>Allowable State Tax Revenues</u> |
|------|-------------------------------|-------------------------------------|--|
| 2017 | \$26,044,206,400              | \$31,095,184,910                    | (\$5,050,978,510)  |
| 2016 | 25,801,807,368                | 29,477,204,724                      | (3,675,397,356)  |
| 2015 | 25,239,065,862                | 28,071,638,151                      | (2,832,572,289)  |
| 2014 | 23,666,801,084                | 27,048,676,153                      | (3,381,875,070)  |
| 2013 | 22,397,185,749                | 26,074,941,366                      | (3,677,755,617)  |

SOURCES: State Auditor's Office.

## COMMONWEALTH EXPENDITURES

This section contains a description of the major categories of Commonwealth expenditures. All percentages and amounts for fiscal 2018 are projected.

### Local Aid

*Commonwealth Financial Support for Local Governments.* The Commonwealth makes substantial payments to its cities, towns and regional school districts (local aid) to mitigate the impact of local property tax limits on local programs and services. See “Property Tax Limits” below. Local aid payments to cities, towns and regional school districts take the form of both direct and indirect assistance. Direct local aid consists of general revenue sharing funds and specific program funds sent directly to local governments and regional school districts. The Commonwealth’s budget for fiscal 2018 provides \$6.142 billion of state-funded direct and indirect local aid to municipalities.

A large portion of general revenue sharing funds is earmarked for public education and is distributed through a formula designed to ensure that each district reaches at least a minimum level of “foundation” spending per public education pupil. The fiscal 2018 budget includes state funding for so-called “Chapter 70” public education aid of \$4.746 billion. This level of funding brings all school districts to the foundation level, ensures that all local educational authorities receive an increase of funding of at least \$30 per pupil, and is an increase of \$118 million over fiscal 2017.

The other major component of direct local aid is unrestricted general governmental aid, which provides unrestricted funds for municipal use. The fiscal 2018 budget provides for \$1.061 billion in unrestricted general government aid, which was allocated to provide a 3.9% increase over fiscal 2017 levels to all municipalities.

*Property Tax Limits.* In November, 1980, voters in the Commonwealth approved a statewide tax limitation initiative petition, commonly known as Proposition 2½, to constrain levels of property taxation and to limit the charges and fees imposed on cities and towns by certain governmental entities, including county governments. Proposition 2½ is not a provision of the state constitution and accordingly is subject to amendment or repeal by the Legislature. Proposition 2½, as amended to date, limits the property taxes that may be levied by any city or town in any fiscal year to the lesser of (i) 2.5% of the full and fair cash valuation of the real estate and personal property therein or (ii) 2.5% over the previous year’s levy limit plus any growth in the tax base from certain new construction and parcel subdivisions. The law contains certain voter override provisions and, in addition, permits debt service on specific bonds and notes and expenditures for identified capital projects to be excluded from the limits by a majority vote at a general or special municipal election. Between fiscal 1981 and fiscal 2017, the aggregate property tax levy across all cities and towns grew from \$3.347 billion to \$16.355 billion, a compound annual growth rate of 4.38%.

### Medicaid and the Health Connector

Many of the Commonwealth’s healthcare programs and expenditures are governed by the federal Affordable Care Act (ACA), to which strong opposition has been expressed by President Trump, the Secretary of the U. S. Department of Health and Human Services, and legislative leaders in Congress. In December, 2017, Congress eliminated the financial penalty under the ACA’s individual shared responsibility provision, otherwise known as the individual mandate, beginning in 2019. However, Massachusetts has its own state law individual mandate which requires that most adults purchase health insurance. As such, it is unlikely that the congressional action will have significant impact on the Massachusetts insurance market. Further, the removal of the federal individual mandate penalty will not have any direct impact on funding for Commonwealth health programs. While it is not possible to predict with any certainty whether or when any other provisions of the ACA may be, in whole or in part, repealed, withdrawn or modified, any such measures could have a material adverse effect on the Commonwealth’s healthcare programs and expenditures. Accordingly, the following discussion should be read with the understanding that significant additional changes could occur in the near future and beyond with respect to many of the programs discussed. See “FISCAL 2018 AND FISCAL 2019 – Fiscal 2018.”

*MassHealth.* The Commonwealth’s Medicaid program, called MassHealth, provides health care to 1.9 million low-income children and families, low-income adults, disabled individuals and low-income elders. The program, administered by the Office of Medicaid within the Executive Office of Health and Human Services,

generally receives 50% in federal reimbursement on most expenditures for adults, and 88% in federal reimbursement on most expenditures for children’s benefits reimbursable under the Children’s Health Insurance Program (CHIP). On January 22, 2018, CHIP was reauthorized for six years (federal fiscal 2018 – federal fiscal 2023) and, on February 9, 2018, was reauthorized for four additional years (through federal fiscal 2027). For Massachusetts, the CHIP matching rate remains at 88% for federal fiscal 2018 and 2019, then drops to 76.5% in federal fiscal 2020 and 65% for federal fiscal 2021 and beyond. The revenue reduction due to the decreased matching rate relative to state fiscal 2019 is estimated to be \$73 million in state fiscal 2020, \$175 million in state fiscal 2021, \$207 million in state fiscal 2022 and \$214 million in state fiscal 2023 and beyond. Under the ACA, beginning January 1, 2014, MassHealth began receiving enhanced federal reimbursement for spending on the new adult group (generally, childless adults with incomes under 133% of the federal poverty limit). In calendar 2017, the federal reimbursement rate for this group was 86%, and in calendar 2018, the federal reimbursement rate is 90%. The reimbursement rate for this group is scheduled to increase to 93% in calendar 2019, and then to level off at 90% in 2020 and beyond.

The fiscal 2018 budget as approved in July, 2017 includes \$16.2 billion in funding for non-administrative spending for the MassHealth program. The \$16.2 billion included \$15.6 billion in programmatic spending, including costs related to the settlement of a claim against the Commonwealth. See “LEGAL MATTERS – Programs and Services; *Hutchinson et al. v. Patrick et al.*” The \$16.2 billion also included approximately \$639 million to support supplemental payments to providers. The November, 2017 supplemental budget included an additional \$295 million to support fiscal 2017 supplemental payments to providers that were pushed into fiscal 2018 due to timing of federal approval. Therefore, the fiscal 2018 budget now includes \$16.5 billion in funding for non-administrative spending. As of March, 2018, estimated non-administrative spending exceeds the fiscal 2018 budget by \$71.5 million net.

#### **Budgeted Operating Funds Medicaid Expenditures and Enrollment (in millions)**

|   | <u>Fiscal 2013</u> | <u>Fiscal 2014 (1)</u> | <u>Fiscal 2015 (2)</u> | <u>Fiscal 2016</u> | <u>Fiscal 2017</u> | <u>Fiscal 2018 (3)</u> |
|---|--------------------|------------------------|------------------------|--------------------|--------------------|------------------------|
| <b>Medicaid program expenses</b>                      | \$10,799.1         | \$11,900.8             | \$13,681.9             | \$14,851.0         | \$15,251.7         | \$15,673.0             |
| <b>Medicaid administrative expenses</b>               | \$84.6             | \$86.7                 | \$87.3                 | \$93.0             | \$97.3             | \$102.3                |
| <b>Total expenditures (4)</b>                         | \$10,883.7         | \$11,987.5             | \$13,769.2             | \$14,944.0         | \$15,349.0         | \$15,775.3             |
| <b>Annual percentage growth in total expenditures</b> | 3.5%               | 10.1%                  | 14.9%                  | 8.5%               | 2.7%               | 2.8%                   |
| <b>Enrollment (in average member months) (5)</b>      | 1,403,225          | 1,592,050              | 1,907,366              | 1,861,298          | 1,892,195          | 1,853,769              |
| <b>Annual percentage growth in enrollment</b>         | 3.5%               | 13.5%                  | 19.8%                  | (2.4%)             | 1.7%               | (2.0%)                 |

SOURCE: Fiscal 2013-2017 (excluding Medicaid administrative expense and enrollment), Office of the Comptroller; fiscal 2013-2017 (Medicaid administrative expense and enrollment only) and fiscal 2018, Executive Office of Health and Human Services.

(1) Fiscal 2014 figures include spending and enrollment growth for a half year of ACA implementation; enrollment figures include the temporary Medicaid coverage population starting January 1, 2014 through the end of the fiscal year.

(2) Fiscal 2015 figures include spending and enrollment coverage for a full year of ACA implementation; enrollment figures include the temporary Medicaid coverage population through February 23, 2015.

(3) Reflects fiscal 2018 estimated spending as of March, 2018; account restructuring in fiscal 2018 budget shifted spending for the Choices program (\$214 million in fiscal 2017) from MassHealth to Elder Affairs.

(4) Total expenditures exclude supplemental payments to providers.

(5) Enrollment in prior fiscal years changes due to the effects of redeterminations, retroactive eligibility, application verification, and eligibility appeals.

*Commonwealth Health Insurance Connector Authority.* State health care reform legislation enacted in 2006 created the Commonwealth Health Insurance Connector Authority (Health Connector). The Health Connector is governed by a board, of which the Secretary of Health and Human Services is the chairperson and the Secretary of Administration and Finance is also a member, each *ex officio*. Most of the funding to support the Health Connector and its programs is paid out of the Commonwealth Care Trust Fund (CCTF), which is supported by dedicated

revenue sources. The Health Connector is also responsible for policy development relative to the Affordability Schedule and Minimum Credible Coverage rules and public education and outreach, including the ACA-required Navigator program.

The Health Connector administers the Commonwealth's Health Insurance Marketplace under the ACA. As the Commonwealth's Marketplace, the Health Connector offers qualified health plans to individuals and small businesses. Individuals with incomes under 400% of the federal poverty level (FPL) are eligible for federal tax credits, and certain small businesses shopping through the Marketplace had access to small business health care tax credits for two years per employer, which may extend into 2018 as new businesses enroll with the Marketplace. Individuals with incomes between 133% and 300% FPL, as well as certain Aliens with Special Status (AWSS) with incomes between 0% and 300% FPL, have access to additional state and federal subsidies through a program called ConnectorCare. The state provides additional state subsidies via ConnectorCare to ensure that the premiums and point-of-service cost sharing for certain low-income members, after factoring in federal subsidies, are similar to what was available through the Commonwealth Care program.

The fiscal 2018 budget for the Health Connector is expected to be fully funded from dedicated revenues in the CCTF. Total Health Connector gross spending in fiscal 2018 is projected to be \$283.6 million, an increase of \$46.7 million from fiscal 2017 gross spending of \$236.9 million. Fiscal 2018 spending for the Health Connector, net of federal revenue, is projected to be \$177.5 million, an increase of \$24.1 million compared to \$153.4 million in fiscal 2017.

*Federal 1115 MassHealth Demonstration Waiver.* Section 1115 of the Social Security Act gives the U. S. Secretary of Health and Human Services authority to waive provisions of major health and welfare programs, including certain Medicaid requirements, and to allow a state to use federal Medicaid funds in ways that are not otherwise allowed under federal rules. The Commonwealth's 1115 waiver was renewed on November 4, 2016. The renewal consisted of an amendment to the current 1115 waiver, which was effective through June 30, 2017, as well as a five-year waiver extension. This waiver extension is authorized from July 1, 2017 through June 30, 2022. The waiver extension is a \$52.4 billion agreement that supports a restructuring of the MassHealth program and is expected to bring in significant federal investment to support health care delivery system reforms. The agreement also extends eligibility and benefit provisions authorized under the waiver, such as coverage for diversionary behavioral health benefits and for individuals with HIV. The waiver extension includes more than \$29 billion in revenue to the Commonwealth through federal financial participation. Additionally, the waiver extension expands services for substance use disorder treatment.

The 1115 waiver extension also preserves and maintains the stability of the Safety Net Care Pool (SNCP) for the full five years of the waiver period with an \$8 billion authorization. This authorization includes a \$1.8 billion investment of new Delivery System Reform Incentive Program (DSRIP) funding that will support MassHealth's payment reform objectives. The SNCP renews authority for the Health Safety Net program, which makes payments to hospitals and community health centers for providing certain health care services to their low-income patients who are not eligible for health insurance or cannot afford it. Under the new SNCP, supplemental payments for safety net hospitals have been restructured and linked to delivery system reform participation. The number of hospitals eligible for these payments increased from seven in the previous waiver to 14 in the waiver extension. In addition, the SNCP expands authority for federal match to include cost-sharing affordability subsidies and enrollment gap coverage for Health Connector enrollees up to 300% FPL. Lastly, the SNCP establishes non-state public hospital payments and incentive programs for Cambridge Health Alliance, tied to delivery system reform performance.

MassHealth also submitted a request in September, 2017 to amend the 1115 waiver to address rapidly rising prescription drug costs and align coverage for non-disabled adults with commercial plans. The pharmacy-related waiver request, combined with the Governor's fiscal 2019 budget proposal, will allow MassHealth to maximize value for the Commonwealth and maintain robust access to prescription drugs for its members. The Commonwealth's proposal would give MassHealth new tools to negotiate with manufacturers for better drug pricing, while the waiver authority would allow MassHealth, under limited circumstances, to exclude certain drugs from the formulary if there is no agreement with manufacturers or if the drug has no proven clinical efficacy.

The waiver also proposes to transition coverage for non-disabled adults with incomes between 100% and 138% FPL from MassHealth to comprehensive, affordable and comparable coverage through the Health Connector.

The proposed shift, effective January 1, 2019, will allow the Commonwealth to maximize federal subsidies and generate significant revenue while maintaining access to high quality, comprehensive and affordable coverage for members, comparable to what they currently receive through MassHealth.

*Health Care Cost Containment.* The Center for Health Information and Analysis (CHIA) is an independent state agency, funded through an industry assessment, to monitor the Massachusetts health care system through data collection and research and to release reliable information and meaningful analysis to a wide variety of audiences.

The Health Policy Commission (HPC) is an independent agency within, but not subject to the control of, the Executive Office for Administration and Finance. The HPC's mission is to advance a more transparent, accountable, and innovative health care system through independent policy leadership and investment programs, to achieve better health and better care at a lower cost across the Commonwealth. Beginning in fiscal 2017, the HPC is funded through an annual assessment on the health care industry, similar to CHIA's assessment.

As required by statute, the health care cost growth benchmark has been equal to PGSP, or 3.6%, for calendar 2013 to 2017. Each year, the HPC, in collaboration with CHIA, releases a report on the Commonwealth's performance under the benchmark. The 2016 Cost Trends Report provides that total health care expenditures in the Commonwealth grew in 2015 by 4.1% (similar to growth in 2014 of 4.2%). Factors contributing to growth exceeding the benchmark in 2015 included continued growth in prescription drug spending, hospital spending, enrollment shifts, and spending on long-term services and supports. Pursuant to statute, the benchmark in calendar 2018 must be set at PGSP minus a half of a percent, or 3.1%.

The statutory cost growth target from 2018 through 2022 will be equal to the growth rate of PGSP minus 0.5%, and from 2023 on, will be equal to the growth rate of PGSP. However, the HPC and the Legislature have some ability to change those growth targets after 2018.

### Other Health and Human Services

#### Other Health and Human Services - Budgeted Operating Funds (in millions)

| <u>Expenditure Category</u>                       | <u>Fiscal 2013</u> | <u>Fiscal 2014</u> | <u>Fiscal 2015</u> | <u>Fiscal 2016</u> | <u>Fiscal 2017</u> | <u>Fiscal 2018 (1)</u> |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|------------------------|
| Office of Health Services                         |                    |                    |                    |                    |                    |                        |
| Department of Mental Health                       | \$638.1            | \$663.0            | \$682.4            | \$712.5            | \$739.2            | \$776.6                |
| Department of Public Health                       | 507.8              | 547.7              | 518.7              | 525.2              | 553.8              | 610.8                  |
| Division of Healthcare and Finance Policy (2)     | <u>3.6</u>         | <u>0.0</u>         | <u>0.0</u>         | <u>0.0</u>         | <u>0.0</u>         | <u>0.0</u>             |
| <b>Sub Total</b>                                  | \$1,149.6          | \$1,210.7          | \$1,201.2          | \$1,237.7          | \$1,293.0          | \$1,387.4              |
| Office of Children, Youth, and Family Services    |                    |                    |                    |                    |                    |                        |
| Department of Children and Families               | \$748.8            | \$795.5            | \$876.4            | \$920.0            | \$958.9            | \$974.1                |
| Department of Transitional Assistance             | 723.3              | 693.8              | 660.9              | 630.2              | 608.1              | 650.9                  |
| Department of Youth Services                      | 150.8              | 160.6              | 168.3              | 169.2              | 171.7              | 177.4                  |
| Office for Refugees and Immigrants                | <u>0.4</u>         | <u>0.9</u>         | <u>1.1</u>         | <u>1.1</u>         | <u>1.3</u>         | <u>0.4</u>             |
| <b>Sub Total</b>                                  | \$1,623.2          | \$1,650.8          | \$1,706.7          | \$1,720.5          | \$1,740.0          | \$1,802.8              |
| Office of Disabilities and Community Services     |                    |                    |                    |                    |                    |                        |
| Department of Developmental Services              | \$1,352.2          | \$1,466.8          | \$1,678.9          | \$1,735.4          | \$1,813.5          | \$1,877.6              |
| Other (3)   | <u>120.5</u>       | <u>124.1</u>       | <u>129.9</u>       | <u>79.5</u>        | <u>86.0</u>        | <u>77.2</u>            |
| <b>Sub Total</b>                                  | \$1,472.6          | \$1,590.9          | \$1,808.8          | \$1,814.9          | \$1,899.5          | \$1,954.8              |
| Executive Office of Elder Affairs (4)             | \$248.2            | \$260.1            | \$291.7            | \$312.0            | \$308.2            | \$527.2                |
| Executive Office of Health and Human Services (5) | 242.0 (3)          | 254.6              | 278.1              | 283.5              | 295.2              | 308.9                  |
| Department of Veterans' Services (6)              | <u>33.3</u>        | <u>12.6</u>        | <u>14.4</u>        | <u>64.4</u>        | <u>65.5</u>        | <u>68.8</u>            |
| <b>Sub Total</b>                                  | \$523.5            | \$527.2            | \$584.2            | \$659.9            | 668.9              | \$917.0                |
| <b>Budgeted Expenditures and Other Uses</b>       | <b>\$4,768.9</b>   | <b>\$4,979.5</b>   | <b>\$5,300.8</b>   | <b>\$5,433.0</b>   | <b>\$5,601.4</b>   | <b>\$6,062.1</b>       |

SOURCES: Fiscal 2013-2017 Office of the State Comptroller; fiscal 2018, Executive Office for Administration and Finance.

(1) Based on fiscal 2018 estimated spending.

(2) Cost containment legislation enacted in 2012 dissolved the Division and shifted its responsibilities to EHS, MassHealth and CHIA.

- (3) Includes Massachusetts Rehabilitation Commission, Massachusetts Commission for the Blind, Massachusetts Commission for the Deaf and Hard of Hearing, and, prior to fiscal 2016, the Chelsea Soldiers' Home, and the Holyoke Soldiers' Home.
- (4) Account restructuring in fiscal 2018 budget shifted spending for the Choices program from MassHealth to Elder Affairs.
- (5) Includes Medicaid program administration.
- (6) The fiscal 2015 budget transferred the Chelsea Soldiers' Home and the Holyoke Soldiers' Home from the Office of Disabilities and Community Services to Veterans' Services. Fiscal 2016 and later years include the Chelsea Soldiers' Home and the Holyoke Soldiers' Home. Beginning in fiscal 2014, Veterans' Services spending does not include veterans' annuities spending, which is captured under local aid spending.

*Office of Health Services.* The Office of Health Services encompasses programs and services from the Department of Public Health and the Department of Mental Health. Their goal is to promote healthy people, families, communities and environments through coordinated care. The departments work in unison to determine that individuals and families can live and work in their communities self-sufficiently and safely. The following are a few examples of programs and services provided by this office: substance abuse programs, immunization services, early intervention programs, environmental health services, youth violence programs, supportive housing and residential services for the mentally ill of all ages, and emergency and acute hospital services.

*Office of Children, Youth and Family Services.* The Office of Children, Youth and Family Services works to provide services to children and their families through a variety of programs and services. The programs and services are offered through the Department of Children and Families, the Department of Youth Services, the Department of Transitional Assistance, and the Office of Refugees and Immigrants. The collaborative goal of this office is to work to ensure that individuals, children and families are provided with public assistance needed as well as access to programs that will allow for them to be safe and self-sufficient.

The Department of Children and Families (DCF) is charged with protecting children from abuse and neglect, and in partnership with families and communities, ensuring that children are able to grow and thrive in a safe and nurturing environment. DCF serves approximately 47,000 children at any given time, primarily children through age 18, and youth ages 18-22 who are transitioning from DCF custody to independent living. DCF is currently undergoing an agency improvement initiative to implement new programmatic policies, review agency management structure, and strengthen workforce capacity.

Through the Department of Transitional Assistance (DTA), the Commonwealth funds three major programs of public assistance for eligible state residents: Transitional Aid to Families with Dependent Children (TAFDC); Emergency Aid to the Elderly, Disabled and Children; and the State Supplemental Program (SSP) for individuals enrolled in the federal Supplemental Security Income program. In addition, DTA is responsible for administering the entirely federally funded Supplemental Nutrition Assistance Program, as well as other smaller programs that assist DTA clients with completing their education, gaining career skills and finding employment.

*Disabilities and Community Services.* Programs and services provided by the Massachusetts Rehabilitation Commission, the Massachusetts Commission for the Deaf and Hard of Hearing, the Massachusetts Commission for the Blind, and the Department of Developmental Services assist some of the most disadvantaged residents of the Commonwealth. These agencies provide assistance to this population and create public awareness in the citizens of the Commonwealth, as well as promote inter-agency collaboration which attend to the needs of the community, disabled and multi-disabled population. This holistic approach is designed to ensure that those of all ages with disabilities are able to lead functionally equivalent lives despite limitations that they may face.

*Executive Office of Elder Affairs.* The Executive Office of Elder Affairs provides a variety of services and programs to eligible seniors and their families. The office administers supportive and congregate housing programs, regulates assisted living residences, and provides home care and caregiver support services and nutrition programs. Eligibility for services is based largely on age, income, and disability status. The Executive Office of Elder Affairs also administers a state-supported prescription drug program for seniors.

*Department of Veterans' Services.* The Department of Veterans' Services provides a variety of services, programs and benefits to eligible veterans and their families. The Department of Veterans' Services provides outreach services to help eligible veterans enroll in a variety of programs, administers supportive housing and homeless services, and provides approximately 26,000 veterans, veterans' spouses and parents with annuity and benefit payments. The Department also oversees the Chelsea Soldiers' Home and the Holyoke Soldiers' Home, state-owned facilities providing long-term health care and domiciliary services to veterans.

## **Education**

*Executive Office of Education.* The Executive Office of Education encompasses the Department of Early Education and Care, the Department of Elementary and Secondary Education (previously the Department of Education), the Department of Higher Education (previously the Board of Higher Education) and the University of Massachusetts system. The office is committed to advancing actions and initiatives that will improve achievement for all students, close persistent achievement gaps, and to create a 21<sup>st</sup> century public education system that prepares students for higher education, work and life in a world economy and global society.

*Department of Elementary and Secondary Education.* The Department of Elementary and Secondary Education serves the student population from kindergarten through 12<sup>th</sup> grade by providing support for students, educators, schools and districts and by providing state leadership. The Department of Elementary and Secondary Education is governed by the Executive Office of Education and by the Board of Education, which includes 11 members. There are 322 school districts in the Commonwealth, serving over 940,000 students.

*Department of Higher Education.* The Commonwealth's system of higher education includes the five-campus University of Massachusetts, nine state universities and 15 community colleges. The higher education system is coordinated by the Department of Higher Education, which is governed by the Board of Higher Education. Each institution of higher education is governed by a separate board of trustees; the University of Massachusetts has one board that governs its five campuses. The Board of Higher Education nominates, and the Secretary of Education appoints, a Commissioner of Higher Education, who is responsible for carrying out the policies established by the board at the Department of Higher Education.

The operating revenues of each institution consist primarily of state appropriations and of student fees that are set by the board of trustees of each institution. Tuition levels are set by the Board of Higher Education for the state universities and community colleges, while the University of Massachusetts board of trustees sets tuition levels for its campuses. The Massachusetts College of Art and Design, the Massachusetts Maritime Academy, and the University of Massachusetts ("UMass") have authority to retain tuition from all students. The other institutions have authority to retain tuition received from out-of-state students and tuitions from self-supporting programs, such as colleges of continuing education and evening schools. Otherwise, tuition revenue is required to be remitted to the State Treasurer by each institution.

The board of trustees of each institution submits annually audited financial statements to the Comptroller and the Board of Higher Education. The Department of Higher Education prepares annual operating budget requests on behalf of all institutions, which are submitted to the Executive Office of Education and subsequently to the Executive Office for Administration and Finance and to the House and Senate Committees on Ways and Means. The Legislature appropriates funds for the higher education system in the Commonwealth's annual operating budget in various line items for each institution.

*Department of Early Education and Care.* The Department of Early Education and Care (EEC) is the agency responsible for all early education and care services and funding in the Commonwealth, including licensing and oversight of and technical assistance to programs for infants, toddlers, preschoolers, and school age children during out-of-school time; group homes; foster care and adoption placement agencies; and residential schools for children with special needs. EEC also oversees home visiting programs, and community-based family engagement networks that provide literacy and other developmental activities for children and parents in libraries and adult education centers. EEC licenses approximately 9,000 child care programs, residential facilities, and foster care/adoption placement agencies that have the capacity to serve an estimated 230,000 children. EEC supports an average of 53,000 children from low-income or at-risk families to attend family or group child care programs, including referrals from the Commonwealth's Department of Children and Families and Department of Transitional Assistance.

## **Public Safety**

Eleven state agencies fall under the umbrella of the Executive Office of Public Safety and Security. The largest is the Department of Correction, which operates 16 correctional facilities and centers across the Commonwealth. Other public safety agencies include the State Police, the Parole Board, the Department of Fire

Services, the Military Division, the Office of the Chief Medical Examiner, and five other public safety related agencies.

### **Energy and Environmental Affairs**

The Executive Office of Energy and Environmental Affairs is responsible for policy development, environmental law enforcement services, and oversight of agencies and programs. Six state agencies and numerous boards fall under the umbrella of the Executive Office of Energy and Environmental Affairs. The largest is the Department of Conservation and Recreation, which operates public parkland, recreational facilities, watersheds and forests across the Commonwealth. Other environmental agencies include the Department of Agricultural Resources, responsible for the state's agricultural and food safety programs, the Department of Environmental Protection, responsible for clean air, water, recycling and environmental remediation programs, and the Department of Fish and Game, responsible for the management and protection of endangered species, fisheries and habitat. Additional agencies include the Department of Public Utilities, responsible for oversight of electric, gas, water and transportation utilities, and the Department of Energy Resources, responsible for energy planning, management and oversight.

### **Debt Service**

Debt service expenditures relate to general obligation bonds and notes, special obligation bonds and federal grant anticipation notes issued by the Commonwealth. See "LONG-TERM LIABILITIES."

### **Employee Benefits**

*Group Insurance.* The Group Insurance Commission (GIC) provides health insurance benefits to more than 440,000 people, including state and participating municipalities' employees, retirees, their spouses, and dependents, and certain retired municipal teachers, their spouses and dependents. State employee contributions are currently based on date of hire; employees hired on or before June 30, 2003 contribute 20% of total premium costs, and employees hired after June 30, 2003 contribute 25% of premium costs. Similarly, state retirees contribute either 10%, 15% or 20%, depending on their retirement date. The GIC also provides health insurance benefits for the employees and retirees of participating municipalities; the municipalities reimburse the state for their enrollees' premium costs. The contribution ratio(s) for municipal enrollees is set through a collective bargaining process within each community. As of July 1, 2017, the GIC provides health insurance to employees and retirees of 56 municipal entities: 11 cities, 34 towns, eight regional school districts, two regional districts and one educational collaborative.

Fiscal 2018 GIC appropriations total \$1.750 billion, approximately \$610 million of which are offset by municipal revenue and \$210 million of which are offset by non-state agency revenue to reimburse the state for providing health insurance benefits to the participating governmental units, including municipalities. In addition, the fiscal 2018 budget authorizes transfers of up to \$432 million to the State Retiree Benefits Trust Fund for the purpose of making expenditures for current state retirees and their dependents.

In keeping with the GIC's commitment to cost containment, the GIC approved a package of benefit changes effective in fiscal 2018 that is designed to encourage greater use of primary care physicians in lower-cost provider systems and to lower the utilization of higher-cost services (the highest-cost hospitals, physician groups and prescription drugs). The average fiscal 2018 premium rates for GIC state and municipal members are projected to increase by 3.7% over fiscal 2017.

*Pensions.* The Commonwealth is responsible for the payment of pension benefits for Commonwealth employees and for teachers of the cities, towns and regional school districts throughout the state. See "PENSION AND OPEB FUNDING."

*Other Post-Employment Benefit Obligations (OPEB).* The Commonwealth is required under state law to provide certain health care and life insurance benefits for retired employees of the Commonwealth and certain other governmental agencies. See "PENSION AND OPEB FUNDING – Other Post-Employment Benefit Obligations (OPEB)."

The fiscal 2018 budget is consistent with Government Accounting Standards Board (GASB) Statement No. 45 and the state's intent to account separately for spending for current retirees with deposits towards the Commonwealth's non-pension retiree liability.

### **Other Program Expenditures**

The remaining expenditures on other programs and services for state government include constitutional officers, the judiciary and district attorneys, sheriffs, the Executive Office for Administration and Finance, the Executive Office for Housing and Economic Development, the Executive Office of Labor and Workforce Development, the Executive Office of Technology Services and Security, and various other programs.

## **SELECTED FINANCIAL DATA**

The table below in this section presents combined revenues and expenditures in the budgeted operating funds. The measurement of revenues for the budgeted operating funds is on a statutory basis and differs from governmental revenues on a GAAP basis. See "Statutory Basis Distribution of Budgetary Revenues and Expenditures" and "GAAP Basis" below.

### **Statutory Basis Distribution of Budgetary Revenues and Expenditures**

The revenues and expenditures of the budgeted operating funds presented in the following table are derived from the Commonwealth's statutory basis financial statements for fiscal 2013 through 2017. Projections for fiscal 2018 have been prepared by the Executive Office for Administration and Finance.

The following table sets forth the Commonwealth's budgeted operating funds revenues and expenditures for fiscal 2013 through fiscal 2017 and projected revenues and expenditures for fiscal 2018. Projected revenues and expenditures for fiscal 2018 are based on the fiscal 2018 budget and on (i) the Executive Office for Administration and Finance's most recent estimate of tax revenue (as officially issued) and non-tax revenue, (ii) enacted appropriations adjusted for projected reversions, and (iii) other spending the Executive Office for Administration and Finance reasonably projects. See "FISCAL 2018 AND FISCAL 2019."

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**Budgeted Operating Funds – Statutory Basis (in millions) (1)**

|  | <u>Fiscal 2013</u>       | <u>Fiscal 2014 (2)</u>   | <u>Fiscal 2015</u>       | <u>Fiscal 2016</u>       | <u>Fiscal 2017</u>       | <u>Projected<br/>Fiscal 2018</u> |
|--|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|----------------------------------|
| <u>Beginning Fund Balances</u>   |                          |                          |                          |                          |                          |                                  |
| Reserved or Designated   | \$170.4                  | \$297.1                  | \$190.0                  | \$226.0                  | \$126.0                  | \$117.3                          |
| Stabilization Fund   | 1,652.1                  | 1,556.7                  | 1,248.4                  | 1,252.4                  | 1,291.5                  | 1,300.7                          |
| Undesignated   | <u>167.2</u>             | <u>20.6</u>              | <u>12.1</u>              | <u>92.3</u>              | <u>64.5</u>              | <u>29.7</u>                      |
| <b>Total</b>   | <b><u>\$1,989.7</u></b>  | <b><u>\$1,874.4</u></b>  | <b><u>\$1,450.5</u></b>  | <b><u>\$1,570.7</u></b>  | <b><u>\$1,482.0</u></b>  | <b><u>\$1,447.7</u></b>          |
| <u>Revenues and Other Sources</u>  |                          |                          |                          |                          |                          |                                  |
| Alcoholic Beverages  | 76.3                     | 78.8                     | 80.8                     | 83.4                     | 85.4                     | 86.2                             |
| Banks  | 78.0                     | 135.8                    | 51.9                     | 23.5                     | (0.1)                    | 0.2                              |
| Cigarettes   | 440.1                    | 520.7                    | 510.3                    | 505.6                    | 490.3                    | 487.2                            |
| Corporations   | 1,821.9                  | 2,049.1                  | 2,172.1                  | 2,312.0                  | 2,196.7                  | 2,107.0                          |
| Deeds  | 188.9                    | 223.1                    | 238.3                    | 281.9                    | 297.2                    | 308.5                            |
| Income   | 12,830.9                 | 13,201.6                 | 14,448.7                 | 14,393.7                 | 14,683.7                 | 15,473.1                         |
| Inheritance and Estate   | 313.4                    | 401.5                    | 340.9                    | 399.4                    | 336.6                    | 332.1                            |
| Insurance  | 426.0                    | 368.1                    | 391.4                    | 429.6                    | 421.9                    | 431.6                            |
| Motor Fuel   | 651.6                    | 732.2                    | 756.1                    | 766.6                    | 769.4                    | 766.8                            |
| Public Utilities (3)   | (11.5)                   | 9.8                      | 3.4                      | (1.6)                    | (0.1)                    | -                                |
| Room Occupancy   | 129.2                    | 138.3                    | 150.7                    | 162.2                    | 156.7                    | 164.1                            |
| Sales:   |                          |                          |                          |                          |                          |                                  |
| Regular  | 3,595.9                  | 3,810.6                  | 3,986.6                  | 4,156.9                  | 4,226.1                  | 4,446.7                          |
| Meals  | 901.2                    | 948.9                    | 998.8                    | 1,063.8                  | 1,132.5                  | 1,181.1                          |
| Motor Vehicles   | <u>666.9</u>             | <u>736.4</u>             | <u>789.1</u>             | <u>833.9</u>             | <u>852.5</u>             | <u>844.4</u>                     |
| Sub-Total-Sales  | 5,163.9                  | 5,495.9                  | 5,774.4                  | 6,054.6                  | 6,211.1                  | 6,472.3                          |
| Miscellaneous  | 14.2                     | 15.1                     | 12.8                     | 13.6                     | 12.9                     | 31.9                             |
| Settlements and Judgments (4)  | -                        | -                        | -                        | -                        | -                        | 100.0                            |
| <b>Total Tax Revenues (5)</b>  | <b><u>\$22,123.0</u></b> | <b><u>\$23,370.0</u></b> | <b><u>\$24,932.2</u></b> | <b><u>\$25,424.5</u></b> | <b><u>\$25,661.7</u></b> | <b><u>\$26,761.0</u></b>         |
| MBTA Transfer (6)  | (786.9)                  | (799.3)                  | (970.6)                  | (986.2)                  | (992.2)                  | (1,006.8)                        |
| MSBA Transfer  | (682.0)                  | (727.5)                  | (764.1)                  | (798.5)                  | (816.8)                  | (846.6)                          |
| Workforce Training Fund<br>Transfer (7)                                  | (22.2)                   | (21.2)                   | (23.6)                   | (22.8)                   | (24.4)                   | (24.5)                           |
| <b>Total Budgeted Operating<br/>Tax Revenues</b>                         | <b><u>\$20,631.9</u></b> | <b><u>\$21,822.0</u></b> | <b><u>\$23,173.8</u></b> | <b><u>\$23,616.9</u></b> | <b><u>\$23,828.3</u></b> | <b><u>\$24,883.1</u></b>         |
| Federal Reimbursements   | 8,228.4                  | 8,372.1                  | 9,480.4                  | 10,642.7                 | 10,857.8                 | 11,481.8                         |
| Departmental and Other<br>Revenues                                       | 3,370.5                  | 3,712.4                  | 3,852.8                  | 4,257.2                  | 4,382.1                  | 4,740.2                          |
| Inter-fund Transfers from<br>Non-budgeted Funds and<br>other sources (8) | <u>1,548.1</u>           | <u>1,555.2</u>           | <u>1,729.5</u>           | <u>1,848.7</u>           | <u>2,099.1</u>           | <u>1,856.4</u>                   |
| <b>Budgeted Revenues and<br/>Other Sources</b>                           | <b><u>\$33,778.9</u></b> | <b><u>\$35,461.7</u></b> | <b><u>\$38,236.5</u></b> | <b><u>\$40,365.5</u></b> | <b><u>\$41,167.3</u></b> | <b><u>\$42,961.5</u></b>         |
| Inter-fund Transfers   | <u>1,456.6</u>           | <u>1,757.0</u>           | <u>735.4</u>             | <u>472.9</u>             | <u>617.4</u>             | <u>663.2</u>                     |
| <b>Total Budgeted Revenues<br/>and Other Sources</b>                     | <b><u>\$35,235.5</u></b> | <b><u>\$37,218.7</u></b> | <b><u>\$38,971.9</u></b> | <b><u>\$40,838.4</u></b> | <b><u>\$41,784.7</u></b> | <b><u>\$43,624.8</u></b>         |
| <u>Expenditures and Uses</u>   |                          |                          |                          |                          |                          |                                  |
| Direct Local Aid   | 5,115.7                  | 5,292.5                  | 5,420.4                  | 5,567.7                  | 5,703.0                  | 5,890.4                          |
| Medicaid   | 10,799.7                 | 11,900.8                 | 13,655.2                 | 14,851.0                 | 15,251.7                 | 15,673.0                         |
| Other Health and Human<br>Services                                       | 4,768.9                  | 4,979.5                  | 5,300.8                  | 5,433.0                  | 5,601.4                  | 6,062.1                          |
| Group Insurance  | 1,278.5                  | 1,402.9                  | 1,665.1                  | 1,629.7                  | 1,662.5                  | 1,729.1                          |
| Department of Elementary and<br>Secondary Education                      | 489.2                    | 515.3                    | 514.9                    | 539.3                    | 523.2                    | 541.6                            |
| Higher Education   | 990.8                    | 1,091.5                  | 1,161.6                  | 1,194.3                  | 1,168.3                  | 1,177.5                          |
| Department of Early<br>Education and Care                                | 483.4                    | 509.6                    | 537.7                    | 547.6                    | 540.0                    | 586.0                            |
| Public Safety  | 960.0                    | 1,010.4                  | 1,040.7                  | 1,065.6                  | 1,059.6                  | 1,120.4                          |
| Energy and Environmental<br>Affairs                                      | 201.8                    | 215.0                    | 225.0                    | 221.4                    | 222.1                    | 238.7                            |

|   | <u>Fiscal 2013</u>       | <u>Fiscal 2014 (2)</u>   | <u>Fiscal 2015</u>       | <u>Fiscal 2016</u>       | <u>Fiscal 2017</u>       | <u>Projected<br/>Fiscal 2018</u> |
|---|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|----------------------------------|
| Debt Service  | 2,117.2                  | 2,122.0                  | 2,190.4                  | 2,174.3                  | 2,284.7 (9)              | 2,415.0                          |
| Post -Employment Benefits (10)  | 1,967.0                  | 2,050.4                  | 2,213.4                  | 2,503.4                  | 2,659.7                  | 2,852.0                          |
| Other Program Expenditures  | 3,006.7                  | 3,293.7                  | 3,113.1                  | 3,240.7                  | 3,235.0                  | 3,247.5                          |
| <b>Total - Programs and Services before transfers to Non-budgeted funds</b>               | <b><u>\$32,178.7</u></b> | <b><u>\$34,383.6</u></b> | <b><u>\$37,038.3</u></b> | <b><u>\$38,968.0</u></b> | <b><u>\$39,911.2</u></b> | <b><u>\$41,533.5</u></b>         |
| <u>Inter-fund Transfers to Non-budgeted Funds</u>   |                          |                          |                          |                          |                          |                                  |
| Commonwealth Care Trust Fund (11)   | 661.2                    | 390.1                    | -                        | -                        | -                        | -                                |
| Medical Assistance Trust Fund   | 390.9                    | 395.0                    | 71.0                     | 665.6                    | 403.4                    | 747.1                            |
| Massachusetts Transportation Trust Fund   | 161.7                    | 270.1                    | 588.6                    | 566.8                    | 484.7                    | 478.5                            |
| Other   | 501.8                    | 446.7                    | 418.4                    | 253.8                    | 402.3                    | 297.1                            |
| <b>Total Inter-Fund Transfers to Non-Budgeted Funds</b>                                   | <b><u>\$1,715.6</u></b>  | <b><u>\$1,501.9</u></b>  | <b><u>\$1,078.0</u></b>  | <b><u>\$1,486.2</u></b>  | <b><u>\$1,290.4</u></b>  | <b><u>\$1,522.7</u></b>          |
| <b>Budgeted Expenditures and Other Uses</b>   | <b><u>\$33,894.3</u></b> | <b><u>\$35,885.5</u></b> | <b><u>\$38,116.3</u></b> | <b><u>\$40,454.2</u></b> | <b><u>\$41,201.6</u></b> | <b><u>\$43,056.1</u></b>         |
| Inter-fund Transfers  | 1,456.6                  | 1,757.0                  | 735.4                    | 472.9                    | 617.4                    | 663.2                            |
| <b>Total Budgeted Expenditures and Other Uses</b>   | <b><u>\$35,350.9</u></b> | <b><u>\$37,642.5</u></b> | <b><u>\$38,851.7</u></b> | <b><u>\$40,927.1</u></b> | <b><u>\$41,819.0</u></b> | <b><u>\$43,719.3</u></b>         |
| <b>Excess (Deficiency) of Revenues and Other Sources Over Expenditures and Other Uses</b> | <b><u>(\$115.4)</u></b>  | <b><u>(\$423.8)</u></b>  | <b><u>\$120.2</u></b>    | <b><u>(\$88.7)</u></b>   | <b><u>(\$34.3)</u></b>   | <b><u>(\$94.6)</u></b>           |
| <u>Ending Fund Balances</u>   |                          |                          |                          |                          |                          |                                  |
| Reserved or Designated (12)   | 297.1                    | 190.0                    | 226.0                    | 126.0                    | 117.3                    | 67.0                             |
| Stabilization Fund  | 1,556.7                  | 1,248.4                  | 1,252.4                  | 1,291.5                  | 1,300.7                  | 1,366.9                          |
| Undesignated (13)   | 20.6                     | 12.1                     | 92.3                     | 64.5                     | 29.7                     | (80.7)                           |
| <b>Total</b>  | <b><u>\$1,874.4</u></b>  | <b><u>\$1,450.5</u></b>  | <b><u>\$1,570.7</u></b>  | <b><u>\$1,482.0</u></b>  | <b><u>\$1,447.7</u></b>  | <b><u>\$1,353.2</u></b>          |

SOURCES: Fiscal 2013-2017, Office of the Comptroller; fiscal 2018, Executive Office for Administration and Finance.

- (1) Totals may not add due to rounding.
- (2) Some fiscal 2014 amounts were reclassified to conform to the fiscal 2015 presentation in the Statutory Basis Financial Report.
- (3) Prior to January 1, 2014, public utility corporations were subject to an excise tax of 6.5% on net income. Legislation enacted in 2013 repealed the separate excise tax for utility corporations, which are now subject to the corporate excise imposed on business corporations.
- (4) For fiscal 2013 through 2017, tax and non-tax revenue from judgments and settlements in excess of \$10 million is included in specific tax and non-tax revenue categories. See "COMMONWEALTH REVENUES – Federal and Other Non-Tax Revenues; *Settlements and Judgments*."
- (5) The total tax revenues for fiscal 2018 reflect the level projected in the fiscal 2018 budget, and the Executive Office for Administration and Finance current estimate of tax-related settlements and judgments.
- (6) Beginning in fiscal 2015, the annual amount of sales tax receipts statutorily credited to the MBTA was increased by \$160 million. See "COMMONWEALTH REVENUES AND EXPENDITURES – State Taxes; *Sales and Use Tax*."
- (7) The Workforce Training Fund is not subject to annual appropriation, and the employer contributions are deposited directly in the Workforce Training Fund after their collection.
- (8) Inter-fund Transfers from Non-budgeted Funds and Other Sources include profits from the State Lottery, abandoned property proceeds and other inter-fund transfers.
- (9) Fiscal 2016 budgeted Debt Service excluded \$113 million in payments made from a non-budgeted fund that was made from budgeted funds in other years.
- (10) Fiscal 2016 and fiscal 2017 Post-Employment Benefits include all budgeted pension transfers and transfers to the State Retiree Benefit Trust Fund (SRBTF). Fiscal 2013 through 2015 Post-Employment Benefits include all budgeted pension transfers and transfers to the SRBTF, excluding transfers to the SRBTF equivalent to a specified percentage of tobacco settlement payments of approximately \$25 million in fiscal 2013, \$56 million in fiscal 2014, and \$73 million in fiscal 2015. In fiscal 2018, Post-Employment Benefits includes a transfer to the SRBTF equivalent to 10% of tobacco settlement revenue (approximately \$25 million) paid out of debt service reversions. See "PENSION AND OPEB FUNDING – Other Post-Employment Benefit Obligations (OPEB)."
- (11) The fiscal 2016 and later budgets do not include appropriations of funding for the Health Connector because they assume that increased dedicated revenues in the CCTF, federal grants and self-generated revenues will be able to cover the full program and administrative costs.
- (12) Consists largely of appropriations authorized to be expended in the following year.

- (13) The Executive Office for Administration and Finance will continue to monitor revenues and spending and implement measures as necessary to ensure that the Commonwealth's budget for fiscal 2018 will achieve statutory balance.

### **Stabilization Fund**

The Stabilization Fund is established by state finance law as a reserve of surplus revenues to be used for the purposes of covering revenue shortfalls, covering state or local losses of federal funds or for any event which threatens the health, safety or welfare of the people or the fiscal stability of the Commonwealth or any of its political subdivisions. The fund is sometimes referred to as the state's "rainy day fund," serving as a source of financial support for the state budget in times of slow or declining revenue growth and as the primary source of protection against having to make drastic cuts in state services in periods of economic downturns.

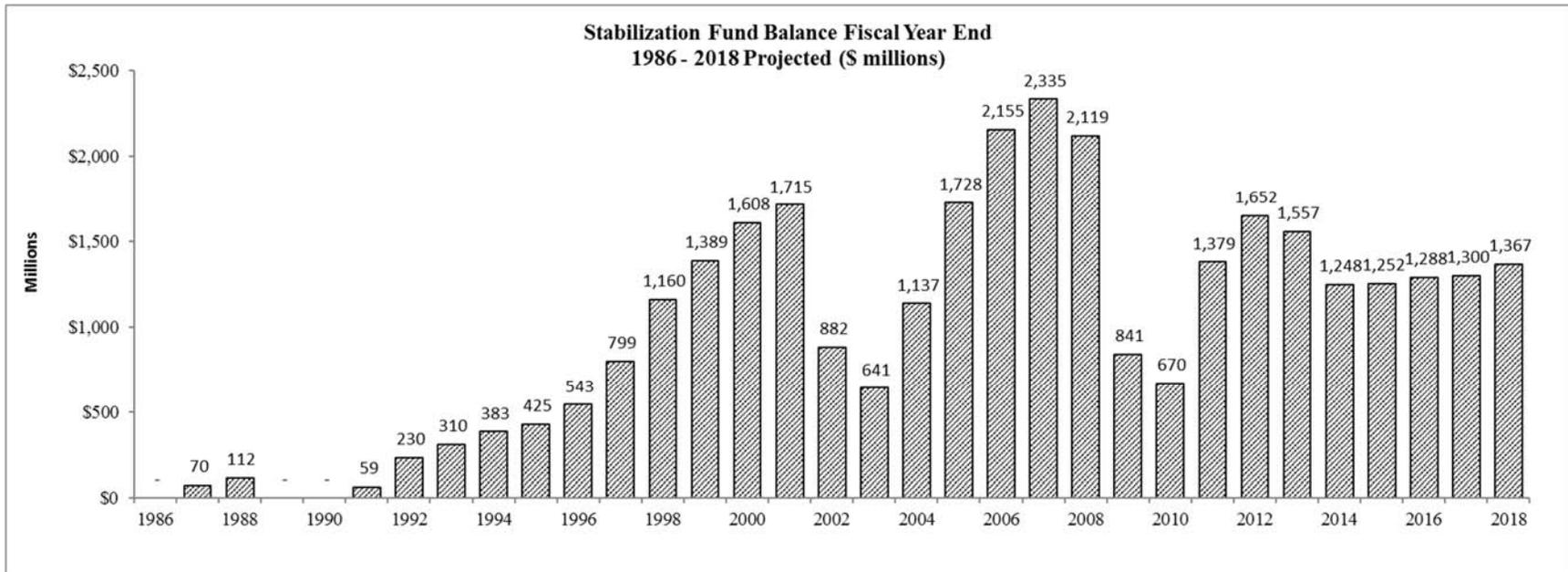
*Required Deposits and Allowable Stabilization Fund Balance.* From fiscal 2005 through fiscal 2013, state finance law provided that (i) 0.5% of current year net tax revenues from each fiscal year be deposited into the Stabilization Fund at fiscal year-end, (ii) 0.5% of current-year net tax revenues be made available for the next fiscal year and (iii) any remaining amount of the year-end surplus be transferred to the Stabilization Fund. Since fiscal 2014, state finance law has required that the entire year-end surplus be transferred to the Stabilization Fund. Since fiscal 2011, state finance law has required that tax revenue from capital gains exceeding \$1 billion in a fiscal year (adjusted annually, beginning in fiscal 2014, for U. S. gross domestic product growth) be deposited into the Stabilization Fund, with 5% of such amount to be transferred to the State Retiree Benefits Trust Fund and, beginning in fiscal 2013, with an additional 5% of such amount to be transferred to the Commonwealth's Pension Liability Fund. However, all of these requirements may be modified or superseded by individual appropriation acts. Legislative enactments in 2015 retained all fiscal 2015 and fiscal 2016 capital gains tax revenues in the General Fund. The fiscal 2017 budget required the Comptroller to transfer all capital gains tax collections that were above \$1.278 billion to the Stabilization Fund in fiscal 2017; however, capital gains tax collections for fiscal 2017 did not exceed this amount.

State finance law requires the Comptroller to transfer 75% of the growth in unclaimed property revenue relative to the prior year to the Stabilization Fund; however, in fiscal 2017, there was no growth in such revenue and therefore no transfer was made to the Stabilization Fund.

The allowable Stabilization Fund balance at fiscal year-end is 15% of total revenues for that year. If the Stabilization Fund balance exceeds the allowable limit, the excess amounts are to be transferred to the Tax Reduction Fund.

The following chart shows the Stabilization Fund balance from fiscal 1986 through fiscal 2017 (actual) and fiscal 2018 (projected).

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SOURCE: Fiscal 1986-fiscal 2017, Office of the Comptroller; fiscal 2018 (projected), Executive Office for Administration and Finance.

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The following table shows the sources and uses of the Stabilization Fund during fiscal 2013 through fiscal 2017:

**Stabilization Fund Sources and Uses (in thousands)**

|   | <b>Fiscal<br/>2013</b>    | <b>Fiscal<br/>2014</b>    | <b>Fiscal<br/>2015</b>    | <b>Fiscal<br/>2016</b>    | <b>Fiscal<br/>2017</b>    |
|---|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Beginning fund balances   | \$1,652,118               | \$1,556,657               | \$1,248,435               | \$1,252,429               | \$1,291,514               |
| <b>Revenues and Other Sources</b>   |                           |                           |                           |                           |                           |
| Deposit of the remaining consolidated net surplus   | -                         | -                         | 123,507                   | -                         | -                         |
| Deposits made directly during fiscal year   | -                         | -                         | 20,000 (1)                | 27,100 (2)                | -                         |
| Capital gains tax transfers in excess of \$1 billion                                      | 467,500                   | 45,457                    | -                         | -                         | -                         |
| Deposits due to judgments and settlements in excess of \$10 million                       | 32,498                    | 414,310                   | -                         | -                         | -                         |
| Lottery transfer taxes  | 1,291                     | 867                       | 647                       | 744                       | 377                       |
| Investment income   | 5,322                     | 7,259                     | 4,646                     | 11,241                    | 8,787                     |
| Excess permissible tax revenue  | -                         | -                         | -                         | -                         | -                         |
| <b>Total Revenues and Other Sources</b>   | <b><u>506,611</u></b>     | <b><u>467,893</u></b>     | <b><u>148,800</u></b>     | <b><u>39,085</u></b>      | <b><u>9,164</u></b>       |
| <b>Total Expenditures and Other Uses</b>  |                           |                           |                           |                           |                           |
|   | <b><u>602,072</u></b>     | <b><u>776,115</u></b>     | <b><u>144,806</u></b>     | -                         | -                         |
| <b>Excess (Deficiency) of Revenues and Other Sources Over Expenditures and Other Uses</b> | <b><u>(95,461)</u></b>    | <b><u>(308,222)</u></b>   | <b><u>3,994</u></b>       | <b><u>39,085</u></b>      | <b><u>9,164</u></b>       |
| <b>Ending fund balances</b>   | <b><u>\$1,556,657</u></b> | <b><u>\$1,248,435</u></b> | <b><u>\$1,252,429</u></b> | <b><u>\$1,291,514</u></b> | <b><u>\$1,300,678</u></b> |
| <b>Allowable Stabilization Fund Balance</b>   | <b><u>\$5,066,844</u></b> | <b><u>\$5,320,973</u></b> | <b><u>\$5,735,471</u></b> | <b><u>\$6,047,764</u></b> | <b><u>\$6,175,099</u></b> |

SOURCE: Office of the Comptroller.

(1) Represents repayment of Massachusetts Gaming Commission start-up funds.

(2) Represents transfer equal to 75% of the growth in abandoned property receipts from the prior fiscal year.

**GAAP Basis**

The Commonwealth's GAAP financial statements for the year ended June 30, 2017, attached as Exhibit C, are prepared in accordance with reporting standards first established by GASB Statements 34 and 35, as amended. See "COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS - Fiscal Control, Accounting and Reporting Practices of the Comptroller." The GAAP financial statements present a government-wide perspective, including debt, capital assets and accrual activity on a comprehensive statement of net position. All capital assets, including road and bridge infrastructure and all long-term liabilities, including outstanding debt and commitments of long-term assistance to municipalities and authorities, are part of the statements. The Commonwealth's statement of revenues, expenditures and changes in fund balances are presented as a statement of activities.

The table below presents the transition from the Commonwealth's statutory basis budgetary fund balance to the "fund perspective" balance, as depicted in the fund financial statements, and then to the Commonwealth's "government-wide" financial position. Differences between statutory and GAAP basis can be summarized in five major adjustments. Those adjustments are for Medicaid (as well as the somewhat related liability for uncompensated care), taxes, projected amounts due to the Commonwealth in the next fiscal year under the master tobacco settlement agreement, claims and judgments, and amounts due to authorities. As evidenced in the trend line of fund balance (deficit) over time, however, these adjustments connect the GAAP basis measurement when viewed using a fund perspective under GAAP and the statutory basis measurement. While the difference in fund balances may vary in a given fiscal year, both balances generally trend in the same direction. To convert to a full accrual basis, major adjustments are made for the net book value of the Commonwealth's capital assets, inclusive of infrastructure, the realizable value of long-term deferred revenues (largely from tax payment plans) and the amount of the Commonwealth's outstanding long-term debt and other liabilities.

**Governmental Funds-Statutory to GAAP-Fund Perspective and to Governmental Net Position  
(in millions)**

|   |                            |
|---|----------------------------|
| <b>Governmental Funds-Statutory Basis, June 30, 2017</b>  |                            |
| Budgeted Fund Balance   | \$1,447.7                  |
| Non-budgeted special revenue fund balance   | 1,891.3                    |
| Capital Projects Fund Balance   | <u>150.6</u>               |
| <b>Governmental Fund Balance-Statutory Basis, June 30, 2017</b>   | <b>\$3,489.6</b>           |
| Plus: Expendable Trust and similar fund statutory balances that are considered governmental funds for GAAP reporting purposes | 640.6                      |
| Less: Massachusetts Department of Transportation Funds  | <u>(1,191.4)</u>           |
| <b>Adjusted Statutory Governmental Fund Balance</b>   | <b>\$2,938.8</b>           |
| Short term accruals, net of allowances and deferrals for increases/(decreases):   |                            |
| Taxes, net of refunds and abatements  | 1,697.3                    |
| Tobacco settlement agreement receivable   | 125.6                      |
| Medicaid  | (559.5)                    |
| Assessments and other receivables   | 213.1                      |
| Amounts due to authorities and municipalities, net  | (606.8)                    |
| Claims, judgments and other risks   | (12.5)                     |
| Amounts due to healthcare providers and insurers  | (43.7)                     |
| Workers' compensation and group insurance   | (154.2)                    |
| Compensated absences  | (11.1)                     |
| Other accruals, net   | <u>297.3</u>               |
| <b>Net increase to governmental funds balances</b>  | <b>\$945.5</b>             |
| Massachusetts School Building Authority fund balance  | <u>1,712.6</u>             |
| <b>Total changes to governmental funds</b>  | <b>\$2,658.1</b>           |
| Governmental fund balance (fund perspective)  | 5,596.9                    |
| Plus: Capital assets including infrastructure, net of accumulated depreciation  | 4,793.1                    |
| Deferred revenue, net of other eliminations   | 655.1                      |
| Long term accruals:   |                            |
| Net pension liability   | (36,941.9)                 |
| Net deferred (inflows)/outflows related to pensions   | 8,002.2                    |
| Post-employment benefits other than pensions cumulative over/(under) funding  | (7,581.0)                  |
| Environmental remediation liability   | (533.1)                    |
| Massachusetts School Building Authority debt and school construction payables   | (7,540.9)                  |
| Long term debt, unamortized premiums and deferred losses on debt refundings   | (28,438.2)                 |
| Compensated absences  | (593.2)                    |
| Capital leases  | (30.9)                     |
| Accrued interest on bonds   | (388.8)                    |
| Other long term liabilities   | <u>(386.3)</u>             |
| <b>Total governmental net position/(deficit) (government-wide perspective)</b>  | <b><u>(\$63,387.0)</u></b> |

SOURCE: Office of the Comptroller

The deficit of \$63.387 billion in government-wide net position can be largely attributed to two factors: first, the Commonwealth's net (or unfunded) pension liability, which, starting in fiscal 2015, has been placed on the Commonwealth's books in accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement required, among other things, the Commonwealth to include the long-term net pension liability on the Government-wide Statement of Net Position. As of June 30, 2017 the Commonwealth reported a net pension liability of approximately \$36.942 billion. Also contributing to the deficit was the Commonwealth's policy decision to finance the construction of assets owned by other governmental entities, particularly Commonwealth roads and bridges, which as a result of transportation reform completed during fiscal 2010 shifted these assets from the books of the Commonwealth to the Massachusetts Department of Transportation (MassDOT), a component unit of the Commonwealth. At the end of fiscal 2017, MassDOT held \$34.944 billion in road, bridge and other transportation-related assets (excluding assets of the MBTA), net of related depreciation, the vast majority of which were formerly held by the Commonwealth. Those assets were financed by the Commonwealth, and the debt remains a long-term obligation of the Commonwealth. In addition, the Commonwealth has a net liability of \$5.743 billion in debt and grant obligations for the school building assistance program that finances construction of schools for the Commonwealth's cities and towns.

### Change in Statement of Net Position

(in thousands)

|                               | <u>Governmental<br/>Activities</u> | <u>Business Type<br/>Activities</u> | <u>Government<br/>Wide</u> |
|-------------------------------|------------------------------------|-------------------------------------|----------------------------|
| <b>Total net position:</b>    |                                    |                                     |                            |
| <b>Fiscal 2016</b>            | (\$58,639,945)                     | \$5,736,165                         | (\$52,903,780)             |
| <b>Fiscal 2017</b>            | (63,387,033)                       | 6,082,464                           | (57,304,569)               |
| <b>Change in net position</b> | <u>(\$4,747,088)</u>               | <u>\$346,299</u>                    | <u>(\$4,400,789)</u>       |

SOURCE: Office of the Comptroller

As of June 30, 2017, approximately \$1.473 billion in restricted net position was set aside for unemployment benefits and approximately \$1.021 billion was restricted for debt retirement.

*Revenues – GAAP Basis.* The measurement of revenues for the budgeted operating funds from a statutory basis differs from governmental revenues on a GAAP basis in that certain funds that are not governmental for statutory purposes are included on a GAAP basis, including revenue accruals for Medicaid and taxes, which are included on a GAAP basis but not on a statutory basis. In addition, internal transfers are eliminated under GAAP on a government-wide perspective. The following table shows the distribution of major sources of revenue in fiscal 2017:

### Comparison of Fiscal 2017 Governmental Revenues (in millions)

|   | <u>Governmental Funds</u> | <u>GAAP Basis – Governmental</u> |  |
|---|---------------------------|----------------------------------|--|
|   | <u>Statutory Basis</u>    | <u>Fund Perspective</u>          | <u>Government-wide<br/>Perspective</u> |
| Taxes                                     | \$26,042                  | \$25,828                         | \$25,950                               |
| Federal Revenue                           | 14,171                    | 15,567                           | 15,578                                 |
| Departmental and<br>Miscellaneous Revenue | <u>21,613</u>             | <u>27,042</u>                    | <u>11,368</u>                          |
| <b>Total</b>                              | <b><u>\$61,826</u></b>    | <b><u>\$68,437</u></b>           | <b><u>\$52,896</u></b>                 |

SOURCE: Office of the Comptroller

The following table provides financial results on a GAAP basis for all governmental funds of the Commonwealth for fiscal 2013 through fiscal 2017.

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**Governmental Fund Operations – GAAP Basis – Fund Perspective (in millions)**

|   | <u>Fiscal 2013</u>      | <u>Fiscal 2014</u>      | <u>Fiscal 2015</u>      | <u>Fiscal 2016</u>      | <u>Fiscal 2017</u>      |
|---|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Beginning fund balances                           | \$6,318.9               | \$4,869.9               | \$4,619.4               | \$5,305.2               | \$5,273.3               |
| Revenues and Financing Sources                    | 55,289.9                | 57,210.0                | 60,658.6                | 67,749.6                | 68,437.1                |
| Expenditures and Financing Uses                   | 56,738.9                | 57,460.5                | 59,972.8                | 67,781.5                | 68,113.5                |
| Excess/(deficit)                                  | <u>(1,449.0)</u>        | <u>(250.5)</u>          | <u>685.8</u>            | <u>(31.9)</u>           | <u>323.6</u>            |
| <b>Ending fund balances—GAAP fund perspective</b> | <b><u>\$4,869.9</u></b> | <b><u>\$4,619.4</u></b> | <b><u>\$5,305.2</u></b> | <b><u>\$5,273.3</u></b> | <b><u>\$5,596.9</u></b> |

SOURCE: Office of the Comptroller.

*Financial Reports.* The Commonwealth issues annual reports, including financial statements on the statutory basis of accounting (reviewed not audited) and the GAAP basis audited financial statements. These financial statements are issued as two separate reports, the Statutory Basis Financial Report (SBFR) and the Comprehensive Annual Financial Report (CAFR). The SBFR is usually published by the Comptroller by October 31 and the CAFR is usually published by the Comptroller by the second Wednesday in January. The SBFR for the year ended June 30, 2017 and the CAFR for the year ended June 30, 2017 are attached hereto as Exhibits B and C, respectively. Copies of these financial reports are also available at the address provided under “CONTINUING DISCLOSURE.” The SBFR for fiscal 1997 through fiscal 2017 and the CAFR for fiscal 1995 through fiscal 2017 are also available on the web site of the Comptroller of the Commonwealth located at <http://www.macomptroller.org> by clicking on “Financial Reports” on the Comptroller’s homepage.

For each year beginning in fiscal 1990, the Commonwealth CAFRs, from which certain information contained in this Information Statement has been derived, have been awarded the Certificate of Achievement for Excellence in Financial Reporting by the Government Finance Officers Association of the United States and Canada (GFOA). The Certificate of Achievement is the highest form of recognition for excellence in state and local government financial reporting. Fiscal 2016 marked the 27th consecutive year that the Commonwealth has received this award. The fiscal 2017 CAFR has been submitted to the GFOA for review.

The Comptroller retains an independent certified public accounting firm to audit the Commonwealth’s financial statements and issue certain other reports required by the Uniform Guidance. As part of the Uniform Guidance, the independent auditors render a report on all programs involving federal funding for compliance with federal and state laws and regulations and assess the adequacy of internal control systems. For fiscal 1990 through 2016 the independent auditors’ opinions were unqualified.

**Discussion of Financial Condition**

As the annual operating budget of the Commonwealth is adopted in accordance with the statutory basis of accounting, public and governmental discourse on the financial affairs of the Commonwealth has traditionally followed the statutory basis. Consequently, the financial information set forth in this document follows the statutory basis, except where otherwise noted. Since fiscal 1990, the Commonwealth has prepared separate financial reports on the statutory basis (reviewed) and on a GAAP basis (audited). See “COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS – Fiscal Control, Accounting and Reporting Practices of the Comptroller; *Financial Reports.*” Without limiting the generality of the references to the SBFR for the year ended June 30, 2017 and the CAFR for the year ended June 30, 2017, attention is called in particular to the portion of the CAFR under the heading “Management’s Discussion and Analysis.”

**Auditors' Report on Fiscal 2017 CAFR**

The basic financial statements included in the CAFR of the Commonwealth for the year ended June 30, 2017 were audited by KPMG LLP (KPMG). The KPMG audit report dated January 10, 2018 on the general purpose financial statements included in the CAFR for the year ended June 30, 2017 contained an unmodified opinion. A copy of the audit report of KPMG dated January 10, 2018 has been filed with EMMA and is included within Exhibit C to this Information Statement. KPMG has not been engaged to perform, and has not performed, since the respective dates of its reports included herein, any procedures on the financial statements addressed in such reports, nor has said independent auditor performed any procedures relating to any official statement of which this Information Statement may be a part.

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## FISCAL 2018 AND FISCAL 2019

### Fiscal 2018

On January 12, 2017, a fiscal 2018 consensus tax revenue estimate of \$27.072 billion was agreed upon by the Secretary of Administration and Finance and the chairs of the House and Senate Committees on Ways and Means. This estimate reflected a projection of 3.9% tax revenue growth over the then-current projected fiscal 2017 tax revenue figure (\$26.056 billion), and also assumed that the state income tax rate would decrease from 5.1% to 5.05% on January 1, 2018, in accordance with the statutory mechanism. Also on January 12, 2017, the Secretary of Administration and Finance filed the triennial funding schedule for the Commonwealth's employee retirement obligations with the House and Senate Committees on Ways and Means, which provides for a fiscal 2018 transfer amount of \$2.394 billion, an increase of \$196 million or 8.9% over the fiscal 2017 transfer amount. See "PENSION AND OPEB FUNDING – Funding Schedule." After accounting for statutorily required transfers for pensions, and to the MBTA, the MSBA and the Workforce Training Fund, the Secretary and Committee chairs agreed that \$22.704 billion would be the maximum amount of tax revenue available for the fiscal 2018 budget. See "COMMONWEALTH REVENUES – Fiscal 2017 and 2018 Tax Revenues; *Fiscal 2018*."

An interim budget of approximately \$5.15 billion for the first month of fiscal 2018 was approved by the Governor on June 26, 2017. The interim budget was superseded by the fiscal 2018 budget when it was approved by the Governor on July 17, 2017.

The fiscal 2018 budget, as approved by the Governor, totaled approximately \$39.4 billion, after accounting for \$193 million in net line-item vetoes, and excluding transfers to the Medical Assistance Trust Fund. The fiscal 2018 budget as approved by the Governor was approximately \$652 million, or 1.7%, greater than fiscal 2017 estimated spending levels at the time of its approval. The fiscal 2018 budget was based on a projection of \$26.504 billion in tax revenue, excluding one-time tax-related settlements and judgments in excess of \$10 million. The fiscal 2018 budget also projected a deposit of \$98.4 million to the Stabilization Fund in fiscal 2018.

Subsequently, the Legislature passed overrides to the Governor's vetoes with an aggregate net budgetary impact of \$118 million. On December 4, 2017, the Governor signed a supplemental appropriation for the Cannabis Control Commission with a budgetary impact of \$2.7 million.

On February 8, 2018, the Governor filed a bill consisting of \$159.5 million in supplemental appropriations, with a net state cost of \$153.8 million, for deficiencies related to routine expenses in the fiscal 2018 budget. Major spending items included \$42.2 million for state sheriffs' offices for costs anticipated since the start of the year, \$25.6 million for Transitional Aid to Families with Dependent Children for costs anticipated since the start of the year as well as later caseload updates, \$19.3 million for Emergency Assistance shelter beds, \$15 million for operating costs of the Massachusetts Health Insurance Exchange, previously funded by the capital budget but now primarily on the operating budget, \$12.1 million in collective bargaining costs, and a variety of other smaller costs.

On February 15, 2018, the Governor approved a supplemental budget for fiscal 2018 including \$17.2 million in supplemental appropriations. The bill consisted primarily of costs associated with the Commonwealth's efforts to assist the residents of Puerto Rico and the United States Virgin Islands as a consequence of Hurricanes Maria and Irma.

On March 2, 2018, the Governor filed a bill consisting of \$5.4 million in supplemental appropriations to fund a ratified collective bargaining agreement, a marijuana-related public awareness campaign and other items.

During calendar 2017, the federal government undertook several attempts to modify, repeal or otherwise change elements of the ACA. The President has undertaken unilateral executive actions that have had adverse impacts on the health insurance marketplace. In December, 2017, Congress eliminated the financial penalty under the ACA's individual shared responsibility provision, otherwise known as the individual mandate; and legislation enacted in February, 2018 both deferred the commencement and accelerated the full implementation of reductions in federal reimbursement for hospitals that treat a disproportionate number of Medicaid recipients. To date, such measures have not had or are not expected to have a material adverse impact on the Commonwealth and its health care programs; however, additional measures have been proposed which, if enacted into law, could have a material

adverse impact on the Commonwealth. The discussions of the Commonwealth's health care programs and services, including the Federal 1115 MassHealth Demonstration Waiver, and their corresponding costs appearing in this Information Statement should be read with the understanding that significant changes could occur in calendar 2018 and beyond affecting the matters discussed. The Executive Office for Administration and Finance, together with the Executive Office of Health and Human Services, continue to monitor federal health care policies. "See "COMMONWEALTH EXPENDITURES – Medicaid and the Health Connector."

On December 22, 2017, President Trump signed into law Public Law 115-97, making major changes to the federal Internal Revenue Code, most of which are effective in the 2018 tax year. The Department of Revenue is in the process of reviewing the implications of the federal changes for the Commonwealth's tax revenues and tax administration. See "COMMONWEALTH REVENUES – State Taxes."

Current estimates indicate that the variance between revenues and spending in fiscal 2018 is less than 0.5%. The Executive Office for Administration and Finance will continue to monitor revenues and spending and implement measures as necessary to ensure that the Commonwealth's budget for fiscal 2018 will achieve statutory balance. See the "Fiscal 2018" column of the table entitled "Budgeted Operating Funds - Statutory Basis" in "SELECTED FINANCIAL DATA – Statutory Basis Distribution of Budgetary Revenues and Expenditures."

### **Fiscal 2019**

On January 12, 2018, a fiscal 2019 consensus tax revenue estimate of \$27.594 billion was agreed upon by the Secretary of Administration and Finance and the chairs of the House and Senate Committees on Ways and Means. This estimate reflects a projection of 3.5% tax revenue growth over projected fiscal 2018 tax revenues (as revised), and also assumes that the state income tax rate will decrease from 5.1% to 5.05% on January 1, 2019, in accordance with the statutory mechanism. After accounting for statutorily required transfers for pensions, the MBTA, the MSBA and the Workforce Training Fund, the Secretary and Committee chairs agreed that \$22.982 billion would be the maximum amount of tax revenue available for the fiscal 2019 budget.

On January 24, 2018, the Governor filed his fiscal 2019 budget recommendation, providing for a total of \$40.904 billion in state spending, excluding \$452 million in projected transfers to the Medical Assistance Trust Fund, which represented an increase of 2.6% over projected fiscal 2018 spending. The budget proposal anticipates a deposit of \$96 million to the Commonwealth Stabilization Fund in fiscal 2019, which, assuming that \$66 million is deposited in the Stabilization Fund in 2018, would produce a fund balance of \$1.463 billion at the end of fiscal 2019.

The Governor's budget recommendation has been filed with the Legislature for consideration in accordance with the Commonwealth's annual budgeting process. The House of Representatives generally approves its version of the budget in late April, and the Senate generally approves its version in late May. The differences between the two versions are then reconciled by a legislative conference committee during the month of June, so that a final version can be enacted by the Legislature and sent to the Governor for his approval prior to the start of the new fiscal year on July 1. It is not unusual for the budget process to extend slightly into the next fiscal year, with final enactment of the budget occurring in early or mid-July. Interim budgets are typically enacted to provide funding after the end of the fiscal year until the full budget can be enacted and approved by the Governor.

### **Cash Flow**

The State Treasurer is responsible for cash management and ensuring that all Commonwealth financial obligations are met on a timely basis. See "COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS – Cash Management Practices of State Treasurer." The Commonwealth does not engage in inter-fund borrowing. Cash flow management incorporates the periodic use of short-term borrowing to meet cash flow needs for both capital and operating expenditures. All revenue anticipation notes, including those issued as commercial paper, must be repaid by the end of the fiscal year. The state currently has liquidity support for a \$400 million commercial paper program for general obligation notes. The Commonwealth has utilized the commercial paper program for additional liquidity, as necessary, since 2002.

The Commonwealth is projected to end fiscal 2018 with a non-segregated cash balance of approximately \$2.510 billion. Fiscal 2019 is projected to end with a non-segregated cash balance of approximately \$2.333 billion.

The fiscal 2018 and fiscal 2019 cash flow statements released on March 9, 2018 are summarized in the table below. Quarterly cash flow statements, as submitted by the State Treasurer to the House and Senate Committees on Ways and Means, are posted on the cash management page of the State Treasurer's website.

Commonwealth cash deposits are held in insured or collateralized bank accounts and with the Massachusetts Municipal Depository Trust (MMDT), the Commonwealth's investment pool for governmental entities. MMDT consists of two portfolios, professionally managed by Federated Investors Inc., the Cash Portfolio and the Short-Term Bond Fund. Cash Portfolio investments are carried at amortized cost, which approximates fair value. Short-Term Bond Fund investments are carried at fair value. General operating cash is invested in the cash portfolio, and moneys in the Stabilization Fund, which are not used by the Commonwealth for liquidity, are invested in both the Cash Portfolio and the Short-Term Bond Fund.

The Cash Portfolio invests in a diversified portfolio of high quality U. S. dollar-denominated money market instruments (eligible under GASB Statement No. 79) of domestic and foreign issuers, United States government securities and repurchase agreements. As of January 31, 2018, the Cash Portfolio holdings were made up of Asset Backed Commercial Paper (40.7%), Certificates of Deposit (23.9%), Financial Company Commercial Paper (17.6%), Non-Negotiable Time Deposits (8.6%), Other Instruments (1.8%), Non-Financial Company Commercial Paper (.6%), Other Asset Back Securities (0.5%), U.S Government Agency Repurchase Agreements (6.0%) and Variable Rate Demand Notes (0.3%). As of February 28, 2018, the Cash Portfolio's monthly weighted average life was 72 days, and the monthly weighted average maturity was 31 days. The three objectives for the Cash Portfolio are safety, liquidity and yield. The Cash Portfolio maintains a stable net asset value of one dollar and is marked to market daily. The Cash Portfolio is fully compliant with GASB 79 as of July 1, 2016.

The Short Term Bond Fund invests in a diversified portfolio of investment grade debt securities. As of January 31, 2018, the Short Term Bond Fund holdings were made up of U. S. Treasury securities (52.9%), Financial Institutions – Banking (5.9%), FHLMC MBS (2.6%), Technology (3.2%), Utility – Electric (3.1%), Consumer Non-Cyclical Pharmaceuticals (2.5%), FNMA MBS (1.3%), Consumer Non-Cyclical Food/Beverage (1.9%), Energy Midstream (1.3%), Consumer Cyclical – Automotive (1.2%) and Other (24.1%). The Short-Term Bond Fund seeks to obtain the highest possible level of current income consistent with preservation of capital and liquidity. The portfolio is required to maintain an average credit rating of A-. The duration of the portfolio is managed to within +/- one-half year duration of the benchmark. The benchmark for the Short-Term Bond Fund is the Barclays Capital 1-to-5-year Government/Credit Index, which includes all medium and larger issues of United States government, investment-grade corporate and investment-grade international dollar-denominated bonds.

For cash flow needs for fiscal 2018, the State Treasurer issued \$1.5 billion in revenue anticipation notes on August 10, 2017. As in previous years, the notes will be repaid in April, May and June 2018.

In May, 2017, the Governor announced the five-year capital investment plan for fiscal 2018 through fiscal 2022. That plan projected \$4.408 billion of spending on capital projects, including \$2.26 billion of bond capital spending, approximately \$351.9 million of special obligation bond spending authorized under the Accelerated Bridge Program and the Rail Enhancement Project, approximately \$1.128 billion in federal reimbursements and grants, approximately \$70.7 million of spending on projects funded by anticipated savings or revenues, approximately \$326.9 million from non-Commonwealth sources such as contributions from campuses, and approximately \$269.7 million in pay-as-you-go capital funded by operating funds, including tolls.

The following table provides General Fund ending cash balances by month for fiscal 2014 through fiscal 2018.

**Month End General Fund Cash Balances (in millions)**

|           | <u>Fiscal 2014</u> | <u>Fiscal 2015</u> | <u>Fiscal 2016</u> | <u>Fiscal 2017</u> | <u>Fiscal 2018</u> |
|-----------|--------------------|--------------------|--------------------|--------------------|--------------------|
| July      | \$ 1,253.7         | \$ 768.9           | \$1,380.2          | \$1,885.9          | \$1,307.3          |
| August    | 1,065.1            | 948.9              | 551.4              | 2,414.1            | 2,273.0            |
| September | 1,918.9            | 1,762.7            | 1,951.6            | 2,670.8            | 2,572.2            |
| October   | 1,744.4            | 1,453.2            | 1,421.0            | 2,437.6            | 2,116.9            |
| November  | 1,272.2            | 1,240.7            | 787.7              | 2,146.4            | 1,875.4            |
| December  | 1,437.6            | 991.5              | 1,029.8            | 1,766.5            | 1,947.9            |
| January   | 1,186.3            | 953.9              | 1,487.5            | 1,835.7            | 2,304.4            |
| February  | 603.2              | 414.1              | 862.0              | 1,432.7            | 2,150.0 (1)        |
| March     | 749.5              | 743.0              | 1,280.0            | 1,332.0            | 2,126.2 (1)        |
| April     | 1,204.6            | 1,860.9            | 2,044.2            | 2,074.6            | 3,164.1 (1)        |
| May       | 703.9              | 1,691.2            | 2,276.6            | 1,647.1            | 2,325.3 (1)        |
| June      | 1,340.8            | 2,140.5            | 2,397.8            | 2,058.0            | 2,509.7 (1)        |

SOURCE: Office of the Treasurer and Receiver-General.

(1) Fiscal 2018 ending balances are estimated for February through June.

The tables on the following pages provide cash flow detail for fiscal 2018 and fiscal 2019.

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**Overview of Fiscal 2018 Non-Segregated Operating Cash Flow (in millions) (1)**

|   | <u>Jul-17</u>    | <u>Aug-17</u>    | <u>Sep -17</u>   | <u>Oct-17</u>    | <u>Nov -17</u>   | <u>Dec-17</u>    | <u>Jan-18</u>    | <u>Feb-18 (2)</u> | <u>Mar-18 (2)</u> | <u>Apr-18 (2)</u> | <u>May-18 (2)</u> | <u>Jun-18 (2)</u> | <b>Total FY<br/>2018 (2)</b> |
|---|------------------|------------------|------------------|------------------|------------------|------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------------------|
| <b>Opening Non-Segregated Operating Cash Balance</b>            | <b>\$2,058.0</b> | <b>\$1,307.3</b> | <b>\$2,273.0</b> | <b>\$2,572.2</b> | <b>\$2,116.9</b> | <b>\$1,875.4</b> | <b>\$1,947.9</b> | <b>\$2,304.4</b>  | <b>\$2,150.0</b>  | <b>\$2,126.2</b>  | <b>\$3,164.1</b>  | <b>\$2,325.3</b>  | <b>\$2,058.0</b>             |
| <b>Operating Activities:</b>                                    |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| Budgetary Funds:  |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| <i>Transfer from/(to) Stabilization Fund</i>                    | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0                          |
| Total Budgetary Revenue/Inflows                                 | 3,443.5          | 3,135.6          | 4,243.8          | 2,884.8          | 3,198.0          | 4,075.2          | 4,593.3          | 3,182.5           | 3,920.6           | 5,340.0           | 3,593.7           | 4,333.3           | 45,944.3                     |
| Total Budgetary Expenditures/Outflows                           | 4,009.6          | 3,802.5          | 3,039.0          | 3,275.4          | 3,335.4          | 3,534.3          | 3,278.3          | 3,725.4           | 3,621.9           | 3,585.2           | 3,374.7           | 3,254.1           | 41,836.1                     |
| Net Budgetary Funds   | (566.1)          | (667.0)          | 1,204.8          | (390.6)          | (137.4)          | 540.9            | 1,315.0          | (542.9)           | 298.7             | 1,754.8           | 219.0             | 1,079.2           | 4,108.2                      |
| Non Budgetary Funds (Non Budgetary, Higher Ed and Trust Funds): |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| Total Non Budgetary Revenue/Inflows                             | 1,037.1          | 1,485.2          | 1,327.0          | 1,089.5          | 945.2            | 890.7            | 348.4            | 1,415.8           | 785.7             | 771.4             | 614.9             | 749.9             | 11,460.8                     |
| Total Non Budgetary Expenditures/Outflows                       | 1,177.4          | 1,281.9          | 2,276.6          | 1,176.6          | 1,206.1          | 1,377.7          | 1,312.8          | 1,058.5           | 1,031.5           | 1,051.0           | 1,173.5           | 1,072.6           | 15,196.2                     |
| Net Non Budgetary Funds   | (140.4)          | 203.3            | (949.5)          | (87.1)           | (260.8)          | (487.1)          | (964.4)          | 357.3             | (245.8)           | (279.6)           | (558.6)           | (322.7)           | (3,735.4)                    |
| Net Undesignated Revenue/Inflows and Expenditures/Outflows      | 3.2              | 18.6             | 5.2              | 6.7              | 6.2              | 6.0              | 7.2              | 1.8               | 1.8               | 1.8               | 1.8               | 1.8               | 62.0                         |
| <b>Net Operating Activities</b>                                 | <b>(\$703.3)</b> | <b>(\$445.1)</b> | <b>\$260.4</b>   | <b>(\$471.0)</b> | <b>(\$392.0)</b> | <b>\$59.8</b>    | <b>\$357.8</b>   | <b>(\$183.8)</b>  | <b>\$54.6</b>     | <b>\$1,477.0</b>  | <b>(\$337.8)</b>  | <b>\$758.3</b>    | <b>\$434.8</b>               |
| <b>Federal Grants:</b>  |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| Total Federal Grants Revenue/Inflows                            | 167.8            | 162.4            | 176.7            | 141.4            | 195.8            | 201.0            | 245.9            | 190.0             | 180.0             | 210.0             | 205.0             | 220.0             | 2,296.0                      |
| Total Federal Grants Expenditures/Outflows                      | 199.2            | 206.5            | 128.8            | 185.0            | 176.3            | 248.7            | 204.8            | 176.0             | 203.0             | 184.0             | 187.0             | 224.0             | 2,323.3                      |
| <b>Net Federal Grants</b>                                       | <b>(\$31.4)</b>  | <b>(\$44.1)</b>  | <b>\$47.9</b>    | <b>(\$43.7)</b>  | <b>\$19.5</b>    | <b>(\$47.7)</b>  | <b>\$41.2</b>    | <b>\$14.0</b>     | <b>(\$23.0)</b>   | <b>\$26.0</b>     | <b>\$18.0</b>     | <b>(\$4.0)</b>    | <b>(\$27.3)</b>              |
| <b>Capital Funds:</b>   |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| Total Capital Revenue/Inflows                                   | 327.2            | 386.7            | 222.2            | 312.4            | 411.6            | 322.7            | 199.9            | 277.4             | 236.6             | 287.0             | 250.7             | 280.9             | 3,515.4                      |
| Total Capital Expenditures/Outflows                             | 343.2            | 431.9            | 231.3            | 253.0            | 280.6            | 262.3            | 242.3            | 262.0             | 292.0             | 245.0             | 262.0             | 342.0             | 3,447.7                      |
| <b>Net Capital Funds</b>  | <b>(\$16.0)</b>  | <b>(\$45.2)</b>  | <b>(\$9.1)</b>   | <b>\$59.4</b>    | <b>\$131.0</b>   | <b>\$60.4</b>    | <b>(\$42.4)</b>  | <b>\$15.4</b>     | <b>(\$55.4)</b>   | <b>\$42.0</b>     | <b>(\$11.3)</b>   | <b>(\$61.1)</b>   | <b>\$67.7</b>                |
| <b>Financing Activities:</b>                                    |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| Cash Flow Financing Activities Inflows:                         |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| <i>Commercial Paper</i>   | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0                          |
| <i>Revenue Anticipation Notes (RANS)</i>                        | 0.0              | 1,500.0          | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 1,500.0                      |
| Total Cash Flow Financing Activities Inflows                    | 0.0              | 1,500.0          | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 1,500.0                      |
| Cash Flow Financing Activities Outflows:                        |                  |                  |                  |                  |                  |                  |                  |                   |                   |                   |                   |                   |                              |
| <i>Commercial Paper – (Principal + Interest)</i>                | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0                          |
| <i>RANS – (Principal + Interest)</i>                            | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 507.0             | 507.8             | 508.7             | 1,523.5                      |
| Total Cash Flow Financing Activities Outflows                   | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0               | 0.0               | 507.0             | 507.8             | 508.7             | 1,523.5                      |
| <b>Net Financing Activities</b>                                 | <b>\$0.0</b>     | <b>\$1,500.0</b> | <b>\$0.0</b>     | <b>\$0.0</b>     | <b>\$0.0</b>     | <b>\$0.0</b>     | <b>\$0.0</b>     | <b>\$0.0</b>      | <b>\$0.0</b>      | <b>(\$507.0)</b>  | <b>(\$507.8)</b>  | <b>(\$508.7)</b>  | <b>(\$23.5)</b>              |
| <b>Ending Non-Segregated Operating Cash Balance</b>             | <b>\$1,307.3</b> | <b>\$2,273.0</b> | <b>\$2,572.2</b> | <b>\$2,116.9</b> | <b>\$1,875.4</b> | <b>\$1,947.9</b> | <b>\$2,304.4</b> | <b>\$2,150.0</b>  | <b>\$2,126.2</b>  | <b>\$3,164.1</b>  | <b>\$2,325.3</b>  | <b>\$2,509.7</b>  | <b>\$2,509.7</b>             |

SOURCE: Office of the Treasurer and Receiver-General.

(1) Totals may not add due to rounding.

(2) Figures are estimated.

**Overview of Fiscal 2019 Non-Segregated Operating Cash Flow (in millions) (1)**

|   | <u>Jul-18 (2)</u> | <u>Aug-18 (2)</u> | <u>Sep -18 (2)</u> | <u>Oct-18 (2)</u> | <u>Nov -18 (2)</u> | <u>Dec-18 (2)</u> | <u>Jan-19 (2)</u> | <u>Feb-19 (2)</u> | <u>Mar-19 (2)</u> | <u>Apr-19 (2)</u> | <u>May-19 (2)</u> | <u>Jun-19 (2)</u> | <b>Total FY<br/>2019 (2)</b> |
|---|-------------------|-------------------|--------------------|-------------------|--------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------------------|
| <b>Opening Non-Segregated Operating Cash Balance</b>            | <b>\$2,509.7</b>  | <b>\$2,460.9</b>  | <b>\$3,057.2</b>   | <b>\$3,658.2</b>  | <b>\$3,133.8</b>   | <b>\$2,502.6</b>  | <b>\$2,293.1</b>  | <b>\$2,742.4</b>  | <b>\$2,034.5</b>  | <b>\$1,892.7</b>  | <b>\$2,815.6</b>  | <b>\$1,870.5</b>  | <b>\$2,509.7</b>             |
| <b>Operating Activities:</b>                                    |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| Budgetary Funds:  |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| <i>Transfer from/(to) Stabilization Fund</i>                    | 0.0               | 0.0               | 0.0                | 0.0               | (66.2)             | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | (66.2)                       |
| Total Budgetary Revenue/Inflows                                 | 3,548.8           | 3,093.1           | 4,002.0            | 3,320.6           | 3,323.7            | 3,777.9           | 4,266.3           | 3,241.9           | 3,839.7           | 5,278.1           | 3,611.5           | 4,328.3           | 45,631.9                     |
| Total Budgetary Expenditures/Outflows                           | 3,344.9           | 3,640.6           | 3,169.5            | 3,661.1           | 3,676.9            | 3,465.3           | 3,639.6           | 3,664.1           | 3,696.0           | 3,621.7           | 3,532.0           | 2,994.8           | 42,106.6                     |
| Net Budgetary Funds   | 203.9             | (547.5)           | 832.5              | (340.5)           | (353.2)            | 312.6             | 626.7             | (422.2)           | 143.7             | 1,656.4           | 79.5              | 1,333.5           | 3,525.3                      |
| Non Budgetary Funds (Non Budgetary, Higher Ed and Trust Funds): |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| Total Non Budgetary Revenue/Inflows                             | 870.3             | 904.5             | 944.7              | 879.6             | 969.7              | 885.3             | 972.9             | 885.5             | 953.7             | 950.1             | 877.7             | 880.6             | 10,974.4                     |
| Total Non Budgetary Expenditures/Outflows                       | 1,133.6           | 1,150.1           | 1,197.1            | 1,121.6           | 1,243.1            | 1,402.8           | 1,115.8           | 1,171.8           | 1,149.8           | 1,179.3           | 1,356.8           | 1,180.8           | 14,402.5                     |
| Net Non Budgetary Funds   | (263.3)           | (245.6)           | (252.4)            | (242.0)           | (273.4)            | (517.5)           | (142.9)           | (286.3)           | (196.1)           | (229.2)           | (479.1)           | (300.2)           | (3,428.1)                    |
| Net Undesignated Revenue/Inflows and Expenditures/Outflows      | 5.5               | 5.5               | 5.5                | 5.5               | 5.5                | 5.5               | 5.5               | 5.5               | 5.5               | 5.5               | 5.5               | 5.5               | 66.0                         |
| <b>Net Operating Activities</b>                                 | <b>(\$53.9)</b>   | <b>(\$787.6)</b>  | <b>\$585.6</b>     | <b>(\$577.0)</b>  | <b>(\$621.2)</b>   | <b>(\$199.4)</b>  | <b>\$489.3</b>    | <b>(\$703.0)</b>  | <b>(\$46.9)</b>   | <b>\$1,432.7</b>  | <b>(\$394.2)</b>  | <b>\$1,038.8</b>  | <b>\$163.2</b>               |
| <b>Federal Grants:</b>  |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| Total Federal Grants Revenue/Inflows                            | 175.0             | 170.0             | 175.0              | 140.0             | 180.0              | 195.0             | 185.0             | 190.0             | 180.0             | 200.0             | 185.0             | 220.0             | 2,195.0                      |
| Total Federal Grants Expenditures/Outflows                      | 191.0             | 175.5             | 139.9              | 179.5             | 174.8              | 220.0             | 193.9             | 181.0             | 203.0             | 184.0             | 187.0             | 219.0             | 2,248.6                      |
| <b>Net Federal Grants</b>                                       | <b>(\$16.0)</b>   | <b>(\$5.5)</b>    | <b>\$35.1</b>      | <b>(\$39.5)</b>   | <b>\$5.2</b>       | <b>(\$25.0)</b>   | <b>(\$8.9)</b>    | <b>\$9.0</b>      | <b>(\$23.0)</b>   | <b>\$16.0</b>     | <b>(\$2.0)</b>    | <b>\$1.0</b>      | <b>(\$53.6)</b>              |
| <b>Capital Funds:</b>   |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| Total Capital Revenue/Inflows                                   | 319.0             | 258.5             | 276.3              | 332.0             | 283.8              | 263.0             | 263.9             | 248.0             | 220.1             | 227.3             | 221.8             | 274.7             | 3,188.4                      |
| Total Capital Expenditures/Outflows                             | 298.0             | 369.0             | 296.0              | 240.0             | 299.0              | 248.0             | 295.0             | 262.0             | 292.0             | 245.0             | 262.0             | 342.0             | 3,448.0                      |
| <b>Net Capital Funds</b>  | <b>\$21.0</b>     | <b>(\$110.5)</b>  | <b>(\$19.7)</b>    | <b>\$92.0</b>     | <b>(\$15.2)</b>    | <b>\$15.0</b>     | <b>(\$31.1)</b>   | <b>(\$14.0)</b>   | <b>(\$71.9)</b>   | <b>(\$17.7)</b>   | <b>(\$40.2)</b>   | <b>(\$67.3)</b>   | <b>(\$259.6)</b>             |
| <b>Financing Activities:</b>                                    |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| Cash Flow Financing Activities Inflows:                         |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| <i>Commercial Paper</i>   | 0.0               | 0.0               | 0.0                | 0.0               | 0.0                | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0                          |
| <i>Revenue Anticipation Notes (RANS)</i>                        | 0.0               | 1,500.0           | 0.0                | 0.0               | 0.0                | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 1,500.0                      |
| Total Cash Flow Financing Activities Inflows                    | 0.0               | 1,500.0           | 0.0                | 0.0               | 0.0                | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 1,500.0                      |
| Cash Flow Financing Activities Outflows:                        |                   |                   |                    |                   |                    |                   |                   |                   |                   |                   |                   |                   |                              |
| <i>Commercial Paper – (Principal + Interest)</i>                | 0.0               | 0.0               | 0.0                | 0.0               | 0.0                | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0               | 0.0                          |
| <i>RANS – (Principal + Interest)</i>                            | 0.0               | 0.0               | 0.0                | 0.0               | 0.0                | 0.0               | 0.0               | 0.0               | 0.0               | 508.0             | 508.8             | 509.7             | 1,526.5                      |
| Total Cash Flow Financing Activities Outflows                   | 0.0               | 0.0               | 0.0                | 0.0               | 0.0                | 0.0               | 0.0               | 0.0               | 0.0               | 508.0             | 508.8             | 509.7             | 1,526.5                      |
| <b>Net Financing Activities</b>                                 | <b>\$0.0</b>      | <b>\$1,500.0</b>  | <b>\$0.0</b>       | <b>\$0.0</b>      | <b>\$0.0</b>       | <b>\$0.0</b>      | <b>\$0.0</b>      | <b>\$0.0</b>      | <b>\$0.0</b>      | <b>(\$508.0)</b>  | <b>(\$508.8)</b>  | <b>(\$509.7)</b>  | <b>(\$26.5)</b>              |
| <b>Ending Non-Segregated Operating Cash Balance</b>             | <b>\$2,460.9</b>  | <b>\$3,057.2</b>  | <b>\$3,658.2</b>   | <b>\$3,133.8</b>  | <b>\$2,502.6</b>   | <b>\$2,293.1</b>  | <b>\$2,742.4</b>  | <b>\$2,034.5</b>  | <b>\$1,892.7</b>  | <b>\$2,815.6</b>  | <b>\$1,870.5</b>  | <b>\$2,333.2</b>  | <b>\$2,333.2</b>             |

SOURCE: Office of the Treasurer and Receiver-General.

(1) Totals may not add due to rounding.

(2) Figures are estimated.

## STATE WORKFORCE

The following table sets forth information regarding the Commonwealth's workforce as of the end of the last five fiscal years.

|   | <u>June 2013</u>     | <u>June 2014</u>     | <u>June 2015</u>     | <u>June 2016 (2)</u> | <u>June 2017</u>     |
|---|----------------------|----------------------|----------------------|----------------------|----------------------|
| Executive Office                            | 68                   | 70                   | 75                   | 75                   | 74                   |
| Office of the Comptroller                   | 111                  | 113                  | 109                  | 107                  | 106                  |
| Executive Departments                       |                      |                      |                      |                      |                      |
| Administration and Finance                  | 2,823                | 2,882                | 2,983                | 2,595                | 2,607                |
| Energy and Environmental Affairs            | 1,915                | 1,900                | 1,907                | 1,773                | 1,736                |
| Health and Human Services                   | 19,379               | 19,699               | 20,096               | 19,556               | 19,844               |
| Board of Library Commissioners              | 10                   | 10                   | 11                   | -                    | -                    |
| Housing and Economic Development            | 684                  | 702                  | 699                  | 673                  | 640                  |
| Labor and Workforce Development             | 236                  | 250                  | 234                  | 236                  | 231                  |
| Executive Office of Education               | 359                  | 523                  | 399                  | 370                  | 334                  |
| Public Safety and Security                  | 8,626                | 8,815                | 8,627                | 8,380                | 8,000                |
| Elder Affairs                               | <u>38</u>            | <u>39</u>            | 36                   | -                    | -                    |
| Subtotal under Governor's Authority         | 34,249               | 35,004               | 35,173               | 33,765               | 33,392               |
| Judiciary                                   | 7,217                | 7,188                | 7,256                | 7,257                | 7,205                |
| Higher Education (1)                        | 12,981               | 13,858               | 14,225               | 14,810               | 14,753               |
| Other (3)                                   | <u>10,356</u>        | <u>10,606</u>        | <u>10,701</u>        | <u>10,747</u>        | <u>10,770</u>        |
| Subtotal funded by the Operating Budget     | <u>64,803</u>        | <u>66,655</u>        | <u>67,358</u>        | <u>66,579</u>        | <u>66,300</u>        |
| Federal Grant, Trust and Capital Funded (4) | <u>20,612</u>        | <u>19,929</u>        | <u>20,243</u>        | <u>19,293</u>        | <u>17,254</u>        |
| <b>Total (5)</b>                            | <b><u>85,415</u></b> | <b><u>86,584</u></b> | <b><u>87,601</u></b> | <b><u>85,872</u></b> | <b><u>83,554</u></b> |

SOURCE: Executive Office for Administration and Finance.

(1) Amounts have been revised to reflect updated Higher Education totals.

(2) June, 2016 and 2017 figures include the Board of Library Commissioners in Other and Elder Affairs in Health and Human Services.

(3) Other includes members of the Legislature and their staff, the offices of the State Treasurer, Secretary of the Commonwealth, Auditor and Attorney General, the eleven District Attorneys, the seven former county sheriffs' offices that have become state agencies, and other agencies independent from the Governor.

(4) The Massachusetts Department of Transportation is included in Federal Grant, Trust, and Capital Funded.

(5) Totals may not add due to rounding.

### Unions and Labor Negotiations

Under Massachusetts law, all employees of the Commonwealth, with the exception of managerial and confidential employees and employees of the Legislature, have the right to bargain collectively with the Commonwealth through certified employee organizations recognized as exclusive bargaining representatives for appropriate bargaining units. The Human Resources Division of the Executive Office for Administration and Finance conducts the collective bargaining negotiations with all employees of the Commonwealth (except those noted below). Such negotiations may cover wages, hours and other terms and conditions of employment, but may not include the levels of pension and group insurance benefits. All labor agreements negotiated by the Human Resources Division are subject to approval by the Secretary of Administration and Finance and, once approved, are forwarded to the Legislature for funding approval. Labor contracts are often funded by supplemental appropriations or advance-funded through reserve accounts.

The Trial Court, the Lottery Commission, state sheriffs, the Registries of Deeds under the control of the Secretary of the Commonwealth, public higher education management, and the Personal Care Attendant Workforce Council negotiate directly with their respective employee representatives, but all wage increases and other economic provisions contained in such agreements are subject to the review of the Governor and to funding approval by the Legislature. If the Governor does not recommend the requested appropriation to fund contractual increases, he may refer the contracts back to the parties for further negotiation.

Approximately 35,307 executive branch full-time-equivalent state employees are organized in 13 bargaining units, the employees of the Commonwealth's colleges and universities are organized in 29 bargaining units, and the employees of the judicial branch, MassDOT, the Lottery Commission, the Registries of Deeds, the state sheriffs, Personal Care Attendants at MassHealth, and family child care providers at the Department of Early

Education and Care are organized in 67 bargaining units. Public employees of the Commonwealth do not have a legal right to strike or otherwise withhold services.

The following is a description of certain terms of the most recent agreements with the collective bargaining units within the responsibility of the Human Resources Division.

1. The contract with the National Association of Government Employees, representing Units 1, 3 and 6, ran from July, 2014 to June, 2017 and provided increases of 3%, 3% and 3% in January, 2015, October, 2015 and July, 2016, respectively. The total estimated incremental cost of the contract was \$96.3 million. This contract has expired, and negotiations are ongoing.

2. The contract with the Service Employees International Union (SEIU), representing employees in units 8 and 10, ran from December 31, 2013 through December 31, 2016. Funding for a new contract with SEIU running from January 1, 2017 through December 31, 2019 and providing salary increases of 1% for calendar 2017, 2% for calendar 2018, and 2% for calendar 2019 has been duly submitted to the Legislature for approval. The total estimated incremental cost of the new contract is \$56.8 million.

3. The contract with the American Federation of State, County and Municipal Employees (AFSCME), representing unit 2, ran from July, 2014 through June, 2017. Funding for a new contract with AFSCME running from July, 2017 through June, 2020 and providing semi-annual salary increases of 1% and 0% in fiscal 2018, 1% and 1% in fiscal 2019, and 1% and 1% in fiscal 2020 (equal to annualized increases of 1%, 2% and 2%, respectively) has been duly submitted to the Legislature for approval. The total estimated incremental cost of the new contract is \$26.9 million.

4. The contract with the Massachusetts Organization of State Engineers and Scientists, representing unit 9, ran from July, 2014 through June, 2017 and provided semi-annual salary increases of 1.5% in each September and February (equal to an annualized increase of 3.0% in the years 2014, 2015 and 2016). The total estimated incremental cost of the contract was \$20.0 million. This contract has expired, and negotiations are ongoing.

5. The contract with the New England Police Benevolent Association, representing unit 4A, ran from July 1, 2014 through June 30, 2017 and provided semi-annual increases of 1.5% each July and January. The total estimated incremental cost of the contract was \$1.2 million. This contract has expired, and negotiations are ongoing.

6. The contract with the Massachusetts Nurses Association ran from January 1, 2015 through December 31, 2017 and provided semi-annual increases of 1.5%, 1.5% and 1.5% effective each January and July, (equal to an annualized increase of 3.0%) in the years 2015, 2016 and 2017. The total estimated incremental cost of the contract was \$25.95 million. This contract has expired, and negotiations are ongoing.

7. The contract with the State Police Association of Massachusetts ran from January 1, 2015 through December 31, 2017 and provided annual increases of 2%, 3.75%, and 3.75%. The total estimated incremental cost of the contract was \$38.5 million. This contract has expired, and negotiations are ongoing.

8. The contract with the Massachusetts Correction Officers Federated Union runs from July 1, 2015 through June 30, 2018 and provides annual increases of 2%, 3.75% and 3.75%, effective July 1, 2015, 2016 and 2017, respectively. The total estimated incremental cost of the contract is \$46.9 million.

9. The contract with the Coalition of Public Safety runs from July 1, 2015 through June 30, 2018 and provides annual increases of 2%, 3%, and 3%. The total estimated incremental cost of the contract is \$2.3 million.

10. The contract with the International Association of Fire Fighters ran from January 1, 2015 through December 31, 2017, and provided annual increases of 2%, 3.5%, 3.5%. The total estimated incremental cost of the contract was \$0.5 million. This contract has expired, and negotiations are ongoing.

The following table sets forth information regarding the 13 bargaining units that are within the responsibility of the Human Resources Division.

**Human Resources Division Bargaining Units (1)**

| <b><u>Contract Unit</u></b> | <b><u>Bargaining Union</u></b>  | <b><u>Type of Employee</u></b>                               | <b><u>FTEs</u></b> | <b><u>Contract Expiration Dates</u></b> |
|-----------------------------|---|--|--------------------|---|
| 1, 3, 6                     | National Association of Government Employees  | Clerical, Skilled<br>Trades, Administrative<br>Professionals | 9,656              | 6/30/17 (2)                             |
| 2                           | Alliance/American Federation of State, County & Municipal Employees and Service Employees International Union | Institutional services                                       | 7,904              | 6/30/17 (3)                             |
| 4                           | Massachusetts Correction Officers Federated Union   | Corrections  | 3,527              | 6/30/18                                 |
| 4A                          | New England Police Benevolent Association   | Corrections  | 61                 | 6/30/17 (2)                             |
| 5                           | Coalition of Public Safety  | Law enforcement  | 175                | 6/30/18                                 |
| 5A                          | State Police Association of Massachusetts   | State Police   | 2,106              | 12/31/17 (2)                            |
| 7                           | Massachusetts Nurses Association  | Health professionals   | 1,546              | 12/31/17 (2)                            |
| 8, 10                       | Alliance/Service Employees International Union  | Social workers,<br>Secondary Education                       | 8,540              | 12/31/16 (3)                            |
| 9                           | Massachusetts Organization of State Engineers and Scientists  | Engineers/scientists   | 1,729              | 6/30/17 (2)                             |
| 11                          | International Association of Fire Fighters  | Fire fighters  | 63                 | 12/31/17 (2)                            |
|                             |   | <b>Total</b>   | <b>35,307</b>      |   |

SOURCE: Executive Office for Administration and Finance.

- (1) Numbers represent full-time equivalent filled positions (FTEs) in the standard workforce as of February 17, 2018 whose positions are established in accounts funded by all sources (the annual operating budget, capital projects funds, direct federal grants and expendable trusts and other non-appropriated funds).
- (2) This contract has expired, and negotiations are ongoing.
- (3) This contract has expired. Funding for a new contract has been submitted to the Legislature for approval.

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## PENSION AND OPEB FUNDING

### Retirement Systems

Almost all non-federal public employees in the Commonwealth participate in defined-benefit pension plans administered pursuant to state law by 104 public retirement systems. The Commonwealth is responsible for the payment of pension benefits for Commonwealth employees (members of the state employees' retirement system) and for teachers of the cities, towns and regional school districts throughout the state (including members of the Massachusetts teachers' retirement system and teachers in the Boston public schools, who are members of the Boston Retirement System but whose pensions are also the responsibility of the Commonwealth). The Commonwealth is also responsible for cost-of-living adjustments (COLAs) granted by local systems from 1981 to 1996. The members of the retirement system do not participate in the Social Security System. Employees of certain independent authorities and agencies, such as the Massachusetts Water Resources Authority, and of counties, cities and towns (other than teachers) are covered by 102 separate retirement systems and the Commonwealth is not responsible for making contributions towards the funding of these retirement systems. Pension benefits for state employees are administered by the State Board of Retirement, and pension benefits for teachers are administered by the Teachers' Retirement Board. Investment of the assets of the state employees' and Massachusetts teachers' retirement systems is managed by the Pension Reserves Investment Management (PRIM) Board. In the case of all other retirement systems, the retirement board for the system administers pension benefits and manages investment of assets. Retirement board members are required to complete 18 hours of training and to file annual statements of financial interest with the Public Employee Retirement Administration Commission (PERAC). Many such retirement boards invest their assets with the PRIM Board, and the PRIM Board may take over the assets of local retirement systems that are less than 65% funded and have failed to come within 2% of the PRIM Board's performance over a 10-year period. With a very small number of exceptions, the members of these state and local retirement systems do not participate in the federal Social Security System.

The Massachusetts State Employees' Retirement System (MSERS) and the Massachusetts Teachers' Retirement System (MTRS) are the two largest plans of the public contributory retirement systems operated in the Commonwealth. Membership in MSERS and MTRS as of January 1, 2017, the date of the most recent combined valuation, is as follows:

#### Retirement Systems Membership

|   | <u>MSERS</u> | <u>MTRS</u> |
|---|--------------|-------------|
| <b>Retirees and beneficiaries currently receiving benefits</b>              | 62,259       | 65,036      |
| <b>Terminated employees entitled to benefits but not yet receiving them</b> | 4,094        | N/A         |
| <b>Subtotal</b>   | 66,353       | 65,036      |
| <b>Current Members</b>  | 90,014       | 92,128      |
| <b>Total</b>  | 156,367      | 157,164     |

SOURCE: Public Employee Retirement Administration Commission

The MSERS is a cost sharing, multiple-employer defined-benefit public employee retirement system. The MTRS is a defined-benefit public employee retirement system managed by the Commonwealth on behalf of municipal teachers and municipal teacher retirees. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefits of the MTRS. Members become vested after 10 years of creditable service. For members who joined the system prior to April 2, 2012 superannuation retirement allowance may be received upon the completion of 20 years of service or upon reaching the age of 55 with 10 years of service. Normal retirement for those employees who were system members before April 2, 2012 occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55. Most members who joined the system after April 1, 2012 cannot retire prior to age 60.

The Commonwealth's retirement systems' funding policies have been statutorily established. The Legislature has the authority to amend these policies. The annuity portion of the MSERS and the MTRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation. Costs of administering the plan are funded out of plan assets. The policies provide for uniform benefit and contribution requirements for all contributory public employee retirement systems. These requirements generally provide for superannuation retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. For employees hired after April 1, 2012, retirement allowances are calculated on the basis of the last five years or any five consecutive years, whichever is greater in terms of compensation. Benefit payments are based upon a member's age, length of creditable service and group creditable service, and group classification.

Boston teachers are not included in the membership data shown above for the MTRS. Legislation approved in May, 2010 changed the methodology for the Commonwealth's funding of pension benefits paid to Boston teachers. Prior to this change, the Commonwealth reimbursed the City of Boston for pension benefits paid to Boston teachers as certified by the Boston Retirement System (BRS). Those costs were funded one fiscal year in arrears. The cost of pension benefits of the other participants of the BRS is the responsibility of the City of Boston. The BRS is a cost-sharing multiple-employer pension system that is not administered by the Commonwealth and is not part of the reporting entity of the Commonwealth for accounting purposes. The 2010 legislation clarified that the Commonwealth is responsible for all employer contributions and future benefit requirements for Boston teachers that are members of the BRS. The Commonwealth's actuarially determined contribution to the BRS was \$132.5 million for fiscal 2017.

Subject to legislative approval, annual increases in cost-of-living allowances are provided in an amount equal to the lesser of 3% or the previous year's percentage increase in the United States consumer price index on the first \$13,000 of benefits for members of the MSERS and MTRS. The Legislature approved the 3% increase in cost-of-living allowances for fiscal 2018. The Commonwealth pension funding schedule (discussed below) assumes that annual increases of 3% will be approved for its retirees.

The MSERS and the MTRS, in conjunction with the Commonwealth, are evaluating whether certain of the statutes or practices governing the systems may have been in conflict with the exclusive benefit rule of Section 401(a)(2) of the Internal Revenue Code or other federal tax law requirements relating to operation of tax-exempt pension plans. The activities being reviewed include (i) the statutorily directed funding of the budget for PERAC solely from the investment income accounts of MSERS and MTRS, (ii) the statutorily directed contributions made from the MSERS account in the PRIT Fund to a separate optional retirement plan available to certain employees of the Commonwealth's higher education system, (iii) the statutorily mandated reimbursements paid by the MSERS to local retirement systems for local cost-of-living allowances for certain participants of those systems, (iv) the deposit of reimbursement revenues received from local retirement systems to the Commonwealth's General Fund rather than to the MTRS and MSERS accounts in the PRIT Fund, and (v) the deposit of federal grant fringe payments to the General Fund rather than to the MTRS and MSERS accounts in the PRIT Fund. The Commonwealth, PERAC, MSERS and the MTRS have each engaged outside tax counsel to review these activities. On March 28, 2017, the Governor approved legislation to address prospectively certain aspects of the issues described above. Additional corrective legislation was approved as part of the Commonwealth's General Appropriations Act for fiscal 2018, approved on July 17, 2017. The Executive Office for Administration and Finance expects to submit for Internal Revenue Service consideration a request for a closing agreement in which the Commonwealth describes the activities listed above, explains the corrective actions already taken by legislation, and requests an affirmation that these activities do not adversely affect the tax qualification of the MSERS and MTRS in light of the corrections already made.

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## Employee Contributions

The MSERS and MTRS are partially funded by employee contributions of regular compensation. The following tables indicate current employee contribution rates (figures are approximate):

### Employee Contribution Rates

| <b><u>MTRS (1)</u></b>  |                                     |                              |                                 |
|-------------------------|-------------------------------------|------------------------------|---------------------------------|
| <b><u>Hire Date</u></b> | <b><u>% of Compensation (1)</u></b> | <b><u>Active Members</u></b> | <b><u>% of Total Active</u></b> |
| Pre-1975                | 5%                                  | 129                          | 0.1%                            |
| 1975-1983               | 7                                   | 545                          | 0.6                             |
| 1984-June 30, 1996      | 8                                   | 6,681                        | 7.3                             |
| July 1, 1996-Present    | 9                                   | 14,627                       | 15.9                            |
| July 1, 2001-Present    | 11                                  | <u>70,146</u>                | <u>76.1</u>                     |
| <b>Totals</b>           |                                     | <b><u>92,128</u></b>         | <b><u>100.0%</u></b>            |

SOURCE: Public Employee Retirement Administration Commission. Membership data from Teachers' Retirement System January 1, 2017 Actuarial Valuation.

(1) Employees hired after January 1, 1979 (except those contributing 11%) contribute an additional 2% of any regular compensation in excess of \$30,000 annually. Legislation enacted in fiscal 2000 established an alternative superannuation retirement benefit program for teachers hired on or after July 1, 2001 (and others who opt in) with an 11% contribution requirement for a minimum of five years. The contribution rate for most employees hired after April 1, 2012 will be reduced to 6% after 30 years of creditable service.

| <b><u>MSERS (1)</u></b>   |                                     |                              |                                 |
|---------------------------|-------------------------------------|------------------------------|---------------------------------|
| <b><u>Hire Date</u></b>   | <b><u>% of Compensation (1)</u></b> | <b><u>Active Members</u></b> | <b><u>% of Total Active</u></b> |
| Pre-1975                  | 5%                                  | 517                          | 0.6%                            |
| 1975-1983                 | 7                                   | 3,612                        | 4.0                             |
| 1984-June 30, 1996        | 8                                   | 17,067                       | 19.0                            |
| July 1, 1996-Present      | 9                                   | 68,155                       | 75.7                            |
| State Police 1996-Present | 12                                  | <u>663</u>                   | <u>0.7</u>                      |
| <b>Totals</b>             |                                     | <b><u>88,081</u></b>         | <b><u>100.0%</u></b>            |

SOURCE: Public Employee Retirement Administration Commission. Membership data from State Board of Retirement January 1, 2017 Actuarial Valuation.

(1) Employees hired after January 1, 1979 contribute an additional 2% of any regular compensation in excess of \$30,000 annually.

## Funding Schedule

The retirement systems were originally established as "pay-as-you-go" systems, meaning that amounts were appropriated each year to pay current benefits, and no provision was made to fund currently the future liabilities already incurred. In fiscal 1988, the Commonwealth began to address the unfunded liabilities of the two state systems by making appropriations to pension reserves. Under current law such unfunded liability is required to be amortized to zero by June 30, 2040. The law also requires that the Secretary of Administration and Finance file a proposed funding schedule with the legislature every three years identifying the appropriations or transfers required to amortize the unfunded liability to zero, to meet the normal cost of all future benefits for which the Commonwealth is obligated and to meet any other component of the Commonwealth's pension liability. Previously designated amounts can be adjusted based on a new funding schedule so long as the adjustments represent an increase in the scheduled amounts for those years. The law requires the funding schedule submitted by the Secretary to be based on actuarial valuation reports and requires the Secretary to provide the actuarial, economic and demographic assumptions upon which the reports are based. The funding schedule is filed with the House Committee on Ways and Means and is deemed approved if no action is taken by the committee within 45 days.

The most recent funding schedule for payments into the Commonwealth's Pension Liability Fund was filed by the Secretary of Administration and Finance on January 13, 2017. The assumptions underlying the funding schedule include valuation of assets and liabilities as of January 1, 2016, an annual rate of return on assets of 7.5%, and appropriation increases of 8.94% per year until the final amortization payment in fiscal 2036 (four years before the statutory requirement). The funding schedule also fully amortizes by fiscal 2027 the liabilities attributable to the employee retirement incentive program approved by the Governor on May 4, 2015.

### Current Funding Schedule for Pension Obligations (in thousands)

| <u>Fiscal Year</u> | <u>Payments</u> | <u>Fiscal Year</u> | <u>Payments</u> |
|--------------------|-----------------|--------------------|-----------------|
| 2018               | 2,394,498       | 2028               | 5,635,069       |
| 2019               | 2,608,453       | 2029               | 6,138,577       |
| 2020               | 2,841,525       | 2030               | 6,687,075       |
| 2021               | 3,095,422       | 2031               | 7,284,583       |
| 2022               | 3,372,006       | 2032               | 7,935,479       |
| 2023               | 3,673,304       | 2033               | 8,644,535       |
| 2024               | 4,001,523       | 2034               | 9,416,947       |
| 2025               | 4,359,070       | 2035               | 10,258,375      |
| 2026               | 4,748,564       | 2036               | 11,174,988      |
| 2027               | 5,172,860       | 2037               | 1,370,935       |

SOURCE: Executive Office for Administration and Finance

### Actuarial Valuations

PERAC's most recent valuation report for the Commonwealth's total pension obligation is dated September 20, 2017. In this report, the unfunded actuarial accrued liability for the Commonwealth's total pension obligation as of January 1, 2017, based on the plan provisions in effect at the time and on member data and asset information as of December 31, 2016, was approximately \$39.622 billion, including approximately \$13.544 billion for the MSERS, \$23.555 billion for the MTRS, \$2.376 billion for Boston teachers that are members of the BRS, and \$146.3 million for cost-of-living increases reimbursable to local systems. This valuation estimates the total actuarial accrued liability as of January 1, 2017 to be approximately \$91.574 billion (comprised of \$38.317 billion for MSERS, \$49.194 billion for MTRS, \$3.917 billion for Boston teachers and \$146.3 million for cost-of-living increases reimbursable to local systems).

Differences each year between the actual experience of the plan and the experience projected by the actuarial assumptions are reflected by adjustments to the unfunded actuarial accrued liability. An experience difference which increases the unfunded actuarial accrued liability is an actuarial loss and one which decreases the unfunded actuarial accrued liability is an actuarial gain.

Total assets were valued on an actuarial basis at approximately \$51.952 billion based on a five-year average valuation method, which equaled 101.7% of the December 31, 2016 total asset market value. During 2016 there was an overall actuarial gain of \$1.1 billion. There was a non-investment related gain on actuarial liability of approximately \$595 million. There was a gain of approximately \$522 million on the actuarial value of assets.

The January 1, 2017 valuation used the same 7.5% investment return assumption used in the January 1, 2016 report. The investment return assumption had previously decreased from 8.25% as of January 1, 2012 to 7.5% as of January 1, 2016. After consideration, PERAC maintained the 7.5% investment return assumption. PERAC is expected to revisit the question of reducing the investment return assumption in connection with the January 1, 2018 valuation.

For the January 1, 2015 valuation, a fully generational mortality assumption was adopted that reflected expected future mortality improvements (increasing life expectancy). This assumption was adopted based on a review of retiree mortality in 2012, 2013 and 2014. In preparing this valuation, PERAC performed an updated analysis of retiree mortality in 2015 and 2016. Based on those results, this assumption was adjusted for the January 1, 2017 valuation. This change in assumption increased the actuarial liability by \$1.574 billion.

PERAC issued detailed experience analyses in 2014 for MSERS and MTRS. These experience studies encompassed the years 2006-2011 and reviewed salary increases and rates of retirement, disability, turnover and mortality. PERAC more recently performed an experience analysis of mortality for retirees of MSERS and MTRS from January 1, 2012 to January 1, 2015. That analysis was the basis for the adoption of a generational mortality assumption described above.

The Actuarial Cost Method which is used to determine pension liabilities in the Commonwealth's valuations is known as the Entry Age Normal Cost Method. Under this method, the Normal Cost for each active member on the valuation date is determined as the level percent of salary, which, if paid annually from the date the

employee first became a retirement system member, would fully fund by retirement, death, disability or termination, the projected benefits which the member is expected to receive. The actuarial accrued liability for each member is determined as the present value as of the valuation date of all projected benefits which the member is expected to receive, minus the present value of future annual Normal Cost payments expected to be made to the fund. Since only active members have a Normal Cost, the actuarial accrued liability for inactive members, retirees and survivors is simply equal to the present value of all projected benefits. The unfunded actuarial accrued liability is the actuarial accrued liability less current assets.

The Normal Cost for a member will remain a level percent of salary for each year of membership, except for changes in provisions of the plan or the actuarial assumptions employed in projection of benefits and present value determinations. The Normal Cost for the entire system will also be changed by the addition of new members or the retirement, death, disability, or termination of members. The actuarial accrued liability for a member will increase each year to reflect the additional accrual of Normal Cost. It will also change if the plan provisions or actuarial assumptions change.

The actuarial value of assets is determined in accordance with the deferred recognition method, under which 20% of the gains or losses occurring in the prior year are recognized, 40% of those occurring two years prior are recognized, etc., so that 100% of gains and losses occurring five years ago are recognized. This has the effect of smoothing the short-term volatility of market values over a five-year period. The actuarial value of assets is adjusted, if necessary, in order to remain between 90% and 110% of market value. (In valuations prior to 1998, plan assets were determined at market value.) The actuarial value of assets as of January 1, 2017 was 101.7% of the market value. This figure was 101.2% as of January 1, 2016.

The following table shows, with respect to the Commonwealth's aggregate pension obligations, a 10-year comparison of the actuarial value of assets to the market values, the ratio of the actuarial value to market value, and the funded ratio based on actuarial value compared to the funded ratio based on the market value of assets:

**Ten Year Comparison of Actuarial and Market Values of Pension Assets (in millions)**

| <u>Valuation Date (Jan. 1)</u> | <u>Actuarial Value of Assets (1)</u> | <u>Market Value of Assets</u> | <u>% of Actuarial Value to Market Value</u> | <u>Funded Ratio (Actuarial Value)</u> | <u>Funded Ratio (Market Value)</u> |
|--------------------------------|--------------------------------------|-------------------------------|---|---------------------------------------|------------------------------------|
| 2017                           | \$51,952                             | \$51,107                      | 101.7%                                      | 56.7%                                 | 55.8%                              |
| 2016                           | 49,535                               | 48,943                        | 101.2                                       | 56.7                                  | 56.0                               |
| 2015                           | 48,106                               | 50,290                        | 95.7  | 59.0                                  | 61.7                               |
| 2014                           | 45,894                               | 48,351                        | 94.9  | 61.2                                  | 64.5                               |
| 2013                           | 43,517                               | 43,760                        | 99.4  | 60.6                                  | 60.9                               |
| 2012                           | 43,942                               | 39,947                        | 110.0                                       | 65.1                                  | 59.1                               |
| 2011                           | 45,631                               | 41,482                        | 110.0                                       | 71.1                                  | 64.6                               |
| 2010                           | 41,589                               | 37,809                        | 110.0                                       | 67.5                                  | 61.4                               |
| 2009                           | 37,058                               | 33,689                        | 110.0                                       | 62.7                                  | 57.0                               |
| 2008                           | 44,532                               | 49,235                        | 90.4  | 78.6                                  | 86.9                               |
| 2007                           | 40,412                               | 44,902                        | 90.0  | 75.2                                  | 83.5                               |

SOURCE: Public Employee Retirement Administration Commission.  
 (1) Based on five-year average smoothing methodology.

The following tables show, for each of the MSERS and the MTRS and for Commonwealth obligations in the aggregate (including Boston teachers and cost-of-living allowances as well as MSERS and MTRS), the historical funded status for the most recent ten years, based on actuarial values and market values of assets:

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**Historical Pension Funding Progress for the Last Ten Fiscal Years - Actuarial Value**  
(in thousands, except for percentages)

|   | <u>Actuarial<br/>Value of<br/>Plan Assets</u> | <u>Actuarial<br/>Accrued<br/>Liability</u> | <u>Unfunded<br/>Actuarial<br/>Accrued<br/>Liability<br/>(UAAL)</u> | <u>Funded<br/>Ratio</u> | <u>Annual<br/>Covered<br/>Payroll</u> | <u>UAAL as<br/>% of<br/>Covered<br/>Payroll</u> |
|---|---|--|--|-------------------------|---------------------------------------|---|
| <b>MSERS</b>  |   |  |  |                         |                                       |   |
| Actuarial Valuation<br>as of Jan. 1                               |   |  |  |                         |                                       |   |
| <b>2017</b>   | \$24,773,042                                  | \$38,316,719                               | \$13,543,677   | 64.7%                   | \$5,927,012                           | 228.6%  |
| <b>2016</b>   | 23,465,963                                    | 36,966,278                                 | 13,500,315   | 63.5                    | 5,792,288                             | 233.1   |
| <b>2015</b>   | 22,720,160                                    | 33,679,150                                 | 10,958,990   | 67.5                    | 5,591,911                             | 196.0   |
| <b>2014</b>   | 21,581,133                                    | 30,679,600                                 | 9,098,467  | 70.3                    | 5,344,510                             | 170.2   |
| <b>2013</b>   | 20,317,389                                    | 29,385,442                                 | 9,068,053  | 69.1                    | 5,183,195                             | 175.0   |
| <b>2012</b>   | 20,507,604                                    | 27,784,731                                 | 7,277,127  | 73.8                    | 4,922,388                             | 185.7   |
| <b>2011</b>   | 21,244,900                                    | 26,242,776                                 | 4,997,876  | 81.0                    | 4,808,250                             | 103.9   |
| <b>2010</b>   | 19,019,062                                    | 24,862,421                                 | 5,843,359  | 76.5                    | 4,711,563                             | 124.0   |
| <b>2009</b>   | 16,992,214                                    | 23,723,240                                 | 6,731,026  | 71.6                    | 4,712,655                             | 142.8   |
| <b>2008</b>   | 20,400,656                                    | 22,820,502                                 | 2,419,846  | 89.4                    | 4,574,233                             | 52.9  |
| <b>MTRS</b>   |   |  |  |                         |                                       |   |
| Actuarial Valuation<br>as of Jan. 1                               |   |  |  |                         |                                       |   |
| <b>2017</b>   | \$25,638,136                                  | \$49,193,503                               | \$23,555,367   | 52.1%                   | \$6,583,871                           | 357.8%  |
| <b>2016</b>   | 24,593,787                                    | 46,562,807                                 | 21,969,020   | 52.8                    | 6,388,732                             | 343.9   |
| <b>2015</b>   | 23,946,759                                    | 44,115,769                                 | 20,169,010   | 54.3                    | 6,204,274                             | 325.1   |
| <b>2014</b>   | 22,940,196                                    | 40,741,695                                 | 17,801,499   | 56.3                    | 5,962,650                             | 298.6   |
| <b>2013</b>   | 21,787,470                                    | 39,135,218                                 | 17,347,748   | 55.7                    | 5,783,294                             | 300.0   |
| <b>2012</b>   | 22,141,475                                    | 36,483,027                                 | 14,341,552   | 60.7                    | 5,655,353                             | 253.6   |
| <b>2011</b>   | 23,117,952                                    | 34,890,991                                 | 11,773,039   | 66.3                    | 5,558,311                             | 211.8   |
| <b>2010</b>   | 21,262,462                                    | 33,738,966                                 | 12,476,504   | 63.0                    | 5,509,698                             | 226.4   |
| <b>2009</b>   | 18,927,731                                    | 32,543,782                                 | 13,616,051   | 58.2                    | 5,389,895                             | 252.6   |
| <b>2008</b>   | 22,883,553                                    | 30,955,504                                 | 8,071,951  | 73.9                    | 5,163,498                             | 156.3   |
| <b>Aggregate<br/>Commonwealth<br/>Pension<br/>Obligations (1)</b> |   |  |  |                         |                                       |   |
| Actuarial Valuation<br>as of Jan. 1                               |   |  |  |                         |                                       |   |
| <b>2017</b>   | \$51,952,206                                  | \$91,573,998                               | \$39,621,792   | 56.7%                   | \$13,059,709                          | 303.4%  |
| <b>2016</b>   | 49,535,323                                    | 87,401,722                                 | 37,866,399   | 56.7                    | 12,702,727                            | 298.1   |
| <b>2015</b>   | 48,105,862                                    | 81,535,003                                 | 33,429,141   | 59.0                    | 12,302,162                            | 271.7   |
| <b>2014</b>   | 45,894,034                                    | 74,936,994                                 | 29,042,960   | 61.2                    | 11,793,788                            | 246.3   |
| <b>2013</b>   | 43,517,498                                    | 71,865,832                                 | 28,348,334   | 60.6                    | 11,408,407                            | 248.5   |
| <b>2012</b>   | 43,941,682                                    | 67,546,587                                 | 23,604,905   | 65.1                    | 11,011,466                            | 214.4   |
| <b>2011</b>   | 45,630,507                                    | 64,219,135                                 | 18,588,628   | 71.1                    | 10,811,975                            | 171.9   |
| <b>2010</b>   | 41,589,706                                    | 61,575,676                                 | 19,985,970   | 67.5                    | 10,655,881                            | 187.6   |
| <b>2009</b>   | 37,057,703                                    | 59,142,155                                 | 22,084,452   | 62.7                    | 10,537,212                            | 209.6   |
| <b>2008</b>   | 44,531,652                                    | 56,636,710                                 | 12,105,058   | 78.6                    | 10,156,252                            | 119.2   |

SOURCE: Public Employee Retirement Administration Commission.

(1) Aggregate Commonwealth pension obligations include obligations with respect to MSERS, MTRS, Boston teachers, and local cost-of-living adjustments from 1981 to 1996.

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**Historical Pension Funding Progress for the Last Ten Fiscal Years - Market Value**  
(in thousands, except for percentages)

|   | <b>Market<br/>Value of<br/>Plan Assets</b> | <b>Actuarial<br/>Accrued<br/>Liability</b> | <b>Unfunded<br/>Actuarial<br/>Accrued<br/>Liability<br/>(UAAL)</b> | <b>Funded<br/>Ratio</b> | <b>Annual<br/>Covered<br/>Payroll</b> | <b>UAAL as<br/>% of<br/>Covered<br/>Payroll</b> |
|---|--|--|--|-------------------------|---------------------------------------|---|
| <b>MSERS</b>  |  |  |  |                         |                                       |   |
| Actuarial Valuation as of Jan. 1                                  |  |  |  |                         |                                       |   |
| 2017  | \$24,366,420                               | \$38,316,719                               | \$13,950,299   | 63.6%                   | \$5,927,012                           | 235.4%  |
| 2016  | 23,176,451                                 | 36,966,278                                 | 13,789,827   | 62.7                    | 5,792,288                             | 238.1   |
| 2015  | 23,739,487                                 | 33,679,150                                 | 9,939,663  | 70.5                    | 5,591,911                             | 177.8   |
| 2014  | 22,721,053                                 | 30,679,600                                 | 7,958,547  | 74.1                    | 5,344,510                             | 148.9   |
| 2013  | 20,405,004                                 | 29,385,442                                 | 8,980,438  | 69.4                    | 5,183,195                             | 173.3   |
| 2012  | 18,643,313                                 | 27,784,731                                 | 9,141,418  | 67.1                    | 4,922,388                             | 147.8   |
| 2011  | 19,313,545                                 | 26,242,776                                 | 6,929,231  | 73.6                    | 4,808,250                             | 144.1   |
| 2010  | 17,290,056                                 | 24,862,421                                 | 7,572,365  | 69.5                    | 4,711,563                             | 160.7   |
| 2009  | 15,447,467                                 | 23,723,240                                 | 8,275,773  | 65.1                    | 4,712,655                             | 175.6   |
| 2008  | 22,538,610                                 | 22,820,502                                 | 281,892  | 98.8                    | 4,574,233                             | 6.2   |
| <b>MTRS</b>   |  |  |  |                         |                                       |   |
| Actuarial Valuation as of Jan. 1                                  |  |  |  |                         |                                       |   |
| 2017  | \$25,225,451                               | \$49,193,503                               | \$23,968,052   | 51.3%                   | \$6,583,871                           | 364.0%  |
| 2016  | 24,308,553                                 | 46,562,807                                 | 22,254,254   | 52.2                    | 6,388,732                             | 348.3   |
| 2015  | 25,046,692                                 | 44,115,769                                 | 19,069,077   | 56.8                    | 6,204,274                             | 307.4   |
| 2014  | 24,183,391                                 | 40,741,695                                 | 16,558,304   | 59.4                    | 5,962,650                             | 277.7   |
| 2013  | 21,934,211                                 | 39,135,218                                 | 17,201,007   | 56.0                    | 5,783,294                             | 297.4   |
| 2012  | 20,128,614                                 | 36,483,027                                 | 16,354,413   | 55.2                    | 5,655,353                             | 289.2   |
| 2011  | 21,016,320                                 | 34,890,991                                 | 13,874,671   | 60.2                    | 5,558,311                             | 249.6   |
| 2010  | 19,329,511                                 | 33,738,966                                 | 14,409,455   | 57.3                    | 5,509,698                             | 261.5   |
| 2009  | 17,207,028                                 | 32,543,782                                 | 15,336,754   | 52.9                    | 5,389,895                             | 284.5   |
| 2008  | 25,316,044                                 | 30,955,504                                 | 5,639,460  | 81.8                    | 5,163,498                             | 109.2   |
| <b>Aggregate<br/>Commonwealth<br/>Pension<br/>Obligations (1)</b> |  |  |  |                         |                                       |   |
| Actuarial Valuation as of Jan. 1                                  |  |  |  |                         |                                       |   |
| 2017  | \$51,107,139                               | \$91,573,998                               | \$40,466,859   | 55.8%                   | \$13,059,709                          | 309.9%  |
| 2016  | 48,943,080                                 | 87,401,722                                 | 38,458,642   | 56.0                    | 12,702,727                            | 302.8   |
| 2015  | 50,289,770                                 | 81,535,003                                 | 31,245,233   | 61.7                    | 12,302,162                            | 254.0   |
| 2014  | 48,350,920                                 | 74,936,994                                 | 26,586,074   | 64.5                    | 11,793,788                            | 225.4   |
| 2013  | 43,760,381                                 | 71,865,832                                 | 28,105,451   | 60.9                    | 11,408,407                            | 246.4   |
| 2012  | 39,946,984                                 | 67,546,587                                 | 27,599,603   | 59.1                    | 11,011,466                            | 250.6   |
| 2011  | 41,482,279                                 | 64,219,135                                 | 22,736,856   | 64.6                    | 10,811,975                            | 210.3   |
| 2010  | 37,808,823                                 | 61,575,676                                 | 23,766,853   | 61.4                    | 10,655,881                            | 223.0   |
| 2009  | 33,688,821                                 | 59,142,155                                 | 25,453,334   | 57.0                    | 10,537,212                            | 241.3   |
| 2008  | 49,234,569                                 | 56,636,710                                 | 7,402,141  | 86.9                    | 10,156,252                            | 72.9  |

SOURCE: Public Employee Retirement Administration Commission.

(1) Aggregate Commonwealth pension obligations include obligations with respect to MSERS, MTRS, Boston teachers, and local cost-of-living adjustments from 1981-1996.

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## Annual Required Contributions

The following table sets forth the annual required contribution (ARC) by the Commonwealth for each of the fiscal years indicated and the actual contributions made. The ARC was determined annually through fiscal 2014, based on the most recent Commonwealth valuation, under Governmental Accounting Standards Board (GASB) Statement No. 27. GASB 27 is no longer applicable with the implementation of GASB 67/68, as described below, but the Commonwealth expects to continue calculating the ARC under GASB 27 principles for comparison. Actuarial valuations have been performed annually since January 1, 2000. As noted above, the Commonwealth also develops a revised funding schedule by statute at least every three years, and the Commonwealth made the full contribution required, under the then-current funding schedule, for each year displayed in the table. The decrease from fiscal 2016 to fiscal 2017 shown below in the percentage of the ARC funded reflects the assumptions and plan changes described in the January 1, 2016 valuation report that increased plan liabilities.

The calculation of the Commonwealth's ARC assumes amortization of the unfunded actuarial liability on a 4.0% annual increasing basis to fiscal 2040. (This is the minimum allowable funding schedule for local systems under state pension law.) The amount shown in the table below for contributions made in the current fiscal year is the amount required by the current funding schedule. The amounts shown for contributions made in fiscal 2016 and fiscal 2017 include the costs associated with the early retirement incentive program (ERIP).

### Annual Required Contributions and Other Pension Contributions (in thousands, except for percentages)

|   | <u>2014</u>        | <u>2015</u>        | <u>2016</u>        | <u>2017</u>        | <u>2018</u>        |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| Annual required contribution (ARC) (1)            | \$2,011,147        | \$2,217,130        | \$2,600,000        | \$3,060,000        | \$3,292,000        |
| Contributions made                                | <u>\$1,630,000</u> | <u>\$1,793,000</u> | <u>\$2,001,093</u> | <u>\$2,198,093</u> | <u>\$2,394,000</u> |
| % of ARC funded for the fiscal year               | 81%                | 75%                | 77%                | 72%                | 73%                |
| ARC as ratio of total government expenditures (2) | 5.3%               | 5.7%               | 6.4%               | 7.2%               | 7.6%               |

SOURCE: Public Employee Retirement Administration Commission.

- (1) The ARC calculations for fiscal 2013 and fiscal 2014 differ from those disclosed in prior Information Statements, because the ARC calculation in prior disclosures did not take into account amounts required to be contributed for Boston teachers and local cost-of-living allowances. The ARC calculation for fiscal 2016 does not include costs associated with the ERIP because such costs had not yet been identified at the time the calculation was made.
- (2) Based on Total Budgeted Expenditures and Other Uses.

On June 25, 2012, GASB voted to approve two new standards that modify the accounting and financial reporting of the Commonwealth's pension obligations, GASB Statement No. 67, *Financial Reporting for Pension Plans*, which was effective for the Commonwealth's fiscal 2014 CAFR, and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, which was effective for the Commonwealth's fiscal 2015 CAFR. GASB 67 established new standards for defined benefit pension plan accounting and reporting, while GASB 68 required changes to governments' reporting of and inclusion of pension assets and liabilities in their annual CAFRs. GASB 68 requires governments to report in their statements of net position (or balance sheet) a net pension liability, defined as the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to current employees, retirees, and their beneficiaries. The new standard requires recognition in the financial statements of pension expense, unlike GASB 27. The rate used to discount projected benefit payments to their present value is based on a single rate that reflects (a) the long-term expected rate of return on plan investments as long as the plan net position is projected under specified conditions to be sufficient to pay pensions of current employees and retirees and the pension plan assets are expected to be invested using a strategy to achieve that return and (b) a yield or index rate on tax-exempt 20-year AA-or-higher rated municipal bonds to the extent that the conditions for use of the long-term expected rate of return are not met. Under the new standards, as noted above, the ARC calculation, and the requirement to fund the ARC under GAAP, have been eliminated.

The tables that follow show pension-related information for both the MTRS and the MSERS as required by GASB 67 and GASB 68 and as shown in the Commonwealth's fiscal 2017 CAFR. The MTRS and MSERS tables subtitled "Schedule of Changes in the Net Pension Liability and Related Ratios" show the beginning and ending liabilities and assets for the MTRS and MSERS, as well as both systems' unfunded pension liability, or net pension

liability (NPL), with the NPL being the amount that the Commonwealth records on its Statement of Net Position as its unfunded pension liability. The table also shows the components of the change in the NPL between the beginning (July 1) and end (June 30) for fiscal years 2014 through 2017.

The tables subtitled “Pension Expense and Deferred Outflows/Inflows of Resources,” “Deferred Outflows/Inflows of Resources,” “Deferred Outflows/Inflows of Resources” and “Projected Recognition of Deferred Outflows/Inflows)” show pension expenses that, under GASB 68, are recognized in the fiscal 2017 CAFR as well as the inflows and outflows that under GASB 68 are recognized either in the fiscal 2017 CAFR or are deferred and projected to be recognized in future fiscal year CAFRs.

The methodology required by GASB 68 to calculate the Commonwealth’s NPL and other pension-related measures (as reflected in the tables below) is in several respects different from the methodology used by PERAC in calculating the Commonwealth’s unfunded pension liability in its annual actuarial valuation. The most important difference between the two methodologies is that GASB 68 requires the value of pension plan assets be recorded at market value as of June 30 of each fiscal year, meaning that investment gains and losses are recognized immediately, while the actuarial value of assets used by PERAC in calculating the Commonwealth’s unfunded liability is measured using a five-year smoothing methodology, meaning that investment gains and losses are amortized over five years. Therefore, the NPL information set out in the tables below based on GASB 68 requirements is not strictly comparable to the unfunded liability and other pension-related information in PERAC’s annual actuarial valuations.

Under GASB 68, in order to provide adequate time for pension plans to distribute pension-related information to pension plan participants (which include state authorities, local school collaboratives, and municipal governments) for use in their annual CAFRs, governments are permitted to use the prior year’s NPL and other pension-related measures in the current year’s CAFR. In conformance with GASB 68, the Commonwealth determined that for the fiscal 2017 CAFR it would use the pension valuation information as of June 30, 2016. The Commonwealth will use the June 30, 2017 pension information in its fiscal 2018 CAFR.

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## GASB 67 Information for the Massachusetts Teachers' Retirement System

### Schedule of Changes in the Net Pension Liability and Related Ratios

Fiscal Years 2017 through 2014  
(in thousands, except for percentages)

|  | <u>Fiscal 2017</u>             | <u>Fiscal 2016</u>             | <u>Fiscal 2015</u>             | <u>Fiscal 2014</u>              |
|--|--------------------------------|--------------------------------|--------------------------------|---------------------------------|
| <b>Total pension liability (as of July 1)</b>                              | <b>\$47,300,000</b>            | <b>\$45,918,711</b>            | <b>\$41,435,000</b>            | <b>\$ 39,931,000</b>            |
| Service cost   | 891,760                        | 843,800                        | 768,032                        | 720,712                         |
| Interest   | 3,505,761                      | 3,402,525                      | 3,166,728                      | 3,227,025                       |
| Differences between expected and actual experience                         | 47,046                         | (74,025)                       | 153,000                        | -                               |
| Changes of assumptions (1), (2), (3)                                       | 1,176,000                      | -                              | 3,080,000                      | 108,000                         |
| <u>Benefit payments, including refunds of member contributions</u>         | <u>(2,896,567)</u>             | <u>(2,791,011)</u>             | <u>(2,684,049)</u>             | <u>(2,551,737)</u>              |
| Net change in total pension liability                                      | <u>2,724,000</u>               | <u>1,381,289</u>               | <u>4,483,711</u>               | <u>1,504,000</u>                |
| <br><b>Total pension liability (as of June 30)</b>                         | <br><b><u>\$50,024,000</u></b> | <br><b><u>\$47,300,000</u></b> | <br><b><u>\$45,918,711</u></b> | <br><b><u>\$ 41,435,000</u></b> |
| <br><b>Plan fiduciary net position (as of July 1)</b>                      | <br><b>\$24,942,072</b>        | <br><b>\$25,429,068</b>        | <br><b>\$25,538,646</b>        | <br><b>\$ 22,697,302</b>        |
| Contributions:   |                                |                                |                                |                                 |
| Non-employer - Commonwealth  | 1,235,515                      | 1,124,583                      | 1,021,930                      | 930,079                         |
| Plan members   | 730,212                        | 699,422                        | 669,941                        | 653,328                         |
| <u>Other additions</u>   | <u>223,746</u>                 | <u>202,796</u>                 | <u>190,925</u>                 | <u>178,998</u>                  |
| Total contributions  | 2,189,473                      | 2,026,801                      | 1,882,796                      | 1,762,405                       |
| Net investment income  | 3,100,352                      | 441,363                        | 845,503                        | 3,771,883                       |
| Benefit payments, including refunds of plan member contributions           | (2,896,567)                    | (2,791,011)                    | (2,684,049)                    | (2,551,737)                     |
| Administrative expense   | (24,053)                       | (24,220)                       | (23,444)                       | (20,499)                        |
| Other changes  | <u>(172,668)</u>               | <u>(139,929)</u>               | <u>(130,384)</u>               | <u>(120,708)</u>                |
| Net change in plan fiduciary net position                                  | <u>2,196,537</u>               | <u>(486,996)</u>               | <u>(109,578)</u>               | <u>2,841,344</u>                |
| <br><b>Plan fiduciary net position (as of June 30)</b>                     | <br><b><u>\$27,138,609</u></b> | <br><b><u>\$24,942,072</u></b> | <br><b><u>\$25,429,068</u></b> | <br><b><u>\$25,538,646</u></b>  |
| <br><b>Plan net pension liability/(asset) (as of June 30)</b>              | <br><b><u>\$22,885,391</u></b> | <br><b><u>\$22,357,928</u></b> | <br><b><u>\$20,489,643</u></b> | <br><b><u>\$15,896,354</u></b>  |
| Plan fiduciary net position as a percentage of the total pension liability | 54.3%                          | 52.7%                          | 55.4%                          | 61.6%                           |
| Covered employee payroll (4)   | <u>\$6,583,871</u>             | <u>\$6,388,732</u>             | <u>\$6,204,274</u>             | <u>\$ 5,962,650</u>             |
| Net pension liability/(asset) as a percentage of covered employee payroll  | 347.6%                         | 350.0%                         | 330.3%                         | 266.6%                          |

SOURCE: Office of the Comptroller

- (1) The changes in assumptions in fiscal 2015 were due to (i) a decrease in the investment rate of return (discount rate) from 8.0% to 7.75% in the January 1, 2015 actuarial valuation and (ii) improved future mortality.
- (2) The changes in assumptions in fiscal 2017 were due to improved future mortality.
- (3) Subsequent to the issuance of the fiscal 2015 CAFR, the Commonwealth further reduced its discount rate to 7.50% from 7.75%. Consequently, the Commonwealth has adjusted certain information as previously reported in the fiscal 2015 CAFR. This change resulted in an increase of approximately \$1.190 billion which affected the net pension liability as of and for the fiscal year ended June 30, 2015.
- (4) Reflects compensation in the January 1 actuarial valuation for each fiscal year.

## GASB 68 Information for the Massachusetts Teachers' Retirement System (1)

### Pension Expense and Deferred Outflows/Inflows of Resources

(in thousands)

Pension Expense for Fiscal 2017 (07/01/2015 - 06/30/2016)

|  |                           |
|--|---------------------------|
| Service cost   | \$843,800                 |
| Interest   | 3,402,525                 |
| Employee contributions   | (699,422)                 |
| Projected earnings on plan investments   | (1,853,858)               |
| Recognized portion of difference between expected and actual experience          | 12,738                    |
| Recognized portion of difference in projected and actual earnings on investments | 99,040                    |
| Recognized portion of plan benefit changes                                       | -                         |
| Recognized portion of assumption changes   | 514,479                   |
| Transfers and reimbursements from other systems                                  | (53,271)                  |
| Member make up, redeposit and payments from rollovers                            | (26,160)                  |
| Other reimbursements   | (2,931)                   |
| Administrative expense   | 24,220                    |
| <u>Other changes (net)</u>   | <u>19,495</u>             |
| <b>Pension expense</b>   | <b><u>\$2,280,655</u></b> |

### Deferred Outflows/(Inflows) of Resources

|  | Year of<br><u>Deferral</u> | Deferred<br><u>Outflows</u> | Deferred<br><u>(Inflows)</u> | Original<br><u>Amount</u> | Amortization<br><u>Period (years)</u> | <u>Amortization</u> |
|--|----------------------------|-----------------------------|------------------------------|---------------------------|---------------------------------------|---------------------|
| Difference between expected and actual experience                        | 2015                       | \$103,645                   | -                            | \$153,000                 | 6.2                                   | \$24,677            |
|  | 2016                       | -                           | (\$62,085)                   | (74,025)                  | 6.2                                   | (11,940)            |
| Assumption changes   | 2014                       | 54,885                      | -                            | 108,000                   | 6.1                                   | 17,705              |
|  | 2015                       | 2,086,452                   | -                            | 3,080,000                 | 6.2                                   | 496,774             |
| Net difference between projected and actual earnings on plan investments | 2014                       | -                           | (797,328)                    | (1,993,320)               | 5                                     | (398,664)           |
|  | 2015                       | 645,614                     | -                            | 1,076,024                 | 5                                     | 215,205             |
|  | 2016                       | <u>1,129,996</u>            | =                            | <u>1,412,495</u>          | 5                                     | <u>282,499</u>      |
| <b>Total</b>   |                            | <b>4,020,592</b>            | <b>(859,413)</b>             | <b>-</b>                  |                                       |                     |
| <b>Net</b>   |                            | <b>\$3,161,179</b>          | <b>-</b>                     | <b>\$3,762,174</b>        |                                       | <b>\$626,256</b>    |

### Projected Recognition of Deferred Outflows/(Inflows)

Deferred Inflows/(outflows) recognized in Future Pension Expense  
(fiscal years ending June 30)

|  | <u>2018</u>             | <u>2019</u>             | <u>2020</u>               | <u>2021</u>             | <u>2022</u>            | <u>2023</u>             |
|--|-------------------------|-------------------------|---------------------------|-------------------------|------------------------|-------------------------|
| Difference between expected and actual experience                        | \$12,738                | \$12,738                | \$12,738                  | \$12,738                | (\$7,004)              | (\$2,388)               |
| Assumption changes   | 514,479                 | 514,479                 | 514,479                   | 498,545                 | 99,355                 | -                       |
| Net difference between projected and actual earnings on plan investments | <u>99,040</u>           | <u>99,040</u>           | <u>497,704</u>            | <u>282,498</u>          | -                      | -                       |
| <b>Total</b>   | <b><u>\$626,257</u></b> | <b><u>\$626,257</u></b> | <b><u>\$1,024,921</u></b> | <b><u>\$793,781</u></b> | <b><u>\$92,351</u></b> | <b><u>(\$2,388)</u></b> |

(1) Fiscal 2016 information is used in the fiscal 2017 CAFR; fiscal 2017 information is to be used in the fiscal 2018 CAFR.

**GASB 67 Information for the State Employees' Retirement System  
Schedule of Changes in the Net Pension Liability and Related Ratios**

Fiscal Year 2017 through 2014  
(in thousands, except for percentages)

|  | <u>Fiscal 2017</u>         | <u>Fiscal 2016</u>         | <u>Fiscal 2015</u>         | <u>Fiscal 2014</u>          |
|--|----------------------------|----------------------------|----------------------------|-----------------------------|
| <b>Total pension liability (as of July 1)</b>                              | <b>\$37,760,000</b>        | <b>\$35,425,414</b>        | <b>\$31,355,000</b>        | <b>\$ 29,988,000</b>        |
| Service cost   | 855,440                    | 813,975                    | 700,012                    | 631,634                     |
| Interest   | 2,813,374                  | 2,638,929                  | 2,411,551                  | 2,405,204                   |
| Changes in benefit terms (1)   | 10,000                     | 400,000                    | 230,302                    | -                           |
| Differences between expected and actual experience                         | (428,232)                  | 589,009                    | 275,000                    | -                           |
| Changes of assumptions (2), (3), (4)                                       | 304,000                    | -                          | 2,330,000                  | 102,000                     |
| Benefit payments, including refunds of member contributions                | <u>(2,207,582)</u>         | <u>(2,107,327)</u>         | <u>(1,876,451)</u>         | <u>(1,771,838)</u>          |
| Net change in total pension liability                                      | <u>1,347,000</u>           | <u>2,334,586</u>           | <u>4,070,414</u>           | <u>1,367,000</u>            |
| <b>Total pension liability (as of June 30)</b>                             | <b><u>\$39,107,000</u></b> | <b><u>\$37,760,000</u></b> | <b><u>\$35,425,414</u></b> | <b><u>\$ 31,355,000</u></b> |
| <br>   |                            |                            |                            |                             |
| <b>Plan fiduciary net position (as of July 1)</b>                          | <b>\$23,971,156</b>        | <b>\$24,042,585</b>        | <b>\$23,930,895</b>        | <b>\$ 21,084,958</b>        |
| Contributions:   |                            |                            |                            |                             |
| Employers – Commonwealth and MassDOT                                       | 716,266                    | 660,818                    | 601,931                    | 550,438                     |
| Non-employer contributions – Commonwealth                                  | 28,455                     | 21,830                     | 18,040                     | 21,293                      |
| Employers and non-employers – other  | 7,999                      | 16,642                     | 15,808                     | 6,048                       |
| ERIP funding contribution - Commonwealth                                   | 29,093                     | 29,093                     | -                          | -                           |
| Plan members   | 604,772                    | 591,948                    | 549,493                    | 501,106                     |
| Other additions  | <u>232,548</u>             | <u>397,077</u>             | <u>92,503</u>              | <u>68,967</u>               |
| Total contributions  | <u>1,619,133</u>           | <u>1,717,408</u>           | <u>1,277,775</u>           | <u>1,147,897</u>            |
| Net investment income  | 2,987,632                  | 422,938                    | 800,886                    | 3,551,012                   |
| Benefit payments, including refunds of plan member contributions           | <u>(2,207,582)</u>         | <u>(2,107,327)</u>         | <u>(1,876,451)</u>         | <u>(1,771,838)</u>          |
| Administrative expense   | <u>(30,030)</u>            | <u>(20,624)</u>            | <u>(15,966)</u>            | <u>(12,705)</u>             |
| Other changes  | <u>(58,077)</u>            | <u>(83,824)</u>            | <u>(74,554)</u>            | <u>(68,429)</u>             |
| Net change in plan fiduciary net position                                  | <u>2,311,076</u>           | <u>(71,429)</u>            | <u>111,690</u>             | <u>2,845,937</u>            |
| <br>   |                            |                            |                            |                             |
| <b>Plan fiduciary net position (as of June 30)</b>                         | <b><u>\$26,282,232</u></b> | <b><u>\$23,971,156</u></b> | <b><u>\$24,042,585</u></b> | <b><u>\$23,930,895</u></b>  |
| <br>   |                            |                            |                            |                             |
| <b>Plan net pension liability/(asset) (as of June 30)</b>                  | <b><u>\$12,284,768</u></b> | <b><u>\$13,788,844</u></b> | <b><u>\$11,382,829</u></b> | <b><u>\$7,424,105</u></b>   |
| <br>   |                            |                            |                            |                             |
| Plan fiduciary net position as a percentage of the total pension liability | 67.2%                      | 63.5%                      | 67.9%                      | 76.3%                       |
| <u>Covered employee payroll (5)</u>  | <u>\$5,927,012</u>         | <u>\$5,792,288</u>         | <u>\$5,591,911</u>         | <u>\$5,344,510</u>          |
| Net pension liability/(asset) as a percentage of covered employee payroll  | 216.4%                     | 238.1%                     | 203.6%                     | 138.9%                      |

SOURCE: Office of the Comptroller

- (1) Fiscal 2015 change in benefit terms reflects costs associated with the retirement incentive program approved in May, 2015. Fiscal 2016 change in benefit terms reflect costs related to Optional Retirement Plan members transferring to the State Employees' Retirement System pursuant to Chapter 176 of the Acts of 2011. Fiscal 2017 change in benefit terms reflect retirement incentive program for certain employees of the highway division of the Massachusetts Department of Transportation.
- (2) The changes in assumptions in fiscal 2015 were due to (1) a decrease in the investment rate of return (discount rate) from 8.0% to 7.75% in the January 1, 2015 actuarial valuation and (2) improved future mortality.
- (3) Subsequent to the issuance of the fiscal 2015 CAFR, the Commonwealth further reduced its discount rate to 7.50% from 7.75%. Consequently, the Commonwealth has adjusted certain information as previously reported in the fiscal 2015 CAFR. This change resulted in an increase of approximately \$933 million which affected the net pension liability as of and for the fiscal year ended June 30, 2015.
- (4) The changes in assumptions in fiscal 2017 were due to improved future mortality.
- (5) Reflects compensation in the January 1 actuarial valuation for each fiscal year.

**GASB 68 Information for the State Employees' Retirement System (1)**  
**Pension Expense and Deferred Outflows/Inflows of Resources**  
(in thousands)

Pension Expense for Fiscal 2017 (07/01/2015 - 06/30/2016)

|  |                           |
|--|---------------------------|
| Service cost   | \$813,975                 |
| Interest   | 2,638,929                 |
| Employee contributions   | (591,948)                 |
| Projected earnings on plan investments   | (1,767,568)               |
| Recognized portion of difference between expected and actual experience          | 159,076                   |
| Recognized portion of difference in projected and actual earnings on investments | 91,915                    |
| Recognized portion of assumption change  | 442,182                   |
| Change in benefit terms  | 400,000                   |
| Transfers and reimbursements from other systems                                  | (194,250)                 |
| Member make up, redeposit and payments from rollovers                            | (138,873)                 |
| COLA reimbursements  | (25,235)                  |
| Other reimbursements   | (38,720)                  |
| Administrative expense   | 20,624                    |
| Other expenses that do not reduce the total pension liability                    | <u>83,825</u>             |
| <b>Pension expense</b>   | <b><u>\$1,893,932</u></b> |

**Deferred Outflows/(Inflows) of Resources**

|   | <u>Year of<br/>Deferral</u> | <u>Deferred<br/>Outflows</u> | <u>Deferred<br/>Inflows</u> | <u>Original<br/>Amount</u> | <u>Amortization<br/>Period (years)</u> | <u>Amortization</u> |
|---|-----------------------------|------------------------------|-----------------------------|----------------------------|--|---------------------|
| Difference between<br>expected and actual<br>experience                           | 2015                        | \$175,000                    | -                           | \$275,000                  | 5.5                                    | \$50,000            |
|   | 2016                        | 479,933                      | -                           | 589,009                    | 5.4                                    | 109,076             |
| Assumption changes  | 2014                        | 46,363                       | -                           | 102,000                    | 5.5                                    | 18,546              |
|   | 2015                        | 1,482,728                    | -                           | 2,330,000                  | 5.5                                    | 423,636             |
| Net difference<br>between projected<br>and actual earnings<br>on plan investments | 2014                        | -                            | (761,893)                   | (1,904,736)                | 5.0                                    | (380,948)           |
|   | 2015                        | 611,809                      | -                           | 1,019,683                  | 5.0                                    | 203,937             |
|   | 2016                        | <u>1,075,704</u>             | -                           | <u>1,344,630</u>           | 5.0                                    | <u>(268,926)</u>    |
| <b>Total</b>  |                             | <b>3,871,537</b>             | <b>(761,893)</b>            | -                          |  | -                   |
| <b>Net</b>  |                             | <b>\$3,109,644</b>           |                             | <b>\$3,755,586</b>         |  | <b>\$155,321</b>    |

**Projected Recognition of Deferred Outflows/(Inflows)**

Deferred Inflows/(outflows) recognized in Future Pension Expense  
(fiscal years ending June 30)

|  | <u>2018</u>             | <u>2019</u>             | <u>2020</u>               | <u>2021</u>             | <u>2022</u>            |
|--|-------------------------|-------------------------|---------------------------|-------------------------|------------------------|
| Difference between expected and actual experience                        | \$159,076               | \$159,076               | \$159,076                 | \$134,075               | \$43,630               |
| Assumption changes   | 442,182                 | 442,182                 | 432,909                   | 211,818                 | -                      |
| Net difference between projected and actual earnings on plan investments | <u>91,915</u>           | <u>91,915</u>           | <u>472,863</u>            | <u>268,927</u>          | -                      |
| <b>Total</b>   | <b><u>\$693,173</u></b> | <b><u>\$693,173</u></b> | <b><u>\$1,064,848</u></b> | <b><u>\$614,820</u></b> | <b><u>\$43,630</u></b> |

(1) Fiscal 2016 information is used in the fiscal 2017 CAFR; fiscal 2017 information is to be used in the fiscal 2018 CAFR.

**Prospective Funded Status of the Pension System**

The following tables project the funded status of the MSERS', the MTRS', the Boston teachers', and the Commonwealth's aggregate pension liabilities through fiscal 2022. Actuarial results reflect assumptions outlined in the January 1, 2017 actuarial valuation report, except that fiscal 2018 assets are as of December 31, 2017. All projections are estimates and will vary based on actual investment returns and plan experience. The projections in this table assume that all assumptions will be realized exactly. The actuarially determined contributions for fiscal 2017 were the amounts required by the funding schedule approved in 2014, plus the additional \$29.1 million appropriations made on account of the employee retirement incentive program. For fiscal 2018 and beyond, these figures reflect the funding schedule filed in 2017. Under this schedule, appropriations increase by 8.94% per year until fiscal 2036. The allocations to individual retirement systems for fiscal 2018 reflect the amounts identified in a memorandum dated May 24, 2017 from the Executive Director of PERAC to the Secretary of Administration and Finance. The allocations to individual retirement systems for fiscal 2019 and beyond are estimated. Actuarial figures other than the actuarially determined contribution reflect January 1 estimates of the fiscal year shown.

The actuarial value of assets on January 1, 2017 was 101.7% of the market value of assets. The actuarial value of assets on January 1, 2018 is 94.6% of the market value of assets. The actuarial value of assets on January 1, 2019 is assumed to be 96.0% of the market value of assets. The actuarial value of assets on January 1, 2020 is assumed to be 98.0% of the market value of assets. The actuarial value of assets on January 1, 2021 and 2022 is assumed to be 100.0% of the market value of assets. The actuarial value of assets is projected using the past history of PRIT Fund cash flows to estimate future cash flows

The actuarial liability is projected from January 1, 2017 to January 1, 2018 using standard methodology. Projections beyond January 1, 2018 reflect slightly decreasing percentage increases to reflect the impact of pension reform legislation enacted in 2011 as well as employee contribution increases as a percentage of pay. Funding schedule information is based on the funding schedule filed by the Secretary of Administration and Finance on January 13, 2017.

For the purpose of calculating the actuarially determined contribution as a percentage of total budgeted operating funds expenditures, the Executive Office for Administration and Finance used the 4.1% compound annual growth rate of budgeted revenues from fiscal 2008 to estimated fiscal 2018. This measure is also used in the Commonwealth's debt affordability analysis. This does not represent an official forecast of the growth in Total Budgeted Expenditures and Other Uses by the Executive Office for Administration and Finance.

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**Prospective Funded Status of the Pension System** (in millions, except for percentages) (1)

| <u>Fiscal Year</u>   | <u>Actuarially Determined Contribution (ADC)</u> | <u>Actuarial Value of Assets</u> | <u>Actuarial Accrued Liability</u> | <u>Unfunded Actuarial Liability</u> | <u>Funded Ratio</u> | <u>ADC as a % of Total Budgeted Operating Funds Expenditures</u> |
|--|--|----------------------------------|------------------------------------|-------------------------------------|---------------------|--|
| <b><u>MSERS</u></b>  |  |                                  |                                    |                                     |                     |  |
| 2017   | \$792  | \$24,773                         | \$38,317                           | \$13,544                            | 64.7%               | 1.8%   |
| 2018   | 910  | 26,248                           | 39,855                             | 13,607                              | 65.9                | 2.0  |
| 2019   | 991  | 27,727                           | 41,528                             | 13,801                              | 66.8                | 2.1  |
| 2020   | 1,080  | 29,513                           | 43,231                             | 13,719                              | 68.3                | 2.2  |
| 2021   | 1,177  | 31,440                           | 44,960                             | 13,521                              | 69.9                | 2.3  |
| 2022   | 1,282  | 32,864                           | 46,759                             | 13,895                              | 70.3                | 2.4  |
| <b><u>MTRS</u></b>   |  |                                  |                                    |                                     |                     |  |
| 2017   | \$1,246  | \$25,638                         | \$49,194                           | \$23,556                            | 52.1%               | 2.8%   |
| 2018   | 1,303  | 27,058                           | 50,839                             | 23,781                              | 53.2                | 2.9  |
| 2019   | 1,419  | 28,467                           | 52,568                             | 24,100                              | 54.2                | 3.0  |
| 2020   | 1,546  | 30,172                           | 54,302                             | 24,130                              | 55.6                | 3.1  |
| 2021   | 1,685  | 32,008                           | 56,040                             | 24,032                              | 57.1                | 3.3  |
| 2022   | 1,835  | 33,319                           | 57,777                             | 24,458                              | 57.7                | 3.4  |
| <b><u>Boston Teachers</u></b>                                |  |                                  |                                    |                                     |                     |  |
| 2017   | \$132  | \$1,541                          | \$3,917                            | \$2,376                             | 39.3%               | 0.3%   |
| 2018   | 131  | 1,612                            | 4,020                              | 2,408                               | 40.1                | 0.3  |
| 2019   | 143  | 1,689                            | 4,148                              | 2,459                               | 40.7                | 0.3  |
| 2020   | 155  | 1,782                            | 4,277                              | 2,495                               | 41.7                | 0.3  |
| 2021   | 169  | 1,882                            | 4,405                              | 2,523                               | 42.7                | 0.3  |
| 2022   | 185  | 1,951                            | 4,537                              | 2,586                               | 43.0                | 0.3  |
| <b><u>Aggregate Commonwealth Pension Obligations (2)</u></b> |  |                                  |                                    |                                     |                     |  |
| 2017 (3)   | \$2,198  | \$51,952                         | \$91,574                           | \$39,622                            | 56.7%               | 5.0%   |
| 2018   | 2,395  | 54,918                           | 94,848                             | 39,930                              | 57.9                | 5.3  |
| 2019   | 2,608  | 57,883                           | 98,369                             | 40,485                              | 58.8                | 5.5  |
| 2020   | 2,842  | 61,467                           | 101,925                            | 40,458                              | 60.3                | 5.8  |
| 2021   | 3,095  | 65,330                           | 105,511                            | 40,181                              | 61.9                | 6.0  |
| 2022   | 3,372  | 68,134                           | 109,170                            | 41,036                              | 62.4                | 6.3  |

SOURCE: Executive Office for Administration and Finance and Public Employee Retirement Administration Commission.

- (1) Actuarial results reflect figures and assumption outlined in the January 1, 2017 Commonwealth Actuarial Valuation Report, except that fiscal 2018 assets are as of December 31, 2017.
- (2) Aggregate Commonwealth pension obligations include obligations with respect to MSERS, MTRS, Boston teachers, and local cost-of-living adjustments.
- (3) Legislation approved in August, 2015 mandated a fiscal 2017 appropriation of \$2,198,092,616, reflecting a \$29.1 million increase to defray costs associated with the employee retirement incentive program.

**PRIT Fund Investments**

The mission of the PRIM Board is to manage the PRIT Fund so as to ensure that pension assets are well invested so that current and future benefit obligations are adequately funded in a cost-effective manner. The PRIM Board therefore seeks to maximize the total return on investment, within acceptable levels of risk and cost for an approximately 60% funded public pension fund. Under current law and projections, by the year 2040 the PRIT Fund plans to have grown, through annual payments in accordance with a legislatively approved funding schedule and through the total return of the fund, to an amount sufficient to meet the then existing pension obligations of the Commonwealth.

The PRIM Board recognizes that over the long-term, asset allocation is the single greatest contributor of return and risk to the PRIT Fund. The asset allocation plan adopted by the Board embodies its decisions about what proportions of the PRIT Fund are to be invested in domestic and international equity and fixed income securities, alternative investments such as real estate, private equity and hedge funds, and, where appropriate, the various sub-

asset classes of each category. At reasonable intervals of not more than three to five years, the Board conducts a comprehensive review of its asset allocation plan and its underlying assumptions, including the Commonwealth's current and projected pension assets and liabilities, long-term capital markets rate of return assumptions, and the Board's risk tolerances. The comprehensive review identifies a reasonable time horizon and investment strategy for matching assets and liabilities, a fund-level total return target, and an optimal allocation among available asset classes and sub-asset classes. The Board examines the asset allocation plan annually and makes adjustments to the plan as may be appropriate given the PRIT Fund's long-term nature and objectives. PRIM has been informed that the current target actuarial rate of return is 7.5%. The PRIM Board does not determine this rate of return, but this rate of return is a key input into the PRIM Board's asset allocation decisions.

The actual asset allocation mix invariably deviates from the PRIT Fund's target allocations due to market movement, cash flows, and manager performance. Material deviations from the asset allocation targets can alter the expected return and risk of the PRIT Fund. The following table sets forth the actual PRIT Fund asset allocation for each of the most recent five fiscal years, as well as the current targets. The actual allocation figures are as of June 30 for each of the years indicated. The targets are those contained in the asset allocation plan, which was most recently reviewed on February 15, 2018.

#### **PRIT Fund Asset Allocation**

|                                 | <u>2013</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> | <u>2017</u> | <u>Target</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|---------------|
| Domestic Equity                 | 20.8%       | 19.0%       | 19.2%       | 18.7%       | 19.8%       | 17.5%         |
| International Equity            | 18.0        | 17.1        | 16.9        | 16.5        | 18.0        | 15.5          |
| Emerging Markets Equity         | 6.5         | 7.0         | 6.6         | 7.0         | 7.9         | 6.0           |
| Core Fixed Income               | 12.6        | 13.9        | 13.7        | 13.9        | 12.0        | 12.0          |
| Value-Added Fixed Income        | 8.9         | 8.5         | 8.3         | 8.4         | 8.1         | 10.0          |
| Private Equity                  | 11.7        | 11.1        | 11.3        | 11.1        | 10.6        | 12.0          |
| Real Estate                     | 8.2         | 8.9         | 10.0        | 10.4        | 9.1         | 10.0          |
| Timber/Natural Resources        | 4.0         | 3.9         | 3.8         | 3.3         | 3.7         | 4.0           |
| Hedge Funds                     | 9.2         | 9.6         | 9.1         | 8.6         | 8.4         | 0.0           |
| Portfolio Completion Strategies | n/a         | 0.0         | 0.2         | 1.2         | 1.1         | 13.0          |

SOURCE: Pension Reserves Investment Management Board.

The following table sets forth the investment rates of return for the assets in the PRIT Fund for the last 10 fiscal years:

#### **PRIT Fund Rates of Return (Gross of Fees)**

| <u>Fiscal Year</u> | <u>Rate of Return</u> | <u>Fiscal Year</u> | <u>Rate of Return</u> |
|--------------------|-----------------------|--------------------|-----------------------|
| <b>2017</b>        | 13.20%                | <b>2012</b>        | (0.08)%               |
| <b>2016</b>        | 2.29                  | <b>2011</b>        | 22.30                 |
| <b>2015</b>        | 3.86                  | <b>2010</b>        | 12.82                 |
| <b>2014</b>        | 17.53                 | <b>2009</b>        | (23.87)               |
| <b>2013</b>        | 12.69                 | <b>2008</b>        | (1.81)                |
|                    | <b>3yr average</b>    |                    | 6.34%                 |
|                    | <b>5yr average</b>    |                    | 9.76%                 |
|                    | <b>10yr average</b>   |                    | 5.08%                 |

SOURCE: Pension Reserves Investment Management Board.

## Other Post-Employment Benefit Obligations (OPEB)

In addition to providing pension benefits, the Commonwealth is statutorily required to provide certain health care and life insurance benefits (“other post-employment benefits” or “OPEB”) for retired employees of the Commonwealth, as well as retired employees of housing authorities, redevelopment authorities and certain other governmental agencies (offline agencies). Substantially all of the Commonwealth’s employees may become eligible for these benefits if they reach retirement age and eligibility while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care/benefit costs. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. (Although, as noted above, the Commonwealth is required to pay pensions to retired municipal teachers, the Commonwealth has no OPEB obligations with respect to retired municipal teachers.)

The GIC manages the Commonwealth’s other post-employment benefits for all state and certain agency employees and retirees. The GIC has representation on the Board of Trustees of the State Retiree Benefits Trust (SRBT). The SRBT is set up to pay for former state employees’ OPEB benefits and to invest state and certain municipalities funds that have been set aside to pay for OPEB benefits and the cost to administer those funds and can only be dissolved when all such health care and other non-pension benefits, current and future, have been paid or defeased.

The Commonwealth also oversees the management and administration of the Massachusetts Turnpike Authority Retiree Benefits Trust, which is restricted for OPEB benefits of the retirees of the former Massachusetts Turnpike Authority.

Employer and employee contribution rates are set by statute. The Commonwealth recognizes its share of the costs on an actuarial basis. As of June 30, 2017, Commonwealth participants contributed 10% to 25% of premium costs, depending on the date of hire and whether the participant is active, retiree or survivor status. See “COMMONWEALTH EXPENDITURES – Employee Benefits; *Group Insurance*.” According to the most recent actuarial valuation as of January 1, 2017, the GIC had 155,247 state enrollees as of January 1, 2017. As of that date, the Commonwealth was responsible for the OPEB liability of 129,017 of those enrollees.

Accounting standards promulgated in 2004 by the Governmental Accounting Standards Board (GASB) required the Commonwealth to begin disclosing its OPEB liability in its fiscal 2008 financial reports.

For fiscal 2017, governmental GAAP reporting is governed by two standards that have different requirements for calculating discount rates. Under GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which is effective for fiscal years beginning after June 15, 2016 (i.e., for fiscal 2017), OPEB plans are required to discount retiree health care liabilities, based on a blend of 30-year municipal bond rates and the expected return for assets in the trust, “blended,” or weighted, by the funding level of the OPEB trust relative to OPEB liabilities. The rate of return for assets in the OPEB trust is assumed to be 7.50%, consistent with the rate used for the Commonwealth’s pension trust, while the relevant municipal bond rate is 3.58%, resulting in a 3.63% blended discount rate, weighted towards the lower municipal bond rate due to the relatively low funding level of the OPEB trust in relation to the Commonwealth’s OPEB liability. Under GASB Statement No. 45, which governs how OPEB liabilities are discounted in the Commonwealth’s financial statements through fiscal 2017, the Commonwealth is required to discount retiree health care liabilities at the estimated long-term yield on investments that are expected to be used to finance the payment of benefits. Since the Commonwealth’s OPEB plan is not pre-funded, the discount rate is based on the portfolio of the general assets used to pay these benefits. Historical monthly yields for this portion of the portfolio are derived from the rate of return of the Massachusetts Municipal Depository Trust (MMDT). While the calculations under GASB Statement No. 45 and GASB Statement No. 74 result in different discount rates, in the interest of consistency and clarity the same rate was used for both calculations, based on the GASB Statement No. 74 requirements.

The January 1, 2017 actuarial valuation was issued on November 10, 2017. According to the report, the Commonwealth’s actuarial accrued OPEB liability, assuming no pre-funding and using a discount rate of 3.63%, was approximately \$19.446 billion as of January 1, 2017. As noted above, the 3.63% discount rate was calculated in accordance with GASB 74 requirements.

A liability for the difference between the amount funded and the actuarially required contribution is reflected on the Commonwealth’s statement of net position, as presented on a GAAP basis. The liability increases or

decreases each year depending on the amount funded, investment return and changes in amortization and assumptions. This change is reflected either as a revenue or expense item in the Commonwealth's statement of activities as presented on a GAAP basis, dependent on these factors. As of June 30, 2017, this net OPEB obligation as reflected on the Commonwealth's statement of net position is \$7.581 billion.

The independent actuarial report covers only the Commonwealth's OPEB obligations for Commonwealth employees and their survivors. Municipalities and authorities of the Commonwealth, even if their health care coverage is administered by the Group Insurance Commission, perform their own valuations, as the Commonwealth acts only as an agent for the entities that participate in the GIC with respect to providing OPEB health insurance benefits and does not assume the risk or financial burden of their health care costs.

GASB Statement No. 45 requires that OPEB obligations be recalculated at two-year intervals. Such calculations may be affected by many factors, including changing experience and assumptions regarding future health care claims, coverage levels and retiree contribution requirements. Accordingly, the actuarial accrued liability of the Commonwealth for OPEB liabilities may fluctuate.

In June 2015, GASB issued a new standard modifying the accounting and financial reporting of the Commonwealth's OPEB, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which is effective for the Commonwealth's fiscal 2018 CAFR. GASB 75 requires governments to report in their statements of net position (or balance sheet) a net OPEB liability, defined as the difference between the total OPEB liability (the present value of projected benefit payments to retirees for certain health care benefits based on past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to retirees or their beneficiaries. The new standard also requires recognition in the statement of activities of net OPEB expense. The rate used to discount projected benefit payments to their present value is based on a single rate that reflects (a) the long-term expected rate of return on plan investments as long as the plan net position is projected under specified conditions to be sufficient to make projected benefit payments and the OPEB plan assets are expected to be invested using a strategy to achieve that return and (b) a yield or index rate on tax-exempt 20-year AA-or-higher rated general obligation municipal bonds to the extent that the conditions for use of the long-term expected rate of return are not met. This statement is similar to the requirements of GASB 68, *Accounting and Financial Reporting for Pensions*, which was first implemented in the fiscal 2015 CAFR.

The State Retiree Benefits Trust Fund was created to consolidate the state's retiree funding efforts and better project future liabilities, and beginning in fiscal 2008, expenses for current state retirees' healthcare were paid from the fund. Also in fiscal 2008, the fund benefited from a one-time transfer of approximately \$329 million from the Health Care Security Trust. The fiscal 2012 budget included a requirement that, beginning in fiscal 2013, 10% of the annual tobacco payments be transferred to the State Retiree Benefits Trust Fund, with the amount deposited to the State Retiree Benefits Trust Fund to increase by 10% increments annually thereafter until 100% of all payments would be transferred to that Fund. Pursuant to this requirement, in May, 2013, tobacco settlement proceeds in the amount of \$25.3 million were transferred to the State Retiree Benefits Trust Fund.

The fiscal 2014 budget included a provision that funded the scheduled transfer to the State Retiree Benefits Trust Fund from unspent appropriations, to the extent that they were available, with any balance to be made up through a transfer of tobacco settlement proceeds. In fiscal 2014, pursuant to that provision, unspent appropriations in the amount of \$56.4 million were transferred to the State Retirees Benefits Trust Fund, and approximately \$15 million of tobacco proceeds were used to fund the balance of the transfer.

The fiscal 2015 budget contained a similar provision requiring the transfer of tobacco settlement funds, equal to approximately \$73.7 million, to be funded from unspent appropriations, to the extent that they were available, with any balance to be made up through a transfer of tobacco settlement proceeds. In fiscal 2015, pursuant to that provision, unspent appropriations in the amount of \$44 million were transferred to the State Retirees Benefits Trust Fund, and approximately \$29.7 million of tobacco proceeds were used to fund the balance of the transfer.

The fiscal 2016 budget contained a similar provision requiring that transfers be made equivalent to 30% of fiscal 2016 tobacco settlement proceeds (the same percentage required in fiscal 2015), or approximately \$77 million, to be funded from unspent appropriations, to the extent they were available, with any balance to be made up through a transfer of fiscal 2016 tax revenues exceeding \$100 million generated by a tax amnesty program that was also

authorized in the fiscal 2016 budget. In fiscal 2016, pursuant to the budget, unexpended appropriations in the amount of \$77.3 million were transferred to the State Retirees Benefits Trust Fund.

The fiscal 2017 budget enacted by the Legislature requires that transfers be made equivalent to 10% of fiscal 2017 tobacco settlement proceeds, or approximately \$25.4 million. That transfer is contingent on the availability of unexpended appropriations, and if those are insufficient to fund the 10% transfer, the balance of the 10% will be funded by tobacco settlement revenues. The Governor returned that section of the Legislature’s proposal with an amendment, proposing instead to require a 30% transfer, as in fiscal 2016, which would result in a transfer of approximately \$76 million. The Governor’s proposal was not acted upon by the Legislature, and expired at the end of the legislative session. Accordingly, under the fiscal 2012 provision cited above, 50% of fiscal 2017 tobacco settlement proceeds, or approximately \$127 million, will be required to be transferred to the State Retirees Benefits Trust Fund unless that provision is modified or waived by a legislative change. The Governor included a proposal in the February 2017 supplemental budget to transfer the equivalent of 10% of fiscal 2017 tobacco settlement proceeds. That proposal was adopted by the Legislature, and approximately \$25.4 million was transferred to the State Retirees Benefits Trust Fund for fiscal 2017.

The fiscal 2018 budget enacted by the Legislature requires that transfers be made equivalent to 10% of the fiscal 2018 tobacco proceeds, or approximately \$25.4 million. The transfer is contingent on the availability of unexpended appropriations, and if those are insufficient to fund the 10% transfer, the balance of the 10% will be funded by tobacco settlement revenues.

State finance law also provides for annual deposits in to the State Retiree Benefits Trust Fund in the amount of 5% of any capital gains tax revenues transferred to the Stabilization Fund in excess of the statutory capital gains threshold. This resulted in deposits to the State Retiree Benefits Trust Fund of \$23.4 million in fiscal 2013 and \$2.3 million in fiscal 2014. This requirement was suspended by the legislature for fiscal years 2015 and 2016, but reinstated for fiscal 2017. As the fiscal 2017 capital gains tax revenues did not exceed the statutory capital gains threshold, no deposits were made to the State Retiree Benefits Trust Fund in fiscal 2017.

The actuarial value of plan assets as of January 1, 2017 was approximately \$817 million.

**State Retiree Benefits Trust**  
(in thousands, except for percentages)

| <b>Actuarial Valuation<br/>as of January 1:</b> | <b>Actuarial<br/>Value of<br/>Plan Assets</b> | <b>Actuarial<br/>Liability</b> | <b>Accrued<br/>Unfunded<br/>Liability<br/>(UAAL)</b> | <b>Actuarial Ratio<br/>Covered</b> | <b>Funded Payroll</b> | <b>Annual<br/>Covered<br/>Payroll as %<br/>of UAAL</b> |
|---|---|--------------------------------|--|------------------------------------|-----------------------|--|
| <b>2017</b>                                     | \$817,400                                     | \$20,263,500                   | \$19,446,100   | 4.0%                               | \$5,927,012           | 328.1%   |
| <b>2016</b>                                     | 760,400                                       | 17,082,900                     | 16,322,500   | 4.5                                | 5,792,288             | 281.8  |
| <b>2015</b>                                     | 610,000                                       | 16,502,800                     | 15,892,800   | 3.7                                | 5,591,911             | 284.2  |
| <b>2014</b>                                     | 511,200                                       | 15,670,200                     | 15,159,000   | 3.3                                | 5,344,500             | 283.6  |
| <b>2013</b>                                     | 406,700                                       | 15,784,100                     | 15,377,400   | 2.6                                | 5,183,195             | 296.7  |
| <b>2012</b>                                     | 360,500                                       | 16,559,400                     | 16,298,900   | 2.2                                | 4,922,388             | 331.1  |
| <b>2011</b>                                     | 350,500                                       | 16,568,600                     | 16,218,100   | 2.1                                | 4,808,250             | 337.3  |
| <b>2010</b>                                     | 309,800                                       | 15,166,300                     | 14,856,500   | 2.0                                | 4,711,563             | 315.3  |
| <b>2009</b>                                     | 273,500                                       | 15,305,100                     | 15,031,600   | 1.8                                | 4,712,655             | 319.0  |
| <b>2008</b>                                     | -   | 9,812,000                      | 9,812,000  | 0.0                                | 4,574,233             | 214.5  |

SOURCE: Office of the Comptroller and Public Employee Retirement Administration Commission

## COMMONWEALTH CAPITAL INVESTMENT PLAN

The Executive Office for Administration and Finance annually updates its five-year capital investment plan on a rolling basis. The five-year plan coordinates capital expenditures by state agencies and authorities that are funded primarily by Commonwealth debt and federal reimbursements. The capital investment plan for fiscal 2018 through fiscal 2022 provides resources for various Commonwealth facilities and programs.

The Executive Office for Administration and Finance also sets an annual administrative limit on the amount of bond-funded capital expenditures. The purpose of the administrative limit, known as the “bond cap,” is to keep Commonwealth debt within affordable levels. In May, 2017, the Governor announced the five-year capital investment plan for fiscal 2018 through fiscal 2022 and an administrative bond cap of \$2.26 billion. This increase represents a 3.2% increase over fiscal 2017, a smaller increase than projected growth in tax revenues.

The following table shows the allocation of administrative bond cap spending by agency and the allocation of total capital spending from all sources of funding for fiscal 2018:

### Fiscal Year 2018 Capital Budget (in millions)

| <u>Agency</u>                     | <u>Bond Cap</u>  | <u>Project-<br/>Financed</u> | <u>Federal<br/>Funds</u> | <u>Other<br/>Funds</u> | <u>Total</u>     |
|-----------------------------------|------------------|------------------------------|--------------------------|------------------------|------------------|
| Administration and Finance        | \$123.9          | \$5.0                        | \$0.0                    | \$118.6                | \$247.4          |
| Capital Asset Management          | 522.5            | 12.5                         | 0.5                      | 32.0                   | 567.4            |
| Education                         | 19.0             | -                            | -                        | 12.0                   | 31.0             |
| Energy and Environmental Affairs  | 210.1            | 2.5                          | 59.1                     | 54.5                   | 326.1            |
| Housing and Community Development | 210.8            | -                            | 3.0                      | 10.0                   | 223.8            |
| Housing and Economic Development  | 131.9            | -                            | -                        | 26.5                   | 158.4            |
| MassIT                            | 138.5            | 42.5                         | 120.3                    | 8.3                    | 309.7            |
| Public Safety                     | 19.2             | 1.2                          | -                        | -                      | 20.4             |
| MassDOT                           | <u>884.1</u>     | <u>0.0</u>                   | <u>910.8</u>             | <u>686.7</u>           | <u>2,481.6</u>   |
| <b>Total (1)</b>                  | <b>\$2,260.0</b> | <b>\$63.7</b>                | <b>\$1,093.7</b>         | <b>\$948.5</b>         | <b>\$4,365.9</b> |

SOURCE: Executive Office for Administration as of May 11, 2017.

(1) Totals may not add due to rounding.

The different sources of funding for the capital program, as reflected in the table above, include:

- Administrative Bond Cap – Commonwealth general obligation borrowing to support the regular capital program.
- Project Financed – General obligation bonds, the debt service for which is supported by savings or revenue related to the project; for example, energy efficiency improvements to Commonwealth facilities, the capital costs for which are expected to be reimbursed through operating savings as a result of reduced energy consumption.
- Federal Funds – Federal reimbursements for capital expenditures.
- Other Funds:
  - Accelerated Bridge Program (ABP) – Commonwealth special obligation bonds secured by revenues credited to the Commonwealth Transportation Fund (CTF) or federal grant anticipation notes secured by federal highway reimbursements issued to fund capital improvements to structurally deficient bridges through the ABP.
  - Rail Enhancement Program (REP) – Commonwealth special obligation bonds to be secured by revenues credited to the CTF to finance certain transit infrastructure projects through the REP, previously referred to as Special Obligation Transit Bonds.
  - Pay-As-You-Go – Funding from current revenue for capital projects, including toll revenue.

- Contributions made by third parties to capital projects being carried out by the Commonwealth, including the I-Cubed program, contributions from campuses for higher education projects, matching funds from cities and towns, and capital projects funded by assessments.

The administrative bond cap is reviewed and subject to revision annually. Actual capital spending is subject to variance from budget due to the nature of capital projects and programs comprising the plan. In addition, debt affordability analysis and the assumptions and methodology that inform the analysis are subject to periodic review and are updated annually. These and other factors are expected to affect the out-years of the current five-year plan.

The Commonwealth aggregates its capital expenditures into seven major categories based primarily on the agencies responsible for spending and carrying out capital projects: information technology, infrastructure and facilities, environment, housing, public safety, transportation and other. The following table sets forth capital spending in fiscal 2013 through fiscal 2017 according to these categories.

**Commonwealth Historical Capital Spending (in millions) (1)**

| <b>Investment Category:</b> | <b><u>Fiscal 2013</u></b> | <b><u>Fiscal 2014</u></b> | <b><u>Fiscal 2015</u></b> | <b><u>Fiscal 2016</u></b> | <b><u>Fiscal 2017</u></b> |
|-----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Information technology      | \$133                     | \$190                     | \$207                     | \$169                     | \$154                     |
| Infrastructure/facilities   | 452                       | 457                       | 449                       | 526                       | 510                       |
| Environment                 | 130                       | 138                       | 221                       | 238                       | 202                       |
| Housing                     | 183                       | 182                       | 188                       | 185                       | 213                       |
| Public safety               | 17                        | 22                        | 26                        | 18                        | 17                        |
| Transportation              | 1,528                     | 1,790                     | 2,041                     | 2,081                     | 1,895                     |
| Other                       | <u>183</u>                | <u>227</u>                | <u>242</u>                | <u>215</u>                | <u>269</u>                |
| Total (2)                   | <u>\$2,626</u>            | <u>\$3,006</u>            | <u>\$3,374</u>            | <u>\$3,432</u>            | <u>\$3,260</u>            |

SOURCE: Office of the State Comptroller.

- (1) Includes all spending funded by capital appropriations, including General Obligation, Special Obligation, project financed, and federal reimbursement spending.
- (2) Totals may not add due to rounding.

One project for which capital spending is anticipated during fiscal 2018 is the extension of the MBTA’s Green Line from Cambridge into Somerville and Medford. MassDOT and the MBTA completed a comprehensive review of the project in May, 2016, following a preliminary analysis that projected a cost increase ranging from \$700 million to \$1 billion, as compared to the prior estimate. Following this review, a revised project scope with a new cost estimate of \$2.3 billion and pledged contributions for the project totaling approximately \$227 million from corridor municipalities and the metropolitan planning organization was developed. MassDOT and the MBTA submitted an updated finance plan to the Federal Transit Administration (FTA) in June, 2017, with a revised project scope, cost estimate, and schedule. Following receipt of the FTA’s concurrence on the revised project scope, cost estimate and schedule, the MBTA initiated a procurement process for a design-build entity to design and construct the project. The MBTA executed a design-build contract with GLX Constructors for a not-to-exceed contract price of \$1.082 billion. The notice to proceed under the contract was issued on December 20, 2017, following the FTA’s obligating an initial tranche of the Capital Investment Grant funds for the project in accordance with the January, 2015 Full Funding Grant Agreement. The Commonwealth’s share of this project is funded by special obligation bonds. See “LONG-TERM LIABILITIES – Special Obligation Debt.”

**Debt Affordability Policy**

The Executive Office for Administration and Finance has established a debt affordability policy for the Commonwealth. Pursuant to the debt affordability policy, the Executive Office for Administration and Finance has set an annual borrowing limit at a level designed to keep debt service on the Commonwealth’s direct debt within 8% of budgeted revenues.

For this purpose, debt service includes programs expected to be funded both within and outside of the bond cap, including principal and interest payments on all general obligation debt, special obligation gas tax debt, ABP debt, projected debt service for REP, general obligation contract assistance payment obligations and budgetary

contract assistant payment obligations on certain capital lease financings. This inclusive definition ensures that while some programs are expected to be funded outside of the bond cap, the related debt service costs of the programs should be fully accounted for under the debt affordability policy in setting the bond cap at appropriate levels.

For the purpose of the debt affordability analysis, budgeted revenue includes all Commonwealth taxes and other revenues available to pay Commonwealth operating expenses, including debt service, pensions and other budgetary obligations. It does not include off-budget revenues dedicated to the MBTA, the MSBA and the Massachusetts Convention Center Authority (MCCA).

For the fiscal 2018 capital budget, the Governor increased the administrative bond cap to \$2.260 billion from \$2.190 billion in fiscal 2017. The fiscal 2018 debt affordability analysis was based on debt service as described above and assumed growth of budgeted revenues at a rate of 3.5% annually. In addition to keeping debt service within 8% of budgeted revenues, the debt management policy limits future annual growth in the bond cap for the regular capital program to not more than \$125 million.

The following table shows the projected total annual debt service payment obligations for the five-year capital investment plan period from fiscal 2018 through fiscal 2022, projected budgetary revenues and the resulting projected debt service as a percentage of projected budgeted revenues within 8% as prescribed by the Debt Affordability Policy.

**Affordability of Commonwealth Indebtedness (in thousands)**

|   | <u>Fiscal 2018</u> | <u>Fiscal 2019</u> | <u>Fiscal 2020</u> | <u>Fiscal 2021</u> | <u>Fiscal 2022</u> |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Total Debt Service (1)</b>                     | \$2,724,262        | \$2,741,171        | \$3,018,799        | \$3,210,532        | \$3,275,906        |
| <b>Estimated Budgeted Revenues (2)</b>            | \$43,425,700       | \$44,945,600       | \$46,518,695       | \$48,146,850       | \$49,831,990       |
| <b>Debt Service as % of Net Budgeted Revenues</b> | 6.27%              | 6.10%              | 6.49%              | 6.67%              | 6.57%              |

SOURCE: Executive Office for Administration and Finance.

- (1) For purposes of Debt Affordability Analysis, debt service includes principal and interest payments on all general obligation debt, special obligation debt, accelerated bridge program debt, general obligation contract assistance and budgetary contract assistant obligations. Projected general obligation borrowings assume level funding of administrative bond cap throughout the five-year capital plan period, special obligation transit spending, and remaining authorized accelerated bridge program spending in fiscal years 2018-2022. Interest on new debt obligations is assumed to be payable at an annual rate of 4.5% for 30 year bonds, increasing annually by 0.10%. Debt structure is assumed to be level annual principal and interest payments. Projections are for planning purposes only and assumptions are subject to change. New debt service is added to existing debt service in this Information Statement, and does not take into account the State Treasurer's active debt service management. Debt service projections will therefore exceed actual debt service in the short term.
- (2) Budgeted revenues are projected to grow at a rate of 3.5% annually. For purposes of the debt affordability analysis, budgeted revenues include all Commonwealth taxes and other revenues available to pay Commonwealth operating expenses, including debt service, pensions and other budgetary obligations. Budgeted revenues do not include off-budget revenues dedicated to the MBTA, the MSBA and the MCCA.

The Capital Debt Affordability Committee is charged with reviewing on a continuing basis the amount and condition of the Commonwealth's tax-supported debt, as well as the debt of certain state authorities. The Committee is also responsible for providing an estimate of the total amount of new Commonwealth debt that can prudently be authorized for the next fiscal year, taking into account certain criteria, to the Governor and Legislature on or before December 15 of each year. The committee's estimates are advisory and not binding on the Governor or the Legislature. The Legislature is responsible for authorizing Commonwealth debt. The Governor determines the total amount capital spending for each fiscal year and the amount of new Commonwealth debt that he considers advisable to finance such spending. The Committee consists of seven voting members – the Secretary of Administration and Finance (who chairs the committee), the State Treasurer, the Comptroller, the Secretary of Transportation, one appointee of the Governor and two appointees of the State Treasurer – and eight legislative leaders who are non-voting members. The committee determined that up to \$2.26 billion of capital debt issuance within the bond cap could be prudently authorized for fiscal 2018. On December 11, 2017, the committee determined that up to \$2.34 billion of capital debt issuance within the bond cap could be prudently authorized for fiscal 2019.

## LONG-TERM LIABILITIES

### General Authority to Borrow

Under its constitution, the Commonwealth may borrow money (a) for defense or in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (b) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit by a two-thirds vote of the members of each house of the Legislature present and voting thereon, but such credit may not in any manner be given or loaned to or in aid of any individual, or of any private association, or of any corporation which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, which includes bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for payment of principal of or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, hereafter enacted extending the time for payment or imposing other constraints upon enforcement, insofar as the same may be constitutionally applied. The United States Bankruptcy Code is not applicable to states.

*Commonwealth Debt.* The State Treasurer is statutorily responsible for the borrowing needs of the Commonwealth, including short-term cash flow needs and long-term borrowing needs for the capital budget. Borrowing is accomplished through the sale of short-term notes and long-term bonds. The Commonwealth is authorized to issue three types of direct debt – general obligation debt, special obligation debt and federal grant anticipation notes. General obligation debt is secured by a pledge of the full faith and credit of the Commonwealth. See “General Obligation Debt” below. Special obligation debt may be secured either with a pledge of receipts credited to the Commonwealth Transportation Fund (formerly the Highway Fund) or with a pledge of receipts credited to the Convention Center Fund. See “Special Obligation Debt” below. Federal grant anticipation notes are secured by a pledge of federal highway construction reimbursements. See “Federal Grant Anticipation Notes” below.

*Other Long-Term Liabilities.* The Commonwealth is also authorized to pledge its credit in aid of and provide contractual support for certain independent authorities and political subdivisions within the Commonwealth. These Commonwealth liabilities are classified as general obligation contract assistance liabilities or contingent liabilities. In addition, the Commonwealth is authorized to pledge its credit in support of scheduled, periodic payments to be made by the Commonwealth under interest rate swaps and other hedging agreements related to bonds or notes of the Commonwealth.

General obligation contract assistance liabilities arise from statutory requirements for (i) payments by the Commonwealth to the Massachusetts Clean Water Trust, MassDOT and the Massachusetts Development Finance Agency that are used by such entities to pay a portion of the debt service on certain of their outstanding bonds and (ii) payments from the Social Innovation Financing Trust Fund on “pay for success” contracts, as described below. Such liabilities constitute a pledge of the Commonwealth’s credit for which a two-thirds vote of the Legislature is required. See “General Obligation Contract Assistance Liabilities” below.

Contingent liabilities relate to debt obligations of certain independent authorities and agencies of the Commonwealth that are expected to be paid without Commonwealth assistance, but for which the Commonwealth has some kind of liability if expected payment sources do not materialize. These liabilities consist of guaranties and similar obligations with respect to which the Commonwealth’s credit has been or may be pledged, as in the case of certain debt obligations of the MBTA (pre-2000), the Woods Hole, Martha’s Vineyard and Nantucket Steamship Authority, and the higher education building authorities. The Commonwealth has certain statutorily contemplated payment obligations with respect to which the Commonwealth’s credit has not been pledged, as in the case of the Commonwealth’s obligation to fund debt service, solely from moneys otherwise appropriated for the affected institution, owed by certain community colleges and state universities on bonds issued by the former Massachusetts Health and Educational Facilities Authority (now the Massachusetts Development Finance Agency) and the Massachusetts State College Building Authority. See “Contingent Liabilities” below.

*Statutory Limit on Direct Debt.* Since December, 1989, state finance law has included a limit on the amount of outstanding “direct” bonds of the Commonwealth. For fiscal 2012, the debt limit was \$18.944 billion under the statute in place during fiscal 2012. In August, 2012, state finance law was amended, effective January 1, 2013, to specify that the debt limit be calculated for fiscal years starting in fiscal 2013 using a fiscal 2012 base value of \$17,070,000,000 and increasing the limit for each subsequent fiscal year to 105% of the previous fiscal year’s limit. Based on this calculation, the statutory limit on “direct” bonds during fiscal 2018 is \$22,875,432,585. Prior to June 10, 2013, this limit was calculated using a statutory definition that differed from GAAP in that the principal amount of outstanding bonds included the amount of any premium and was measured net of any discount, costs of issuance and other financing costs (“net proceeds”). On June 10, 2013, state finance law was amended, effective January 1, 2013, to change the statutory definition of outstanding debt from net proceeds to principal outstanding, a change that brings the outstanding debt definition in conformance with GAAP.

The debt limit law provides that bonds to be refunded from the proceeds of Commonwealth refunding bonds are to be excluded from outstanding “direct” bonds upon the issuance of the refunding bonds. Pursuant to special legislation enacted over the years, certain outstanding Commonwealth debt obligations are not counted in computing the amount of bonds subject to the limit, including Commonwealth refunding/restructuring bonds issued in September and October, 1991, federal grant anticipation notes, bonds issued to pay operating notes issued by the MBTA or to reimburse the Commonwealth for advances to the MBTA, bonds payable from the Central Artery and Statewide Road and Bridge Infrastructure Fund, bonds issued to finance the Massachusetts School Building Authority and bonds issued to finance the Commonwealth’s Accelerated Bridge Program. On August 10, 2016, the Governor approved legislation that exempts from the statutory debt limit bonds that are issued to finance the Commonwealth’s rail enhancement program.

The outstanding Commonwealth debt, the amounts of such outstanding debt excluded from the statutory debt limit, the net amounts of such outstanding Commonwealth debt subject to the statutory debt limit and the statutory debt limit as of the end of each of the last five fiscal years are shown in the following table on a statutory basis.

*[Remainder of page intentionally left blank.]*

**Calculation of the Debt Limit**  
(in thousands)

|  | <u>Fiscal 2013</u>         | <u>Fiscal 2014 (4)</u>     | <u>Fiscal 2015</u>         | <u>Fiscal 2016</u>         | <u>Fiscal 2017</u>         | <u>Fiscal 2018 (5)</u>     |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Total principal balance  | \$21,513,039               | \$22,419,852               | \$23,826,301               | \$25,079,591               | \$26,445,665               | \$27,016,369               |
| Less: principal of direct debt excluded from the statutory debt limit: |                            |                            |                            |                            |                            |                            |
| Special obligation debt (1)  | (935,095)                  | (888,405)                  | (829,340)                  | (768,365)                  | (703,690)                  | (680,380)                  |
| Accelerated bridge program   | (988,605)                  | (1,403,850)                | (1,495,150)                | (1,535,890)                | (1,642,730)                | (1,679,155)                |
| Rail enhancement program (2)   | -                          | -                          | -                          | -                          | (644,540)                  | (944,540)                  |
| Federal grant anticipation notes (1)                                   | (449,100)                  | (530,935)                  | (699,855)                  | (657,040)                  | (738,010)                  | (797,355)                  |
| Assumed county debt  | -                          | -                          | -                          | -                          | -                          | -                          |
| MBTA forward funding   | (207)                      | (207)                      | (207)                      | (207)                      | (207)                      | (207)                      |
| Transportation Infrastructure Fund School Building Assistance (SBA)    | (1,303,013)                | (1,241,263)                | (1,197,127)                | (1,150,296)                | (1,110,195)                | (1,092,519)                |
|  | <u>(764,338)</u>           | <u>(723,917)</u>           | <u>(689,446)</u>           | <u>(652,197)</u>           | <u>(632,348)</u>           | <u>(598,985)</u>           |
| Outstanding direct debt, principal (3)                                 | <u>\$17,072,681</u>        | <u>\$17,631,275</u>        | <u>\$18,915,176</u>        | <u>\$20,315,596</u>        | <u>\$20,973,945</u>        | <u>\$21,223,229</u>        |
| Statutory Debt Limit   | <u><b>\$17,923,500</b></u> | <u><b>\$18,819,675</b></u> | <u><b>\$19,760,659</b></u> | <u><b>\$20,748,692</b></u> | <u><b>\$21,786,126</b></u> | <u><b>\$22,875,433</b></u> |

SOURCE: Office of the Comptroller.

- (1) Includes federal grant anticipation notes issued as crossover refunding bonds. The refunding escrows funded by these bonds and related premiums are used to pay interest on the refunding bonds until the refunded bonds are callable and then to redeem the refunded bonds. Interest on the refunded bonds prior to redemption continues to be paid from pledged revenues as before.
- (2) Exempt from the debt limit, effective August 10, 2016.
- (3) Includes accretion of capital appreciation bonds.
- (4) In accordance with GAAP, includes \$200 million in principal related to commercial paper bond anticipation notes (BANs) which were retired subsequent to year-end upon the issuance of long-term general obligation bonds on July 11, 2014.
- (5) Amounts are as of February 28, 2018 and are unaudited.

### General Obligation Debt

As of February 28, 2018, the Commonwealth had approximately \$22.9 billion in general obligation bonds outstanding, of which \$19.4 billion, or approximately 85% was fixed rate debt and \$3.5 billion, or 15%, was variable rate debt. The Commonwealth's outstanding general obligation variable rate debt consists of several variable rate structures. These structures include floating rate notes in various interest rate modes, direct purchase agreements in various interest rate modes, multi-modal bonds currently in the Term Mode, and variable rate demand bonds. Variable rate demand bonds, which account for \$552.7 million of outstanding general obligation debt as of February 28, 2018, are supported by liquidity facilities that require the bonds to be tendered by a specified date if the facility is not replaced or the bonds are not otherwise refinanced. See "Liquidity Facilities." For the purpose of reporting general obligation debt outstanding and variable rate debt outstanding, future compounded interest on the Commonwealth's variable rate College Opportunity Bonds, as discussed in greater detail below, is included as debt outstanding. Additionally, any outstanding commercial paper, bond anticipation notes, or revenue anticipation notes, as more fully described below, are not reported in general obligation debt outstanding calculations.

Of all Commonwealth variable rate debt outstanding, the interest rates on \$1.6 billion, or approximately 7% of total general obligation debt, have been synthetically fixed by means of floating-to-fixed interest rate swap agreements. These agreements are used as hedges to mitigate the risk associated with variable rate bonds.

Under state finance law, scheduled, periodic payments to be made by the Commonwealth pursuant to swap agreements in existence on August 1, 2008 or entered into after such date constitute general obligations of the Commonwealth to which its full faith and credit are pledged. The remaining variable rate debt of \$1.9 billion or approximately 8% of the total outstanding general obligation debt, is unhedged and, accordingly, floats with interest rates re-set on a periodic basis.

The Commonwealth has announced its intention to implement a multi-year asset/liability management strategy. The intent of the asset/liability strategy is to better balance the Commonwealth's interest rate exposure between its cash assets and debt liabilities by increasing the portion of its outstanding debt issued as unhedged, floating rate bonds. The Commonwealth intends to achieve this balance over a number of years, in part by issuing additional variable rate debt.

As of February 28, 2018, the Commonwealth had outstanding approximately \$149.1 million (\$79.8 million principal and including a discount equal to \$69.3 million) of variable rate "U. Plan" bonds, sold in conjunction with a college savings program administered by the Massachusetts Educational Financing Authority (MEFA), which bear deferred interest at a rate equal to the percentage change in the consumer price index plus 2%, together with current interest at the rate of 0.5%. This debt is held directly by MEFA and has no secondary market.

The Commonwealth is authorized to issue short-term general obligation debt as revenue anticipation notes or bond anticipation notes. Fixed-rate revenue anticipation notes (RANs) are issued by the State Treasurer annually in anticipation of revenue receipts for the same fiscal year. Revenue anticipation notes must be repaid no later than the close of the fiscal year in which they are issued. Bond anticipation notes may be issued by the State Treasurer in anticipation of the issuance of bonds, including, in some circumstances special obligation bonds. See "Special Obligation Debt" below. In addition, as of February 28, 2018, the Commonwealth had liquidity support for a \$400 million commercial paper program which it utilizes for cash flow purposes.

### **Special Obligation Debt**

*Commonwealth Transportation Fund.* Section 20 of Chapter 29 of the General Laws, as amended, authorizes the Commonwealth to issue special obligation bonds secured by all or a portion of revenues accounted to the Commonwealth Transportation Fund (formerly the Highway Fund). Revenues which are accounted to the Commonwealth Transportation Fund are primarily derived from taxes and fees relating to the operation or use of motor vehicles in the Commonwealth, including the motor fuels excise tax and registry of motor vehicles fees. In addition, a portion of the Commonwealth's receipts from the sales tax is dedicated to the Commonwealth Transportation Fund (see "COMMONWEALTH REVENUES – State Taxes; *Sales and Use Tax*"), and state finance law currently provides for a series of substantial transfers from the General Fund to the Commonwealth Transportation Fund through fiscal 2020; none of the sales tax receipts or General Fund transfers has been pledged to secure Commonwealth special obligation bonds.

Between 1992 and 2005, the Commonwealth issued special obligation bonds secured by a lien on a specified portion of the motor fuels excise tax. As of February 28, 2018, the Commonwealth had outstanding approximately \$128.3 million of such special obligation bonds secured by a pledge of 6.86¢ of the 24¢ motor fuels excise tax. In December, 2010, the trust agreement securing such bonds was closed to further issuance of additional debt, with the exception of refunding bonds.

The Commonwealth is also authorized to issue approximately \$1.876 billion of special obligation bonds secured by a pledge of all or a portion of revenues accounted to the Commonwealth Transportation Fund ("CTF Bonds") to fund a portion of the Accelerated Bridge Program. Additionally, in April, 2014, the Commonwealth was authorized to issue up to \$6.7 billion in general obligation debt, special obligation debt, or a combination of both, for the purpose of funding capital expenditures of MassDOT, for the benefit of the MBTA and for other Rail Enhancement Program projects. As of February 28, 2018, the Commonwealth had outstanding approximately \$2.6 billion of CTF Bonds, which are secured by a pledge of registry fees and a specified portion of the motor fuels excise tax, \$1.7 billion of which have been issued in support of the ABP and \$944.5 million of which have been issued in support of the REP.

*Convention Center Fund.* Chapter 152 of the Acts of 1997, as amended, authorized \$694.4 million of special obligation bonds to be issued for the purposes of building a new convention center in Boston (\$609.4 million), the Springfield Civic Center (\$66 million), and the Worcester Convention Center (\$19 million). The bonds are payable from moneys credited to the Convention Center Fund created by such legislation, which include certain hotel tax receipts from hotels in Boston, Cambridge, Springfield and Worcester, a surcharge on car rentals in Boston, a parking surcharge at all three facilities, a surcharge on sightseeing tours and cruises in Boston and sales tax receipts from certain hotels and other retail establishments in Boston, Cambridge and Springfield. The legislation requires a capital reserve fund to be maintained at a level equal to maximum annual debt service and provides that if the fund falls below its required balance, the 2.75% convention center financing fee in Boston is to

be increased (though the overall hotel tax in Boston, including the fee, cannot exceed 14%). In June, 2004, the Commonwealth issued \$686.7 million of special obligation bonds secured solely by the pledge of receipts of tax revenues within the special districts surrounding the centers and other special revenues connected to such facilities, and in June, 2005, the Commonwealth issued \$527.6 million of special obligation refunding bonds, which advance refunded, in part, the 2004 issue. Of the 2004 and 2005 special obligation bonds secured solely by the pledge of receipts of tax revenues in the Convention Center Fund, approximately \$552.1 million remained outstanding as of February 28, 2018.

On July 29, 2014, the Governor approved legislation authorizing the Commonwealth to issue an additional \$1.1 billion in special obligation bonds to finance an expansion of the convention center in Boston, to finance costs of issuance and fund a debt service reserve fund. Such bonds would be secured by and payable from the Convention Center Fund, with the State Treasurer and Secretary of Administration and Finance having the authority to pledge additional state hotel/motel room occupancy excises to the new bonds. The expansion project is currently on hold.

### **Federal Grant Anticipation Notes**

The Commonwealth is also authorized to issue \$1.1 billion of grant anticipation notes (“GANs”) secured by future federal funds to fund a portion of the ABP. Such notes are secured by a back-up pledge of net amounts in the Commonwealth Transportation Fund after application of such amounts in accordance with the trust agreement securing the CTF Bonds and previously issued bonds secured by motor fuels excise taxes. The Commonwealth expects to pay interest on the notes supporting the ABP from state appropriations. As of February 28, 2018, \$797.4 million of GANs was outstanding.

### **Build America Bonds**

The Commonwealth has issued bonds in the form of Build America Bonds (BABs) and as Recovery Zone Economic Development Bonds (RZEDBs). BABs and RZEDBs were authorized under the federal American Recovery and Reinvestment Act of 2009 (ARRA). Pursuant to ARRA, the Commonwealth is entitled to receive cash subsidy payments from the federal government equal to 35% of the debt service payable on the BABs and 45% of the debt service payable on the RZEDBs, provided, in both cases, that the Commonwealth makes certain required filings in accordance with applicable federal rules. Such interest subsidy payments are treated under federal law as overpayments of tax and, accordingly, are subject to offset against certain amounts that may be owed by the Commonwealth to the federal government or its agencies. In federal fiscal year 2016, such payments were subject to a sequestration reduction of 6.8%, with the Bipartisan Budget Act of 2015, approved by the President on November 2, 2015, extending the sequestration provisions through federal fiscal year 2025. For federal fiscal year 2017, this reduction increased to 6.9%, and for federal fiscal year 2018, this reduction has been decreased to 6.6%. Such interest subsidy payments could become subject to a much larger sequestration reduction, and potentially be eliminated altogether, under the Statutory Pay-As-You-Go (PAYGO) Act of 2010, which is designed to limit federal deficit spending. Since the enactment of the PAYGO Act, the U. S. Congress has consistently acted to prevent its implementation, but there can be no assurance that it will continue to do so.

Beginning in fiscal 2012, federal interest subsidy payments received by the Commonwealth are required to be deposited in a Build America Bonds Subsidy Trust Fund and used, without further legislative appropriation, to pay debt service on the related BABs and RZEDBs. The Commonwealth is obligated to make payments of principal and interest on the BABs and RZEDBs whether or not it receives interest subsidy payments. As of February 28, 2018, \$2.1 billion of the Commonwealth’s outstanding general obligation debt was comprised of BABs, \$419.8 million of the outstanding CTF Bonds were comprised of BABs, \$156.4 million of the outstanding CTF Bonds were comprised of RZEDBs and \$65.1 million of the outstanding GANs were comprised of BABs.

The following table shows long-term debt of the Commonwealth issued and retired from fiscal 2013 through fiscal 2017, exclusive of unamortized bond premiums.

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**General and Special Obligation Long-Term Debt Issuance and Repayment Analysis (in thousands) (1)**

|  | <u>Fiscal 2013</u>         | <u>Fiscal 2014 (4)</u>     | <u>Fiscal 2015</u>         | <u>Fiscal 2016</u>         | <u>Fiscal 2017</u>         |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| <b>Beginning Balance as of July 1</b>                | \$21,433,553               | \$21,513,039               | \$22,419,852               | \$23,826,301               | \$25,079,591               |
| Debt Issued  | <u>1,470,473</u>           | <u>2,359,899</u>           | <u>2,918,817</u>           | <u>2,766,419</u>           | <u>2,877,265</u>           |
| Subtotal   | <u>22,904,026</u>          | <u>23,672,983</u>          | <u>25,338,669</u>          | <u>26,592,720</u>          | <u>27,956,856</u>          |
| Debt retired or defeased, exclusive of refunded debt | (1,386,527)                | (1,434,511)                | (1,486,243)                | (1,446,444)                | (1,389,581)                |
| Refunding debt issued, net of refunded debt (3)      | (4,460)                    | (18,575)                   | (26,125)                   | (66,685)                   | (121,610)                  |
| <b>Ending Balance June 30 (2)</b>                    | <b><u>\$21,513,039</u></b> | <b><u>\$22,419,852</u></b> | <b><u>\$23,826,301</u></b> | <b><u>\$25,079,591</u></b> | <b><u>\$26,445,665</u></b> |

SOURCE: Office of the Comptroller.

(1) Including accretion of capital appreciation bonds.

(2) Includes federal grant anticipation notes issued as crossover refunding bonds. The refunding escrows funded by these bonds and related premiums are used to pay interest on the refunding bonds until the refunded bonds are callable and then to redeem the refunded bonds. Interest on the refunded bonds prior to redemption continues to be paid from pledged revenues as before.

(3) Amounts may be negative due to defeasances of debt of authorities from the issuance of Commonwealth debt as afforded under General Laws.

(4) In accordance with GAAP, includes \$200 million in principal related to commercial paper bond anticipation notes (BANs) which were retired subsequent to year-end upon the issuance of long-term general obligation bonds on July 11, 2014.

The following table sets forth the amounts of Commonwealth long-term general obligation debt, special obligation debt and federal grant anticipation notes outstanding, exclusive of unamortized bond premiums, as of the end of the last five fiscal years.

**Outstanding Long Term Commonwealth Debt (in thousands)**

|                                  | <u>Fiscal 2013</u>         | <u>Fiscal 2014 (1)</u>     | <u>Fiscal 2015</u>         | <u>Fiscal 2016</u>         | <u>Fiscal 2017</u>         |
|----------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| General Obligation Debt          | \$19,140,239               | \$19,596,662               | \$20,801,956               | \$21,668,296               | \$22,716,695               |
| Special Obligation Debt          | 1,923,700                  | 2,292,255                  | 2,324,490                  | 2,754,255                  | 2,990,960                  |
| Federal Grant Anticipation Notes | <u>449,100</u>             | <u>530,935</u>             | <u>699,855</u>             | <u>657,040</u>             | <u>738,010</u>             |
| <b>TOTAL</b>                     | <b><u>\$21,513,039</u></b> | <b><u>\$22,419,852</u></b> | <b><u>\$23,826,301</u></b> | <b><u>\$25,079,591</u></b> | <b><u>\$26,445,665</u></b> |

SOURCE: Office of the Comptroller.

(1) In accordance with GAAP, includes \$200 million in principal related to commercial paper bond anticipation notes (BANs) which were retired subsequent to year-end upon the issuance of long-term general obligation bonds on July 11, 2014.

**Debt Service Requirements**

The following table sets forth, as of February 28, 2018, the annual fiscal year debt service requirements on outstanding Commonwealth general obligation bonds, special obligation bonds and federal GANs. For variable-rate bonds with respect to which the Commonwealth is a fixed-rate payor under an associated interest rate swap agreement, the debt service schedule assumes payment of the fixed rate due under such agreement. For other variable-rate bonds, the schedule assumes a 5% interest rate.

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**Debt Service Requirements on Commonwealth Bonds as of February 28, 2018 through Maturity (in thousands)**

| Period Ending     | <u>General Obligation Bonds</u> |                     |                 |                              |                     |                     | <u>Federal Highway Grant Anticipation Notes</u> |                  |                              |                  |                    |
|-------------------|---------------------------------|---------------------|-----------------|------------------------------|---------------------|---------------------|---|------------------|------------------------------|------------------|--------------------|
|                   | Principal                       | Gross Interest      | CABs            | Build America Bond Subsidies | Net Interest        | Debt Service        | Principal                                       | Gross Interest   | Build America Bond Subsidies | Net Interest     | Debt Service       |
| 6/30/2018         | \$ 241,435                      | \$285,777           | \$ -            | (\$ 6,380)                   | \$279,397           | \$ 520,832          | \$35,225  | \$20,281         | (\$532)                      | \$19,748         | \$ 54,973          |
| 6/30/2019         | 1,361,150                       | 999,584             | 4,852           | (36,557)                     | 963,027             | 2,329,028           | 62,985  | 37,477           | (973)                        | 36,504           | 99,489             |
| 6/30/2020         | 1,280,519                       | 944,227             | 4,410           | (36,300)                     | 907,928             | 2,192,857           | 66,015  | 34,447           | (782)                        | 33,665           | 99,680             |
| 6/30/2021         | 1,361,643                       | 879,234             | 4,265           | (35,014)                     | 844,220             | 2,210,129           | 78,485  | 31,191           | (577)                        | 30,614           | 109,099            |
| 6/30/2022         | 1,202,285                       | 818,597             | 4,436           | (32,698)                     | 785,899             | 1,992,621           | 82,375  | 27,302           | (357)                        | 26,945           | 109,320            |
| 6/30/2023         | 1,042,048                       | 764,565             | 4,532           | (31,412)                     | 733,153             | 1,779,733           | 86,470  | 23,205           | (122)                        | 23,083           | 109,553            |
| 6/30/2024         | 1,008,931                       | 712,530             | 4,195           | (31,412)                     | 681,118             | 1,694,243           | 89,510  | 19,290           | -                            | 19,290           | 108,800            |
| 6/30/2025         | 1,002,664                       | 665,067             | 4,303           | (31,177)                     | 633,890             | 1,640,856           | 93,985  | 14,815           | -                            | 14,815           | 108,800            |
| 6/30/2026         | 928,327                         | 620,059             | 4,414           | (30,776)                     | 589,283             | 1,522,024           | 98,685  | 10,115           | -                            | 10,115           | 108,800            |
| 6/30/2027         | 838,475                         | 577,508             | 4,605           | (30,203)                     | 547,305             | 1,390,386           | 103,620   | 5,181            | -                            | 5,181            | 108,801            |
| 6/30/2028         | 801,137                         | 539,603             | 4,842           | (28,953)                     | 510,650             | 1,316,628           | -   | -                | -                            | -                | -                  |
| 6/30/2029         | 867,906                         | 502,656             | 4,433           | (26,687)                     | 475,969             | 1,348,308           | -   | -                | -                            | -                | -                  |
| 6/30/2030         | 829,819                         | 463,921             | 4,148           | (22,892)                     | 441,029             | 1,274,995           | -   | -                | -                            | -                | -                  |
| 6/30/2031         | 833,937                         | 420,057             | 3,985           | (16,808)                     | 403,249             | 1,241,171           | -   | -                | -                            | -                | -                  |
| 6/30/2032         | 742,883                         | 388,010             | 3,709           | (14,776)                     | 373,234             | 1,119,826           | -   | -                | -                            | -                | -                  |
| 6/30/2033         | 562,010                         | 358,837             | 2,836           | (12,440)                     | 346,397             | 911,243             | -   | -                | -                            | -                | -                  |
| 6/30/2034         | 557,354                         | 333,929             | 2,149           | (11,068)                     | 322,861             | 882,364             | -   | -                | -                            | -                | -                  |
| 6/30/2035         | 565,406                         | 310,191             | 1,483           | (9,647)                      | 300,544             | 867,433             | -   | -                | -                            | -                | -                  |
| 6/30/2036         | 598,908                         | 284,502             | 887             | (8,177)                      | 276,325             | 876,120             | -   | -                | -                            | -                | -                  |
| 6/30/2037         | 623,896                         | 256,430             | 548             | (6,654)                      | 249,776             | 874,220             | -   | -                | -                            | -                | -                  |
| 6/30/2038         | 588,711                         | 228,315             | 279             | (5,077)                      | 223,238             | 812,228             | -   | -                | -                            | -                | -                  |
| 6/30/2039         | 594,255                         | 201,644             | -               | (3,445)                      | 198,199             | 792,454             | -   | -                | -                            | -                | -                  |
| 6/30/2040         | 590,500                         | 175,122             | -               | (1,609)                      | 173,513             | 764,013             | -   | -                | -                            | -                | -                  |
| 6/30/2041         | 594,630                         | 149,502             | -               | -                            | 149,502             | 744,132             | -   | -                | -                            | -                | -                  |
| 6/30/2042         | 658,140                         | 125,027             | -               | -                            | 125,027             | 783,167             | -   | -                | -                            | -                | -                  |
| 6/30/2043         | 701,130                         | 98,504              | -               | -                            | 98,504              | 799,634             | -   | -                | -                            | -                | -                  |
| 6/30/2044         | 628,725                         | 69,131              | -               | -                            | 69,131              | 697,856             | -   | -                | -                            | -                | -                  |
| 6/30/2045         | 503,485                         | 47,775              | -               | -                            | 47,775              | 551,260             | -   | -                | -                            | -                | -                  |
| 6/30/2046         | 474,320                         | 26,791              | -               | -                            | 26,791              | 501,111             | -   | -                | -                            | -                | -                  |
| 6/30/2047         | 236,000                         | 8,625               | -               | -                            | 8,625               | 244,625             | -   | -                | -                            | -                | -                  |
| 6/30/2048         | 25,000                          | 1,250               | -               | -                            | 1,250               | 26,250              | -   | -                | -                            | -                | -                  |
| <b>Totals (1)</b> | <b>\$22,845,628</b>             | <b>\$12,256,971</b> | <b>\$69,311</b> | <b>(\$470,163)</b>           | <b>\$11,786,808</b> | <b>\$34,701,747</b> | <b>\$797,355</b>                                | <b>\$223,303</b> | <b>(\$3,343)</b>             | <b>\$219,960</b> | <b>\$1,017,315</b> |

SOURCE: Office of the Comptroller.  
 (1) Totals may not add due to rounding.

**Special Obligation Revenue Bonds**  
**(Convention Center)**

**Special Obligation Revenue Bonds**  
**(CTF- Accelerated Bridge Program)**

| Period Ending     | Principal        | Interest         | Debt Service     | Principal          | Gross Interest     | Build America Bond Subsidies | Net Interest       | Debt Service       |
|-------------------|------------------|------------------|------------------|--------------------|--------------------|------------------------------|--------------------|--------------------|
| 6/30/2018         | \$ -             | \$ -             | \$ -             | \$13,600           | \$41,749           | (\$ 6,157)                   | \$35,593           | \$ 49,193          |
| 6/30/2019         | 24,475           | 30,126           | 54,601           | 15,350             | 81,721             | (12,314)                     | 69,406             | 84,756             |
| 6/30/2020         | 23,380           | 28,842           | 52,222           | 16,595             | 80,984             | (12,314)                     | 68,670             | 85,265             |
| 6/30/2021         | 24,610           | 27,673           | 52,283           | 17,950             | 80,154             | (12,314)                     | 67,840             | 85,790             |
| 6/30/2022         | 25,970           | 26,380           | 52,350           | 21,475             | 79,257             | (12,314)                     | 66,942             | 88,417             |
| 6/30/2023         | 27,440           | 24,952           | 52,392           | 29,925             | 78,215             | (12,314)                     | 65,900             | 95,825             |
| 6/30/2024         | 28,990           | 23,443           | 52,433           | 39,535             | 76,730             | (12,314)                     | 64,416             | 103,951            |
| 6/30/2025         | 30,625           | 21,848           | 52,473           | 51,370             | 74,756             | (11,937)                     | 62,819             | 114,189            |
| 6/30/2026         | 32,360           | 20,164           | 52,524           | 53,970             | 72,149             | (11,529)                     | 60,620             | 114,590            |
| 6/30/2027         | 34,190           | 18,384           | 52,574           | 56,035             | 69,309             | (11,065)                     | 58,244             | 114,279            |
| 6/30/2028         | 36,125           | 16,504           | 52,629           | 51,115             | 66,351             | (10,575)                     | 55,776             | 106,891            |
| 6/30/2029         | 38,170           | 14,517           | 52,687           | 54,240             | 63,677             | (10,058)                     | 53,619             | 107,859            |
| 6/30/2030         | 40,330           | 12,418           | 52,748           | 54,150             | 61,066             | (9,512)                      | 51,554             | 105,704            |
| 6/30/2031         | 42,610           | 10,199           | 52,809           | 59,875             | 58,313             | (8,935)                      | 49,378             | 109,253            |
| 6/30/2032         | 45,020           | 7,856            | 52,876           | 62,950             | 55,094             | (8,316)                      | 46,778             | 109,728            |
| 6/30/2033         | 47,565           | 5,380            | 52,945           | 66,195             | 51,708             | (7,661)                      | 44,046             | 110,241            |
| 6/30/2034         | 50,250           | 2,764            | 53,014           | 69,455             | 48,318             | (6,970)                      | 41,348             | 110,803            |
| 6/30/2035         | -                | -                | -                | 69,480             | 44,828             | (6,239)                      | 38,589             | 108,069            |
| 6/30/2036         | -                | -                | -                | 72,995             | 41,331             | (5,466)                      | 35,865             | 108,860            |
| 6/30/2037         | -                | -                | -                | 80,985             | 37,654             | (4,650)                      | 33,004             | 113,989            |
| 6/30/2038         | -                | -                | -                | 80,520             | 33,616             | (3,718)                      | 29,898             | 110,418            |
| 6/30/2039         | -                | -                | -                | 84,765             | 29,596             | (2,546)                      | 27,050             | 111,815            |
| 6/30/2040         | -                | -                | -                | 89,105             | 25,240             | (1,308)                      | 23,932             | 113,037            |
| 6/30/2041         | -                | -                | -                | 93,740             | 20,646             | -                            | 20,646             | 114,386            |
| 6/30/2042         | -                | -                | -                | 98,580             | 16,696             | -                            | 16,696             | 115,276            |
| 6/30/2043         | -                | -                | -                | 102,315            | 12,739             | -                            | 12,739             | 115,054            |
| 6/30/2044         | -                | -                | -                | 108,520            | 8,007              | -                            | 8,007              | 116,527            |
| 6/30/2045         | -                | -                | -                | 8,670              | 2,637              | -                            | 2,637              | 11,307             |
| 6/30/2046         | -                | -                | -                | 55,695             | 2,260              | -                            | 2,260              | 57,955             |
| <b>Totals (1)</b> | <b>\$552,110</b> | <b>\$291,450</b> | <b>\$843,560</b> | <b>\$1,679,155</b> | <b>\$1,414,800</b> | <b>(\$200,529)</b>           | <b>\$1,214,272</b> | <b>\$2,893,427</b> |

SOURCE: Office of the Comptroller.  
(1) Totals may not add due to rounding.

**Special Obligation Revenue Bonds**  
**(Gas Tax)**

**Special Obligation Revenue Bonds**  
**(CTF – Rail Enhancement Program)**

| <b>Period<br/>Ending</b> | <b>Principal</b> | <b>Interest</b> | <b>Debt Service</b> | <b>Principal</b> | <b>Interest</b>  | <b>Debt Service</b> |
|--------------------------|------------------|-----------------|---------------------|------------------|------------------|---------------------|
| 6/30/2018                | \$23,040         | \$3,393         | \$26,433            | \$23,435         | \$22,447         | \$45,882            |
| 6/30/2019                | 24,300           | 5,518           | 29,818              | 26,495           | 42,576           | 69,071              |
| 6/30/2020                | 25,640           | 4,182           | 29,822              | 27,195           | 41,369           | 68,564              |
| 6/30/2021                | 26,905           | 2,916           | 29,821              | 27,965           | 40,074           | 68,039              |
| 6/30/2022                | 28,385           | 1,436           | 29,821              | 26,715           | 38,694           | 65,409              |
| 6/30/2023                | -                | -               | -                   | 24,240           | 37,438           | 61,678              |
| 6/30/2024                | -                | -               | -                   | 17,295           | 36,255           | 53,550              |
| 6/30/2025                | -                | -               | -                   | 8,200            | 35,449           | 43,649              |
| 6/30/2026                | -                | -               | -                   | 8,555            | 35,051           | 43,606              |
| 6/30/2027                | -                | -               | -                   | 9,695            | 34,636           | 44,331              |
| 6/30/2028                | -                | -               | -                   | 18,005           | 34,151           | 52,156              |
| 6/30/2029                | -                | -               | -                   | 18,340           | 33,300           | 51,640              |
| 6/30/2030                | -                | -               | -                   | 21,900           | 32,383           | 54,283              |
| 6/30/2031                | -                | -               | -                   | 19,800           | 31,445           | 51,245              |
| 6/30/2032                | -                | -               | -                   | 20,860           | 30,455           | 51,315              |
| 6/30/2033                | -                | -               | -                   | 21,965           | 29,412           | 51,377              |
| 6/30/2034                | -                | -               | -                   | 23,120           | 28,313           | 51,433              |
| 6/30/2035                | -                | -               | -                   | 27,655           | 27,157           | 54,812              |
| 6/30/2036                | -                | -               | -                   | 28,745           | 25,960           | 54,705              |
| 6/30/2037                | -                | -               | -                   | 25,770           | 24,523           | 50,293              |
| 6/30/2038                | -                | -               | -                   | 31,460           | 23,234           | 54,694              |
| 6/30/2039                | -                | -               | -                   | 32,665           | 21,669           | 54,334              |
| 6/30/2040                | -                | -               | -                   | 34,150           | 20,052           | 54,202              |
| 6/30/2041                | -                | -               | -                   | 35,650           | 18,361           | 54,011              |
| 6/30/2042                | -                | -               | -                   | 36,435           | 16,692           | 53,127              |
| 6/30/2043                | -                | -               | -                   | 38,275           | 15,072           | 53,347              |
| 6/30/2044                | -                | -               | -                   | 38,505           | 13,366           | 51,871              |
| 6/30/2045                | -                | -               | -                   | 145,435          | 11,656           | 157,091             |
| 6/30/2046                | -                | -               | -                   | 105,015          | 5,426            | 110,441             |
| 6/30/2047                | -                | -               | -                   | 21,000           | 1,050            | 22,050              |
| <b>Totals (1)</b>        | <b>\$128,270</b> | <b>\$17,444</b> | <b>\$145,715</b>    | <b>\$944,540</b> | <b>\$807,664</b> | <b>\$1,752,204</b>  |

SOURCE: Office of the Comptroller.

(1) Totals may not add due to rounding.

## Interest Rate Swaps

The Commonwealth has entered into interest rate swap agreements for the sole purpose of hedging changes in the interest rates on a portion of its outstanding variable rate bonds, predicated on the assumption that the interest on such bonds, combined with the cost of the associated interest rate swaps, would produce lower aggregate interest costs than fixed-rate bonds. As of February 28, 2018, approximately \$1.6 billion of the Commonwealth's outstanding variable-rate debt is synthetically fixed via floating-to-fixed interest rate swap hedge agreements. Not included in this figure is an additional \$54.0 million in synthetically fixed debt associated with special obligation issues as shown in the table below.

Under the terms of these floating-to-fixed rate hedge agreements, the counterparties to the swaps are obligated to pay the Commonwealth an amount equal or approximately equal to the variable-rate payment on the related bonds or a payment based on a market index, and the Commonwealth is obligated to pay the counterparties a stipulated fixed rate. The floating rate received by the Commonwealth from swap counterparties is used to offset the variable rate paid to bondholders. Only the net difference in interest payments is actually exchanged with the counterparty. The net payments made or received on these agreements are reported as part of interest expense in the Commonwealth's basic financial statements. In all cases, the Commonwealth remains responsible for making interest payments to the variable-rate bondholders.

The intended effect of these agreements is essentially to fix the Commonwealth's interest rate obligations with respect to its variable-rate bonds in order to hedge or mitigate the Commonwealth's exposure to changes in interest rates on these bonds. For example, during a period when interest rates rise, the Commonwealth would receive higher payments from swap counterparties that would be used to offset higher payments to bondholders of the outstanding variable rate bonds. During a period when interest rates decline, the reduction in interest payments to bondholders would offset the higher payments made to swap counterparties. In both scenarios, the net obligation of the Commonwealth is essentially fixed through the life of the swap and bonds. This allows the Commonwealth to finance its capital budget using floating rate bonds, which, combined with interest rate swaps, are assumed to be less costly than fixed-rate bonds, while hedging the risk of rising interest rates on those bonds to provide long-term budget certainty. As of June 30, 2017, all of the Commonwealth's interest rate swaps were floating-to-fixed rate agreements and were deemed effective hedges, as provided for in GASB Statement No. 53.

The bonds and related swap agreements have final maturities ranging from 2018 to 2033. The total notional value of approximately \$1.6 billion effectively matches the par amount of the related variable-rate bonds. Under the swap agreements, the Commonwealth pays the relevant counterparties fixed rates ranging from 3.770% to 4.515% and receives variable-rate payments equal to or approximately equal to the amount of variable rate payments the Commonwealth pays on the related variable-rate refunding bonds or a payment based on a market index.

All of the Commonwealth's counterparties are required to post collateral in certain circumstances. The Commonwealth is not required to post collateral under any of its existing swap agreements.

*[Remainder of page intentionally left blank.]*

The following table describes the interest rate swap agreements, all of which are floating-to-fixed rate hedges that the Commonwealth has entered into in connection with certain of its outstanding variable rate bond issues as of February 28, 2018.

| Associated Bond Issue                          | Outstanding Notional Amount (thousands) | Bond Floating Rate | Swap Fixed Rate Paid (Range) | Swap Variable Rate Received    | Effective Date | Termination Date | Fair value as of 2/28/2018    | Counterparty                    |
|--|---|--------------------|------------------------------|--------------------------------|----------------|------------------|-------------------------------|---------------------------------|
| <i>General Obligation Bonds:</i>               |   |                    |                              |                                |                |                  |                               |                                 |
| Series 2001B & C Refunding                     | 280,510                                 | VRDB               | 4.150%                       | Cost of Funds                  | 2/20/2001      | 1/1/2021         | (15,948,763)                  | Morgan Stanley Capital Services |
| Series 2015B, 2015C, 2017A & 2017B (refunding) | 433,855                                 | SIFMA              | 3.769%-4.004%                | SIFMA                          | 3/15/2005      | 2/1/ 2028        | (52,276,545)                  | Wells Fargo Bank                |
| Series 2006C (refunding)                       | 99,510                                  | CPI                | 3.78%-3.85%                  | CPI-based formula              | 1/1/2007       | 11/1/2020        | (2,042,562)                   | Wells Fargo Bank                |
| Series 2007A (refunding)                       | 31,665                                  | LIBOR              | 3.936%                       | 67% 3-Month LIBOR + 0.46%      | 10/8/2008      | 11/1/2020        | (1,836,892)                   | Wells Fargo Bank                |
| Series 2007A (refunding)                       | 414,130                                 | LIBOR              | 3.936%-4.083%                | 67% 3-Month LIBOR + 0.46-0.55% | 10/8/2008      | 11/1/2025        | (42,711,102)                  | Bank of NY Mellon               |
| Series 2000A                                   | 13,492                                  | VRDB               | 3.942%                       | SIFMA - 3 basis points         | 8/16/2007      | 8/1/2018         | (250,626)                     | Merrill Lynch Capital Services  |
| Series 2000A                                   | 6,583                                   | VRDB               | 3.942%                       | SIFMA - 3 basis points         | 8/16/2007      | 8/1/2018         | (126,839)                     | JP Morgan formerly Bear Stearns |
| Series 2006B, Series 2016C                     | <u>\$293,985</u>                        | VRDB               | 4.515%                       | 67% 3-Month LIBOR              | 4/2/2009       | 6/15/2033        | <u>(67,350,049)</u>           | Barclays Bank PLC               |
| <b>Subtotal</b>                                | <b><u>\$1,573,730</u></b>               |                    |                              |                                |                |                  | <b><u>(\$182,543,378)</u></b> |                                 |

*Special Obligation Dedicated Tax Revenue Bonds*

|                        |                           |     |                   |                      |           |          |                               |                                   |
|------------------------|---------------------------|-----|-------------------|----------------------|-----------|----------|-------------------------------|-----------------------------------|
| Series 2005A (Gas Tax) | <u>54,025</u>             | CPI | 4.771%-<br>5.059% | CPI-based<br>formula | 1/12/2005 | 6/1/2022 | <u>(2,262,467)</u>            | Merrill Lynch<br>Capital Services |
| <b><u>Subtotal</u></b> | <b><u>\$54,025</u></b>    |     |                   |                      |           |          | <b><u>(\$2,262,467)</u></b>   |                                   |
| <b><u>Total</u></b>    | <b><u>\$1,627,755</u></b> |     |                   |                      |           |          | <b><u>(\$184,805,845)</u></b> |                                   |

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SOURCE: Office of the Treasurer and Receiver General.

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## Liquidity Facilities

Some of the Commonwealth's outstanding variable rate debt consists of variable rate demand bonds whose interest rates re-set daily or weekly through a remarketing process. Because these bonds offer a "put" or tender feature, they are supported by standby bond purchase agreements with commercial banks which require the applicable bank to purchase any bonds that are tendered and not successfully remarketed. The following table describes the liquidity facilities that the Commonwealth had with respect to such bonds as of February 28, 2018.

| <b><u>Variable Rate Bonds</u></b> | <b><u>Outstanding Principal Amount (in thousands)</u></b> | <b><u>Bank</u></b> | <b><u>Termination Date</u></b> |
|-----------------------------------|---|--------------------|--------------------------------|
| 2000 Series A                     | \$200,000   | Citibank           | 4/24/2018                      |
| 2000 Series B                     | 75,590  | Bank of America    | 4/24/2018                      |
| 2001 Series C (Refunding)         | 140,255   | Barclays Bank      | 1/01/2021                      |
| 2006 Series A                     | 136,880   | Barclays Bank      | 8/03/2020                      |

SOURCE: Office of the Treasurer and Receiver General.

The Commonwealth also has liquidity support for three series of commercial paper totaling \$400 million.

| <b><u>Commercial Paper Series</u></b>                       | <b><u>Outstanding Principal Amount (in thousands)</u></b> | <b><u>Bank</u></b> | <b><u>Termination Date</u></b> |
|---|---|--------------------|--------------------------------|
| Series I (tax-exempt) and Series K (taxable) <sup>(1)</sup> | \$200,000   | TD Bank            | 4/17/2018                      |
| Series L (tax-exempt)                                       | 200,000   | State Street Bank  | 1/29/2019                      |

SOURCE: Office of the Treasurer and Receiver General.

(1) One or both series may be outstanding as long as the total amount outstanding does not exceed \$200 million.

## Direct Purchase Agreements

Certain of the Commonwealth's variable rate bonds have been directly purchased by a bank. The following table lists the Commonwealth's direct purchase agreements, as of February 28, 2018.

| <b><u>Direct Purchase Bonds</u></b>      | <b><u>Outstanding Principal Amount (in thousands)</u></b> | <b><u>Mandatory Tender Date</u></b> |
|--|---|-------------------------------------|
| 2001 Series B (Refunding) <sup>(1)</sup> | \$140,255   | 1/01/2021                           |
| 2006 Series B                            | 182,605   | 5/31/2019                           |
| 2015 Series C (Refunding) <sup>(1)</sup> | 125,000   | 2/01/2019                           |
| 2016 Series B                            | 100,000   | 4/01/2021                           |
| 2016 Series C                            | 200,000   | 4/01/2021                           |
| 2018 Series A (Refunding) <sup>(1)</sup> | 120,365   | 2/01/2021                           |

SOURCE: Office of the Treasurer and Receiver General.

(1) Dates provided represent hard maturities rather than mandatory tenders.

## General Obligation Contract Assistance Liabilities

*Massachusetts Department of Transportation, as successor to the Massachusetts Turnpike Authority.* On February 19, 1999, the Commonwealth and the Massachusetts Turnpike Authority entered into a contract which provides for the Commonwealth to make annual operating assistance payments to MassDOT, as successor to the Turnpike Authority, which are capped at \$25 million annually and extend until June 30, 2050, which is the end of the 40<sup>th</sup> fiscal year following the transfer of certain facilities associated with the Commonwealth's Central Artery/Ted Williams Tunnel Project (CA/T) to MassDOT. On June 30, 2009, the Commonwealth and the Turnpike Authority entered into a contract for financial assistance which provides for the payment by the Commonwealth to MassDOT, as successor to the Turnpike Authority, of \$100 million per fiscal year, commencing July 1, 2009 until June 30, 2039. Payments under both contracts constitute a general obligation pledge of the Commonwealth for which the full faith and credit of the Commonwealth are pledged.

*Massachusetts Clean Water Trust.* The Massachusetts Clean Water Trust (the Trust) manages the Commonwealth's state revolving fund program under the federal Clean Water Act and the federal Safe Drinking Water Act. The Trust is authorized to apply for and accept federal grants and associated Commonwealth matching grants to capitalize the revolving funds and to issue debt obligations to make loans to local governmental units and others to finance eligible water pollution abatement and drinking water projects. Under state law, loans made by the Trust are required to provide for subsidies or other financial assistance to reduce the debt service expense on the loans. Currently, most new loans made by the Trust bear interest at 2%. Other loans made by the Trust may bear interest at lower rates, including a zero rate of interest, and a portion of the principal of certain loans has also been subsidized by the Trust. To provide for a portion of the subsidy on most of its loans, the Trust receives contract assistance payments from the Commonwealth. Under the Trust's enabling act, the aggregate annual contract assistance payment for the Trust's programs may not exceed \$138 million. The Commonwealth's agreement to provide contract assistance constitutes a general obligation of the Commonwealth for which its full faith and credit are pledged, and the Commonwealth's contract assistance payments are pledged as security for repayment of the Trust's debt obligations. As of February 28, 2018, the Trust had approximately \$2.7 billion of bonds outstanding. Approximately 6.55% of the Trust's aggregate debt service is covered by Commonwealth contract assistance. Prior to August, 2014, the Trust was known as the Massachusetts Water Pollution Abatement Trust.

*Massachusetts Development Finance Agency.* Under the infrastructure investment incentive program, known as "I-Cubed," up to \$600 million of public infrastructure improvements to support significant new private developments may be financed by bonds issued by the Massachusetts Development Finance Agency (MassDevelopment) that are secured by and payable from a general obligation pledge of contract assistance from the Commonwealth. Until a related new private development is completed and occupied, the developer's property is assessed by the municipality in which the development is located in amounts equal to the debt service cost on the bonds to reimburse the Commonwealth for such cost. After each phase of the private development is completed and occupied, the municipality is required to reimburse the Commonwealth for any portion of the debt service cost on the bonds that is not covered by new state tax revenues generated from the related private development. The municipality's reimbursement obligation is secured by a general obligation pledge of the municipality, a local aid intercept and a reserve fund which must be funded in an amount equal to or greater than two years of debt service on the bonds. The obligation of the municipality ends when the Commonwealth has collected revenues sufficient to pay principal and interest payments to date, or in some cases to the next redemption date, plus all remaining principal payments due. Pursuant to this program, MassDevelopment has issued contract assistance bonds to finance and refinance infrastructure projects associated with the Fan Pier development in Boston, the Assembly Row project in Somerville, the Chestnut Hill Square project in Newton, the Boston Landing project in Boston, the Van Ness project in Boston, the University Station project in Westwood, and the Northpoint project in Cambridge. As of February 28, 2018, total "I-Cubed" program bonds were outstanding in the amount of approximately \$130.3 million.

Legislation approved by the Governor on August 8, 2008 included an authorization to finance up to \$43 million of the costs of a parkway at the former South Weymouth naval air base to support the development of the former base. Similar to the I-Cubed program financing model, the bonds issued by MassDevelopment to finance the parkway are secured by and payable from a general obligation pledge of contract assistance from the Commonwealth. As of February 28, 2018, approximately \$24.0 million of such bonds were outstanding.

*Social Innovation Financing Trust Fund.* Legislation approved in 2012 established a Social Innovation Financing Trust Fund for the purpose of funding contracts to improve outcomes and lower costs for contracted government services, referred to as “pay for success contracts.” The legislation authorized the Secretary of Administration and Finance to enter into pay for success contracts in which a substantial portion of Commonwealth payments, from amounts appropriated by the Legislature to the Trust Fund, would be conditioned on the achievement of specified performance outcomes. The Commonwealth’s obligation to make such payments is a general obligation for which the Commonwealth’s full faith and credit are pledged. The first such contract was entered into in January, 2014, to help young men leaving the juvenile justice system or on probation avoid re-offending. The contract obligates the Commonwealth to make up to \$28 million in success payments, in the aggregate, through fiscal 2020. In September, 2016, the Commonwealth entered into a side letter to permit the parties to negotiate a contract amendment to extend the period in which young men may be referred to the project without changing the timing or maximum amount of success payments. The Commonwealth entered into a second such contract in December, 2014, to address chronic individual homelessness through permanent stable, supportive housing. The contract obligates the Commonwealth to make up to \$6 million in success payments, in the aggregate, through fiscal 2021. The Commonwealth entered into a third such contract in June, 2016, to assist individuals in Adult Basic Education (ABE) or English for Speakers of Other Languages (ESOL) programs transition to employment, higher wage jobs, and higher education. The contract obligates the Commonwealth to make up to \$15 million in success payments, in the aggregate, through fiscal 2023.

The following table sets forth the Commonwealth’s general obligation contract assistance requirements for all of fiscal 2018 and each fiscal year thereafter pursuant to contracts with the Massachusetts Clean Water Trust, MassDOT (as successor to the Turnpike Authority), and MassDevelopment (including the I-Cubed Program and the South Weymouth naval air base contract assistance requirements) and contracts associated with the Social Innovation Financing Trust Fund.

**General Obligation Contract Assistance Requirements**  
(in thousands)

| <u>Fiscal Year</u> | <u>Massachusetts<br/>Clean<br/>Water Trust</u> | <u>Massachusetts<br/>Department of<br/>Transportation</u> | <u>Massachusetts<br/>Development<br/>Finance Agency</u> | <u>Social Innovation<br/>Financing<br/>Trust Fund (3)</u> | <u>Total</u>              |
|--------------------|--|---|---|---|---------------------------|
| 2018               | \$57,952                                       | \$125,000   | \$8,067   | \$6,451   | \$197,470                 |
| 2019               | 46,489   | 125,000   | 9,838   | 9,100   | 190,427                   |
| 2020               | 40,782   | 125,000   | 9,838   | 24,200  | 199,820                   |
| 2021               | 33,714   | 125,000   | 9,844   | 4,435   | 172,993                   |
| 2022               | 24,305   | 125,000   | 9,843   | 400   | 159,548                   |
| 2023               | 24,468   | 125,000   | 9,838   | 50  | 159,356                   |
| 2024               | 16,192   | 125,000   | 9,837   | -   | 151,029                   |
| 2025               | 12,015   | 125,000   | 9,845   | -   | 146,860                   |
| 2026               | 9,636  | 125,000   | 9,840   | -   | 144,476                   |
| 2027 through 2050  | 46,320 (1)                                     | 1,900,000 (2)   | 178,342   | -   | 2,099,662                 |
| <b>Total (4)</b>   | <b><u>\$311,873</u></b>                        | <b><u>\$3,125,000</u></b>                                 | <b><u>\$265,132</u></b>                                 | <b><u>\$ 44,636</u></b>                                   | <b><u>\$3,746,641</u></b> |

SOURCES: Massachusetts Clean Water Trust column – Office of the Treasurer and Receiver-General; MassDOT, Massachusetts Development Finance Agency and Social Innovation Financing Trust Fund columns - Executive Office for Administration and Finance.

- (1) Current contract assistance payments end in fiscal 2047.
- (2) Represents \$25 million per year for fiscal years 2027 to 2050, inclusive and \$100 million per year for fiscal years 2027 to 2039, inclusive.
- (3) Projected payment schedule. The actual amount and timing of payments will be based on the achievement of specified performance outcomes.
- (4) Totals may not add due to rounding.

## Long-Term Operating Leases and Capital Leases

In addition to Commonwealth-owned buildings and facilities, the Commonwealth leases additional space from private parties. In certain circumstances, the Commonwealth has acquired certain types of capital assets under long-term capital leases; typically, these arrangements relate to computer and telecommunications equipment and to motor vehicles. Minimum future rental expenditure commitments of the Commonwealth under operating leases and long-term principal and interest obligations related to leases in effect as of June 30, 2017 are set forth in the table below.

### Long-Term Leases (in thousands)

| <u>Fiscal Year</u> | <u>Leases (1)</u>       |
|--------------------|-------------------------|
| 2018               | \$226,548               |
| 2019               | 146,537                 |
| 2020               | 113,370                 |
| 2021               | 79,506                  |
| 2022               | 59,877                  |
| 2023               | 47,916                  |
| 2024               | 42,146                  |
| 2025               | 31,305                  |
| 2026               | 21,266                  |
| 2027               | 15,421                  |
| 2028 through 2051  | <u>197,124</u>          |
| <b>Total</b>       | <b><u>\$981,016</u></b> |

SOURCES: Office of the Comptroller

(1) Includes operating and capital leases. Leases with the institutions of higher education that are supported by tuition and fees are not included.

## Contingent Liabilities

*Massachusetts Bay Transportation Authority.* The MBTA issues its own bonds and notes. Prior to July 1, 2000, the Commonwealth supported MBTA bonds, notes and other obligations through guaranties of the debt service on its bonds and notes, contract assistance generally equal to 90% of the debt service on outstanding MBTA bonds and payment of the MBTA's net cost of service (current expenses, including debt service, minus current income). Beginning July 1, 2000, the Commonwealth's annual obligation to support the MBTA for operating costs and debt service is limited to a portion of the revenues raised by the Commonwealth's sales tax, but the Commonwealth remains contingently liable for the payment of MBTA bonds and notes issued prior to July 1, 2000 and for MBTA payment obligations related to leases, reimbursement obligations, interest exchange agreements and other financing obligations entered into prior to July 1, 2000. The Commonwealth's obligation to pay such prior bonds is a general obligation for which its full faith and credit have been pledged. As of February 28, 2018, the MBTA had approximately \$196.8 million of such prior bonds outstanding. Such bonds are currently scheduled to mature annually through fiscal 2030.

*Massachusetts Development Finance Agency.* Under legislation approved in 2010 and amended in 2011, MassDevelopment is authorized to issue bonds for the benefit of nonprofit community hospitals and nonprofit community health centers. Such bonds are to be secured by capital reserve funds funded at the time of bond issuance in an amount equal to the maximum annual debt service on the bonds. The legislation provides that MassDevelopment is to notify the Governor if any such capital reserve fund needs to be replenished, and that the Legislature is to appropriate the amount necessary to restore the fund to its required level. The legislation contains no limit on the amount of such bonds that may be issued. Any project to be financed by such bonds must be approved by the Secretary of Health and Human Services, and any loan to a community hospital or community health center (and the issuance and terms of the related bonds) must be approved by the Secretary of Administration and Finance. If any such institution defaults on a loan, any moneys in the custody of the Commonwealth that are payable to the institution may be withheld by the Commonwealth and used to pay debt service or to replenish the applicable capital reserve fund. If, following a Commonwealth transfer to replenish a capital reserve fund, the applicable institution fails to reimburse the Commonwealth within six months, the Commonwealth may withhold funds payable to the institution, and all contracts issued by the Group Insurance Commission, the Commonwealth

Health Insurance Connector Authority and MassHealth to a third party for the purposes of providing health care insurance paid for by the Commonwealth are to provide that the third party is to withhold payments to the institution and transfer the withheld amounts to the Commonwealth. No bonds have ever been issued pursuant to this legislation.

*Woods Hole, Martha’s Vineyard and Nantucket Steamship Authority.* The Steamship Authority operates passenger and vehicle ferries to Martha’s Vineyard and Nantucket. The Steamship Authority issues its own bonds and notes. Commonwealth support of the bonds and notes of the Steamship Authority includes a Commonwealth guaranty pursuant to statutory provisions requiring the Commonwealth to provide the Steamship Authority with funds sufficient to meet the principal of and interest on their bonds and notes as they mature to the extent that funds sufficient for this purpose are not otherwise available to the Steamship Authority and the Commonwealth’s payment, under applicable statutory provisions, of the net cost of service of the Steamship Authority (current expenses, including debt service, minus current income). The Steamship Authority is currently self-supporting, requiring no net cost of service or contract assistance payments. As of February 28, 2018, the Steamship Authority had approximately \$71.6 million of bonds outstanding. The Commonwealth’s obligations to the Steamship Authority are general obligations for which its full faith and credit have been pledged.

*University of Massachusetts Building Authority.* This authority, created to assist the University of Massachusetts, is permitted by its enabling act to have outstanding up to \$200 million in Commonwealth-guaranteed debt. The Commonwealth’s guaranty of principal and interest is a general obligation of the Commonwealth for which its full faith and credit are pledged. In addition to such guaranty, certain revenues of the Building Authority, including dormitory rental income and student fees, are pledged to pay the Building Authority’s bonds. As of February 28, 2018, the Building Authority had approximately \$114.2 million of Commonwealth-guaranteed debt outstanding.

**Authorized and Unissued Debt**

General obligation bonds of the Commonwealth are authorized to correspond with capital appropriations. See “COMMONWEALTH BUDGET AND FINANCIAL MANAGEMENT CONTROLS – Capital Investment Process and Controls.” Over the last decade, the Commonwealth has typically had a large amount of authorized and unissued debt. However, the Commonwealth’s actual expenditures for capital projects in a given year relate more to the capital needs which the Commonwealth determines it can afford to finance in such year than to the total amount of authorized and unissued debt. The table below presents authorized and unissued debt at year end:

**Authorized and Unissued Debt (in thousands)**

| <u>Fiscal Year</u> | <u>Authorized and Unissued Debt</u> |
|--------------------|-------------------------------------|
| 2013               | \$13,762,257                        |
| 2014               | 26,255,768                          |
| 2015               | 29,071,339                          |
| 2016               | 26,145,997                          |
| 2017               | 22,716,302                          |

SOURCE: Office of the Comptroller.

Authorized and unissued debt is measured in accordance with the statutory basis of accounting, which is different from GAAP. Only the net proceeds of bonds issued (exclusive of underwriters’ discount, costs of issuance and other financing costs) are deducted from the amount of authorized and unissued debt. Therefore, the change in authorized and unissued debt at the end of any fiscal year is not intended to correlate to the change in the principal amount of debt outstanding as measured and reported in conformity with GAAP.

The Legislature has enacted various bond authorizations to fund the Commonwealth's capital investment plan. See "COMMONWEALTH CAPITAL INVESTMENT PLAN." Capital spending and subsequent debt issuance is constrained by the debt affordability policy and the statutory debt limit, and will be published annually in the five-year capital investment plan.

## LEGAL MATTERS

There are pending in state and federal courts within the Commonwealth and in the Supreme Court of the United States various suits in which the Commonwealth is a party. In the opinion of the Attorney General, no litigation is pending or, to her knowledge, threatened which is likely to result, either individually or in the aggregate, in final judgments against the Commonwealth that would affect materially its financial condition.

### Programs and Services

From time to time actions are brought against the Commonwealth by the recipients of governmental services, particularly recipients of human services benefits, seeking expanded levels of services and benefits and by the providers of such services challenging the Commonwealth's reimbursement rates and methodologies. To the extent that such actions result in judgments requiring the Commonwealth to provide expanded services or benefits or pay increased rates, additional operating and capital expenditures might be needed to implement such judgments.

*Rosie D., et al. v. The Governor*, United States District Court, Western Division. In a memorandum of decision dated January 26, 2006, the District Court ruled in favor of a class of Medicaid-recipient children that the Commonwealth fails to provide the in-home and community-based services required under the Early and Periodic Screening, Diagnosis and Treatment ("EPSDT") provisions of the Medicaid Act. In February 2007, the District Court adopted the defendants' proposed remedial plan, with some modifications, and, in July 2007, entered judgment in accordance with that plan, as modified. The Commonwealth did not appeal from that judgment; instead MassHealth has implemented all required program changes. Although the monitoring period had been set to expire December 31, 2012, the court has subsequently extended the monitoring period several times, most recently through December 31, 2018. MassHealth estimates that its implementation of program changes in compliance with the court's remedial orders will continue to increase its costs, including administrative costs, prospectively by over \$20 million annually. The Commonwealth maintains that it is in full compliance with the court's judgment. A status conference is scheduled for April 5, 2018.

*Hutchinson et al v. Patrick et al*, United States District Court, Massachusetts. This is a class action, commenced in 2007, brought by two organizations and five individuals with brain injuries who are residents of various nursing facilities. Plaintiffs claim that they and a class of between 2,000 and 4,000 brain-injured individuals are entitled to, among other things, placement in community settings. Plaintiffs asserted claims under the Americans with Disabilities Act, the Rehabilitation Act and the Medicaid Act; they sought declaratory and injunctive relief. After the court certified a class in October 2007, the parties engaged in an intensive period of settlement negotiations. In May, 2008, the parties entered into a settlement agreement which was subsequently amended in July, 2013 ("Agreement"). Under the terms of the Agreement, the defendants will use the Massachusetts Money Follows the Person Demonstration Project ("MFP Project") and various waiver programs to provide community residential and non-residential supports in an integrated setting to Massachusetts Medicaid-eligible persons with an acquired brain injury who are in nursing and long-term rehabilitation facilities ("Class Members in Facilities"). Over the six-year term of the Agreement, the defendants will provide between 905 and 1,174 waiver slots for Class Members in Facilities. The exact number of slots to be added will depend on the level of demand for waiver services. The cost of implementing these programs was originally projected to be approximately \$386 million, phased in over six years, with approximately half of that amount expected to be reimbursed by the federal government. Year five of the Agreement began on July 1, 2017. The fiscal 2018 appropriation for funding of the Agreement is approximately \$71.7 million. By year six of the agreement, fiscal 2019, when the program will be fully implemented, the annualized cost of the program as initially projected will be approximately \$112 million (gross) or \$56 million (net) state cost.

*Fowler, et al., for themselves and others similarly situated v. Thomas Turco, in his official capacity as the Commissioner of the Massachusetts Department of Correction, and the Massachusetts Partnership for Correctional Healthcare, LLC*, United States District Court, Massachusetts. Four state prisoners have filed a class action suit

relating to treatment of the Hepatitis C virus (HCV) among prisoners in the custody of the Massachusetts Department of Correction (DOC). The suit alleges that the DOC and its healthcare services provider, the Massachusetts Partnership for Correctional Healthcare (MPCH), have failed to provide HCV-positive prisoners with access to new medications that, plaintiffs claim, enjoy higher success rates, fewer side effects, and shorter treatment duration than prior treatments. Employing the uppermost range estimate for the rate of HCV infection among prisoners nationwide - 41.1% - to the Massachusetts prison population, the number of HCV-infected individuals in Massachusetts custody could be as high as 4,800. (At present, approximately 1,100 prisoners have been identified as HCV-positive.) The State Office of Pharmacy Services, which procures the medications for MPCH, pays between approximately \$39,000 and \$75,000 per patient, depending on the patient's specific medical needs and the appropriate medication regimen, for the typical 12-week course of treatment, although that cost has very recently come down for certain patients as new drugs gain FDA approval and shorter treatment durations become possible. Based on these figures, if the defendants are required to provide the medications to all HCV-infected prisoners in DOC custody, the total cost could reach \$90-\$350 million dollars. The parties have recently agreed upon terms to settle this matter. Plaintiffs and the DOC have submitted a joint motion to the court for approval of this settlement, which is required because this litigation is a class action. If the court grants preliminary approval of the settlement, plaintiffs will provide notice of the terms of the settlement to class members. Class members will then be given an opportunity to comment or object. The court will then hold a hearing on the fairness of the proposed settlement.

### **Medicaid Audits and Regulatory Reviews**

*In re: Centers for Medicare and Medicaid Services regulations (Uncompensated Care Pool/Health Safety Net Trust Fund).* The federal Health Care Financing Administration (now CMS) asserted in June, 2000 that the portion of the Medicaid program funded by the Commonwealth's Health Safety Net Trust Fund (formerly the Uncompensated Care Pool) might violate federal regulations regarding permissible taxes on health care providers. Since 1993, MassHealth has sought federal waivers for the Commonwealth's assessment on acute care hospitals and surcharge payers, respectively, which fund the Uncompensated Care Pool and its successor, the Health Safety Net Trust Fund. The Commonwealth believes that the assessments are within the federal law pertaining to health care-related taxes. In 2017, a change in state law was made to the hospital assessment making a federal waiver for the hospital assessment unnecessary. Under federal regulations, if the Commonwealth were ultimately determined to have imposed an impermissible health care-related tax, the federal government could seek retroactive repayment of federal Medicaid reimbursements. By the end of Health Safety Net fiscal year 2017, the Commonwealth will have collected an estimated \$6.234 billion in acute hospital assessments since 1990 and an estimated \$2.857 billion in surcharge payments since 1998.

*In re: Office of the Inspector General Report Number: A-01-12-0006 (Claiming the correct Federal medical assistance percentage for claim adjustments made to the Form CMS-64).* On April 6, 2012, the federal Office of the Inspector General (OIG) initiated an audit of MassHealth's federal reporting of certain claims with dates of service between January 1, 2006 and December 31, 2010. The OIG issued a draft report on June 3, 2014. MassHealth responded on July 3, 2014. The OIG draft report concludes that during the audit period MassHealth over-claimed \$105 million in federal financial participation due to timing issues associated with the temporary Federal Medical Assistance Percentages increase due to ARRA and EOHHS' "void and replace" claiming system. EOHHS' response to the draft report states that MassHealth worked closely with the federal Centers for Medicare and Medicaid Services (CMS) to develop the system it uses to submit claims and adjustments for federal matching funds on the CMS form since June 2009, and that CMS validated and accepted the "void and replace" claims adjustment system EOHHS used. The OIG's audit focused on a specific time period that, based on its calculations, resulted in a federal overpayment. Based on the OIG's methodology, there was a \$108 million federal underpayment to the Commonwealth for the subsequent period of January, 2011 through September, 2013. Based on the OIG's audit report, MassHealth has implemented the OIG's interpretation of the claiming rules after the audit period, and has requested increased federal reimbursement totaling approximately \$108.2 million from CMS, which will offset OIG's recommended adjustment. In its response to the OIG's report, EOHHS advised the OIG that if CMS agrees with the OIG's interpretation of federal claiming rules and the rules are applied consistently, EOHHS has no objection to the OIG's recommended finding. The OIG issued its final report in September, 2014. The OIG did not accept EOHHS' position. EOHHS is pursuing this matter further with CMS. CMS has not taken any action to disallow the \$108.2 million that the OIG insists is an overpayment.

## Taxes

*Comcast of Massachusetts I, Inc. v. Commissioner of Revenue*, Appellate Tax Board. On June 7, 2016, the Appellate Tax Board (the “Board”) issued a decision in favor of the Commissioner in these ten consolidated corporate excise tax cases for the years 2003-2008. On November 10, 2017, the Board issued its Findings of Fact and Report explaining its decision. On January 8, 2018, the taxpayers filed a Notice of Appeal, which likely will result in the final consolidated case decision being reviewed by the Massachusetts Appeals Court. The case below presented a variety of issues, including: (a) whether the taxpayers were entitled to a re-computation of the sales factor of various members of the combined group based on the costs of performance rule under G.L. c. 63, section 38(f), as in effect during the years at issue; (b) whether the taxpayers were entitled to a refund of corporate excise attributable to final IRS determinations adjusting the income of the taxpayers; (c) whether the taxpayers may properly claim interest expense deductions that they had added back under the Massachusetts Add Back Statute, G.L. c. 63, § 31J, on their originally filed returns; (d) whether the taxpayers improperly treated as sales within the meaning of G.L. c. 63, § 38(f), certain intercompany reimbursements made at cost, and (e) whether the taxpayers’ position that investment expenses were apportionable to Massachusetts, when these same expenses were associated with dividend income that the parties agreed was properly allocable 100% to Pennsylvania, was without legal merit. Before the Board, the potential refund claims totaled approximately \$201 million. About three months after the Board’s 2016 decision, the taxpayers filed a Motion to Alter, Amend or Clarify Decision. The taxpayers contended that during the course of proceedings of the case, the Commissioner conceded five issues and that the Board’s decision should therefore be in favor of the taxpayers on those five issues. As to the issues the parties conceded during trial, the Board ruled in 2017 that it was incumbent upon the parties to calculate the numerical consequences of such concessions. On November 20, 2017, the parties filed a Joint Motion for Additional Findings of Fact and to Amend the Judgment. The purpose of the motion was to ensure that the numerical consequences were resolved prior to an appeal commencing. On January 9, 2018, the Board allowed the motion and issued a Supplemental Decision and Findings incorporating the parties’ stipulated abatement amounts, which totaled \$47,932,447. The Commissioner has issued a refund of this amount. Thus, approximately \$155 million in potential refunds remains at stake in the taxpayers’ pending appeal.

*Northeastern University, et al. v. Commissioner of Revenue* (Appeals Court, Suffolk Superior Court) and related Brownfields Credits Claims. The plaintiffs in a Superior Court case, three Massachusetts universities, alleged that the Commissioner of Revenue (“Commissioner”) wrongfully denied their requests for Brownfields Tax Credits. Legislation in 2006 made not-for-profit institutions eligible, for the first time, to claim tax credits for work those institutions performed to remediate an environmentally contaminated site. (Because not-for-profits do not typically pay corporate excise taxes, against which such a credit may be applied, the legislation also made it possible, for the first time, for taxpayers granted such a credit to “sell” that credit to individuals or corporations who do incur tax liability, so that the buyer can make use of the credit. The law specifies that any unused portion of a credit, as reduced from year to year, can be carried over and applied to a tax liability for any subsequent year, not to exceed five years.) The sole issue in the *Northeastern University* litigation, filed in August, 2014, is whether the nonprofit universities may receive a Brownfields Tax Credit for site remediation achieved prior to the taxable year commencing on or after June 24, 2006 (*i.e.*, the effective date of the legislative amendment). The Commissioner denied the plaintiffs’ applications for the credit because the site remediation had been achieved prior to the taxable year commencing on or after June 24, 2006. The plaintiffs prevailed in the Superior Court and, if all other application conditions are met, they would be entitled to tax credits in the cumulative amount of \$17.7 million. Additionally, other entities may now be bolstered in claims for credits that they have not yet asserted; those claims may be worth tens of millions of dollars. The Commonwealth appealed the adverse Superior Court judgment. On December 28, 2017, the Appeals Court, in an unpublished decision, affirmed the Superior Court’s judgment. The Commonwealth has filed an application for further appellate review with the Supreme Judicial Court, which may be acted upon in March of 2018.

In the category of Brownfields Credits claims not yet docketed at the Appellate Tax Board (subcategories of pending and unasserted claims), which principally raise legal issues distinct from the *Northeastern University* claims, the Department of Revenue estimates a total of \$113.9 million worth of potential revenue loss, with three of the individual credit amount claims exceeding \$10 million.

## Other Revenues

*Commonwealth of Massachusetts v. Philip Morris Inc., RJ Reynolds Tobacco Company, Lorillard Tobacco Company, et al.*, Supreme Judicial Court, Middlesex Superior Court (a/k/a the Tobacco Master Settlement Agreement, Nonparticipating Manufacturer (“NPM”) Adjustment Disputes)

These matters arise under the Tobacco Master Settlement Agreement (“MSA”), entered into in 1998, that settled litigation and claims by Massachusetts and 51 other states or dependencies (collectively the “States”) against the major tobacco manufacturers. Under the MSA, yearly payments made by the Original Participating Manufacturers (“OPMs”) and Subsequent Participating Manufacturers (collectively the Participating Manufacturers or “PMs”) are subject to a number of adjustments. One such adjustment is the Non-Participating Manufacturer (“NPM”) Adjustment, which can be triggered if the PMs suffer a specified market share loss as compared to their market share during the base year 1997. Under the MSA, a nationally recognized economic firm selected jointly by the States and the PMs must make a determination that “the disadvantages experienced” by the PMs as a result of complying with the MSA were “a significant factor contributing to the Market Share Loss” for a given year. Even if such a determination is made, the States can still avoid the NPM adjustment if it is determined that the States “diligently enforced” their individual NPM Escrow Statutes.

(a) (2004 NPM Adjustment) The PMs seek to reduce, by approximately \$1.1 billion, the MSA payments they made to the States for 2004 sales and so they deposited a portion of this amount into a disputed payment account pending a resolution of this claim. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs and the States are arbitrating the 2004 NPM Adjustment. In June, 2017, however, the PMs decided not to contest the Commonwealth’s diligence in 2004. Accordingly, the Commonwealth no longer has any risk of loss concerning the 2004 NPM Adjustment.

(b) (2005 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$753 million, the MSA payments they made to the States for 2005 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2005 following the conclusion of the 2003 NPM Adjustment Arbitration proceedings. If the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$30 million, plus interest, up to but not exceeding the full amount of the state’s MSA payment for 2005 sales, depending upon the outcome of similar NPM proceedings against other states.

(c) (2006 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$704 million, the MSA payments they made to the States for 2006 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2006 following the conclusion of the 2003 NPM Adjustment Arbitration proceedings. If the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$7 million, plus interest, up to but not exceeding the full amount of the state’s MSA payment for 2006 sales, depending upon the outcome of similar NPM proceedings against other states.

(d) (2007 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$791 million, the MSA payments they made to the States for 2007 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2007 following the conclusion of the 2003 NPM Adjustment Arbitration proceedings. If the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$8.8 million, plus interest, up to but not exceeding the full amount of the state’s MSA payment for 2007 sales, depending upon the outcome of similar NPM proceedings against other states.

(e) (2008 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$888 million, the MSA payments they made to the States for 2008 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2008 following the conclusion of the 2003 NPM Adjustment Arbitration proceedings. If the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$900,000, plus interest, up to but not exceeding the full amount of the state's MSA payment for 2008 sales, depending upon the outcome of similar NPM proceedings against other states.

(f) (2009 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$859 million, the MSA payments they made to the States for 2009 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2009. If the matter is arbitrated and the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$1.3 million, plus interest, up to but not exceeding the full amount of the state's MSA payment for 2009 sales, depending upon the outcome of similar NPM proceedings against other states.

(g) (2010 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$873 million, the MSA payments they made to the States for 2010 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2010. If the matter is arbitrated and the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$500,000, plus interest, up to but not exceeding the full amount of the state's MSA payment for 2010 sales, depending upon the outcome of similar NPM proceedings against other states.

(h) (2011 NPM Adjustment) In the same manner as described above, the PMs seek to reduce, by approximately \$728 million, the MSA payments they made to the States for 2011 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2011. If the matter is arbitrated and the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$500,000, plus interest, up to but not exceeding the full amount of the state's MSA payment for 2011 sales, depending upon the outcome of similar NPM proceedings against other states.

(i) (2012 NPM Adjustment) In the same manner as described above, the PMs seek to reduce by approximately \$797 million, the MSA payments they made to the States for 2012 sales. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2012. If the matter is arbitrated and the Commonwealth does not prevail, future MSA payments to Massachusetts would be reduced by an amount yet to be determined, between \$300,000, plus interest, up to but not exceeding the full amount of the state's MSA payment for 2012 sales, depending upon the outcome of similar NPM proceedings against other states.

(j) (2013 NPM Adjustment) In the same manner as described above, the PMs seek to reduce by approximately \$823 million, the MSA payments they made to the States for 2013 sales. This amount is subject to revision until a Final Calculation in March, 2018. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2013. The largest PMs

have not yet had an opportunity to designate funds related to 2013 sales as disputed and place the funds in escrow. Until they have had such an opportunity and Final Calculations are received in March, 2018, the Commonwealth's potential exposure cannot be determined.

(k) (2014 NPM Adjustment) In the same manner as described above, the PMs seek to reduce by approximately \$824 million, the MSA payments they made to the States for 2014 sales. This amount is subject to revision until a Final Calculation in March, 2019. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2014. The largest PMs have not yet had an opportunity to designate funds related to 2014 sales as disputed and place the funds in escrow. Until they have had such an opportunity and Final Calculations are received in March, 2019, the Commonwealth's potential exposure cannot be determined.

(l) (2015 NPM Adjustment) In the same manner as described above, the PMs seek to reduce by approximately \$895 million, the MSA payments they made to the States for 2015 sales. This amount is subject to revision until a Final Calculation in March, 2020. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2015. The largest PMs have not yet had an opportunity to designate funds related to 2015 sales as disputed and place the funds in escrow. Until they have had such an opportunity and Final Calculations are received in March, 2020, the Commonwealth's potential exposure cannot be determined.

(m) (2016 NPM Adjustment) In the same manner as described above, the PMs seek to reduce by approximately \$901 million, the MSA payments they made to the States for 2016 sales. This amount is subject to revision until a Final Calculation in March, 2021. A determination has been made that the PMs suffered a market share loss and that the disadvantages experienced by the PMs as a result of complying with the MSA were a significant factor contributing to the market share loss. The PMs have not yet notified the States of their intent to arbitrate the issue of whether each state diligently enforced its NPM Escrow Statute during 2015. The largest PMs have not yet had an opportunity to designate funds related to 2015 sales as disputed and place the funds in escrow. Until they have had such an opportunity and Final Calculations are received in March, 2021, the Commonwealth's potential exposure cannot be determined.

## **Environment**

*In re Massachusetts Military Reservation* (pre-litigation). The Commonwealth, through the Executive Office of Energy and Environmental Affairs, the Department of Environmental Protection and the Attorney General's office, were engaged in discussions with federal Natural Resource Trustees, including the United States Army and Air Force, the Department of the Interior and the National Oceanic and Atmospheric Administration, and private contractors regarding natural resource damages at the Massachusetts Military Reservation on Cape Cod. Federal Trustees and private contractors claim that the Commonwealth and others are liable for natural resource damages due to widespread contamination primarily from past military activities at the Reservation and are responsible for response actions and related clean-up activities. The assessment process for natural resource damages is set out in federal regulations and has not been completed. While no recent comprehensive estimate of natural resource damages and response actions is available, it is expected that the damages and response actions may cost at least tens of millions of dollars. In 2013, the state and federal trustees reopened preliminary discussions per a Trustee Council resolution on a potential settlement framework.

## **Other**

*McHugh et al v. Commonwealth et al.*, Suffolk Superior Court. Four Massachusetts Department of Environmental Protection ("DEP") contract employees have filed a purported class action suit against the Commonwealth, DEP, and the Commissioner of DEP, Martin Suuberg. The suit alleges that Commonwealth entities (including but not limited to DEP) are hiring and employing contract employees as long-term replacements for full-time state employees and not providing them employment benefits. Plaintiffs purport to bring suit on behalf

of approximately 3,330 to 7,600 similarly situated individuals who are or have been employed by the Commonwealth or DEP for a period of three or more years. Plaintiffs assert claims under the United States and Massachusetts Constitutions, a variety of Massachusetts statutes, and the common law. Plaintiffs seek monetary damages as well as declaratory and injunctive relief. Defendants moved to dismiss all claims brought against them. Subsequently, plaintiffs filed an opposition to the motion to dismiss and a cross-motion to amend the complaint. The Court allowed the cross-motion to amend and took no action on the motion to dismiss, canceling a February 2018 hearing. Defendants will file a motion to dismiss the amended complaint after it is filed.

*Drug Testing Laboratory disputes.* In August, 2012, Annie Dookhan, a chemist formerly employed at the state's drug testing laboratory in Boston, admitted to several types of misconduct involving her handling of laboratory samples, which were used in criminal cases. The Attorney General's office conducted a criminal investigation and, in December, 2012, Ms. Dookhan was indicted by a statewide grand jury on charges in connection with altering drug evidence during the testing process and obstructing justice; she pled guilty in 2013 and was sentenced to 3-to-5 years in state prison. On January 18, 2017, the Supreme Judicial Court, in *Bridgeman, et al. v. District Attorney for the Suffolk District, et al.*, SJC-12157, held that, in order to resolve the ongoing issues relating to the rights of criminal defendants potentially affected by Ms. Dookhan's misconduct in some 20,000-24,000 cases, the state's district attorneys, within 90 days of the order, were required to review those cases to determine which they could and would re-prosecute, and then move to vacate and dismiss the rest. Defendants in the cases that remain shall receive a judicially-approved notice, after which the Committee for Public Counsel Services shall assign counsel, at state expense, to all indigent defendants who wish to pursue vacatur or a new trial. In April 2017, prosecutors announced that they would be moving to vacate and/or dismiss approximately 21,500 cases, and only a few hundred would remain open for re-prosecution. This came to pass.

Meanwhile, in January, 2013, Sonja Farak, a chemist formerly employed at the state's Amherst drug testing laboratory was arrested for theft of a controlled substance and tampering with evidence. In January, 2014, Ms. Farak pled guilty to charges that she removed drug samples for her own use and mixed drug evidence samples with counterfeit drugs to hide the theft, and she was given a split sentence of 2.5 years in a house of correction with 18 months to serve. The Attorney General's Office conducted an investigation into the full scope and timing of Ms. Farak's misconduct and the operations of the Amherst laboratory, issuing a report dated April 1, 2016, to the Hampden County Superior Court. Many thousands of criminal prosecutions may have been affected. In December, 2016, the Hampden County Superior Court held an evidentiary hearing on motions for new trial or to withdraw guilty pleas and motions to dismiss filed by a small group of 10 defendants whose cases the Court had consolidated for purposes of evidentiary hearings. On June 26, 2017, the court (Carey, J.) vacated the convictions or dismissed the indictments of six defendants and allowed another to withdraw a guilty plea. The court found that two former prosecutors "tampered with the fair administration of justice" and perpetrated "a fraud upon the court" by deliberately concealing documents which arguably showed that Ms. Farak's drug abuse (and, inferentially, tampering in the lab) had begun earlier than previously acknowledged and by making misrepresentations in connection with discovery motions decided by another judge. With respect to certain other criminal prosecutions, the court found that their misconduct has systemic ramifications. With regard to the Amherst lab, while the court found that Ms. Farak's drug use impaired her ability to test and analyze controlled substances and to check the equipment and instruments used to analyze suspected drugs on occasions which cannot be identified, the court also found that, with the exception of Ms. Farak's work, the Amherst lab was "free from any deficiency in analytical procedure, was kept in an orderly fashion, and that work flowed through the lab smoothly."

In September, 2017, the Committee for Public Counsel Services filed a petition under G.L. c. 211, § 3, and c. 231A, § 1, against the Attorney General and the 11 Massachusetts District Attorneys' Offices, seeking to vacate and dismiss with prejudice convictions of defendants allegedly tainted by Ms. Farak's misconduct. *Committee for Public Counsel Services, et al. v. Attorney General of Massachusetts, et al.*, SJ-2017-0347. That same month, one of the defendants whose criminal charges were dismissed in the case heard by Judge Carey initiated a civil action in the United States District Court for the District of Massachusetts. *Penate v. Kaczmarek et al.*, Civil Action No. 3:17-cv-30119-KAR. Penate's complaint alleges, among other claims, constitutional rights violations under 42 U.S.C. § 1983 against former state employees, employees of the Springfield Police Department, the City of Springfield, and two former and one current Assistant Attorneys General. The complaint seeks compensatory and punitive damages, interest, costs, and attorneys' fees. Certain defendants have moved to dismiss the complaint; the federal court has not yet ruled on any of these motions.

In the *Committee for Public Counsel Services* case, the District Attorneys agreed to vacate more than 8,000 so-called “Farak defendant” convictions that were obtained using Farak-signed drug certificates. The District Attorneys, however, declined to vacate approximately 45 “Farak defendant” cases and expressed their intent to re-prosecute those defendants if motions for new trials are allowed. On January 26, 2018, Associate Justice Frank Gaziano reserved and reported the following three questions to the full Supreme Judicial Court:

1. Whether any of the 45 defendants whom the District Attorneys intend to re-prosecute are entitled to have their convictions vacated and drug charges dismissed with prejudice?;
2. Whether the definition of “Farak defendants” is too narrow?; and
3. Whether the court should adopt additional prophylactic measures to address future cases involving widespread prosecutorial misconduct?

The Supreme Judicial Court will hear oral argument on these issues in May, 2018. Justice Gaziano is retaining jurisdiction over remaining matters in the case.

Given the tens of thousands of cases from both laboratories potentially affected, there likely will be continuing significant, but as yet undetermined, state costs to remedy alleged malfeasance, including, but not limited to: vendor costs for maintaining an electronic document review platform; costs to defend civil complaints alleging state liability in both state and federal courts; and for potential settlements or judgments. In addition, in *Nelson v. Colorado*, 137 S. Ct. 1239 (2017), the United States Supreme Court declared that when a criminal conviction is invalidated by a reviewing court and no retrial will occur, a state is obliged to refund fees, court costs, and any restitution exacted from a defendant upon, and as a consequence of, the conviction. On February 23, 2018, and based on this Supreme Court decision, three plaintiffs filed a purported class action on behalf of the criminal defendants whose convictions were vacated as the result of Ms. Dookhan’s misconduct, seeking “refund of all Case-Related Payments, payment for all Uncompensated Labor, and return of all Forfeited Property.” *Foster, et al. v. Commonwealth, et al.*, 1:18-cv-10354 (D. Mass.). In two similar appeals docketed in February, 2018, involving Dookhan defendants whose convictions were vacated, the Massachusetts Supreme Judicial Court is likely to decide whether those defendants are entitled to a refund of court fees or fines paid and/or the return of forfeited property. See *Commonwealth v. Martinez*, SJC-12479; *Commonwealth v. S.G.*, SJC-12480. If the *Nelson* ruling is applicable to the facts and legal circumstances of the Dookhan and Farak defendants’ cases, and the former criminal defendants’ legal theories prevail in one or more of the above-cited federal or state cases, it could require the Commonwealth to budget for millions of dollars’ worth of refundable exactions and administrative expenses.

## CONTINUING DISCLOSURE

The Commonwealth prepares its Statutory Basis Financial Report and its Comprehensive Annual Financial Report with respect to each fiscal year ending June 30. The Statutory Basis Financial Report usually becomes available on or around October 31 of the following fiscal year and the Comprehensive Annual Financial Report becomes available in January of the following fiscal year. Copies of such reports and other financial reports of the Comptroller referenced in this document may be obtained by requesting the same in writing from the Office of the Comptroller, One Ashburton Place, 9<sup>th</sup> Floor, Boston, Massachusetts 02108. The financial statements are also available at the Comptroller’s web site located at <http://www.macomptroller.org> by clicking on “Financial Reports” on the Comptroller’s homepage.

The Department of the State Auditor audits all agencies, departments and authorities of the Commonwealth at least every three years. Copies of audit reports may be obtained from the State Auditor, State House, Room 229, Boston, Massachusetts 02133.

On behalf of the Commonwealth, the State Treasurer will provide to the MSRB, through EMMA, no later than 270 days after the end of each fiscal year of the Commonwealth, certain financial information and operating data relating to such fiscal year, as provided in Rule 15c2-12, as amended, adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, together with audited financial statements of the Commonwealth for such fiscal year. Except as noted below, the Commonwealth has not failed in the last five years to comply with its continuing disclosure undertakings with respect to any of its debt.

The Commonwealth failed to file an event notice in October, 2013 when the Moody's rating on outstanding junior-lien GANs was upgraded from Aa2 to Aa1, and failed to file an event notice in March, 2014 when the Standard & Poor's rating on certain insured special obligation bonds payable from the Convention Center Fund was upgraded from A to AA-. The Commonwealth has filed notices of all such rating changes with respect to the bonds that are currently outstanding.

The fiscal 2012 and fiscal 2013 annual financial information filed by the Commonwealth pursuant to its continuing disclosure undertakings related to its grant anticipation note program contained incorrect information concerning the amounts of CTF pledged funds. Amended filings have been posted with EMMA.

The fiscal 2012 annual financial information filed by the Commonwealth on March 26, 2013 pursuant to its continuing disclosure undertakings related to its general obligation bond program contained incorrect information about the amount of outstanding direct debt subject to the statutory debt limit and the amount of the limit. An amended filing for fiscal 2012 has been posted with EMMA, and a corrected table is included in this Information Statement. See "LONG-TERM LIABILITIES – General Authority to Borrow; *Statutory Limit on Direct Debt.*"

The fiscal 2014 annual financial information was filed by the Commonwealth on March 27, 2015 pursuant to its continuing disclosure undertakings with respect to its general obligation bonds; however, there was a failure to link the filing to certain CUSIP numbers for Commonwealth general obligation bonds issued from October 29, 2014 through December 31, 2014. In addition, certain annual financial information was not properly linked to certain Commonwealth contract assistance bonds and certain CTF Bonds. Corrective filings have since been posted on EMMA.

In the course of substituting liquidity facilities in connection with certain Commonwealth general obligation variable rate demand bonds, supplements to the respective official statements for such bonds were posted in a timely manner to EMMA setting forth detailed information regarding the substituted liquidity facilities; however, separate event notices were not posted at the time. Event notices of the liquidity substitutions have since been posted.

In the course of reviewing its event notice filings, the Commonwealth discovered that bond call notices were not posted in a timely manner to EMMA in connection with certain advance refunding transactions and that a notice of defeasance was not timely posted to EMMA until approximately three and a half months after the defeasance occurred. The Commonwealth has posted such notices with respect to all Commonwealth bonds that have been advance refunded, where the funds to redeem or pay the bonds remain held in escrow.

The State Treasurer also regularly files information with EMMA beyond the documents required by the Commonwealth's continuing disclosure undertakings, including updated Information Statements. In addition, information of interest to investors may be posted on the Commonwealth's investor website at [www.massbondholder.com](http://www.massbondholder.com), on twitter at [twitter.com/BuyMassBonds](https://twitter.com/BuyMassBonds) and on the Commonwealth's "Mass. Investor Disclosure" mobile app.

*[Remainder of page intentionally left blank.]*

## MISCELLANEOUS

Any provisions of the constitution of the Commonwealth, of general and special laws and of other documents set forth or referred to in this Information Statement are only summarized, and such summaries do not purport to be complete statements of any of such provisions. Only the actual text of such provisions can be relied upon for completeness and accuracy.

This Information Statement contains certain forward-looking statements that are subject to a variety of risks and uncertainties that could cause actual results to differ from the projected results, including without limitation general economic and business conditions, conditions in the financial markets, the financial condition of the Commonwealth and various state agencies and authorities, receipt of federal grants, litigation, arbitration, force majeure events and various other factors that are beyond the control of the Commonwealth and its various agencies and authorities. Because of the inability to predict all factors that may affect future decisions, actions, events or financial circumstances, what actually happens may be different from what is set forth in such forward-looking statements. Forward-looking statements are indicated by use of such words as “may,” “will,” “should,” “intends,” “expects,” “believes,” “anticipates,” “estimates” and others.

All estimates and assumptions in this Information Statement have been made on the best information available and are believed to be reliable, but no representations whatsoever are made that such estimates and assumptions are correct. So far as any statements in this Information Statement involve any matters of opinion, whether or not expressly so stated, they are intended merely as such and not as representations of fact. The various tables may not add due to rounding of figures.

Neither the Commonwealth’s independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with, the prospective financial information.

The information, estimates and assumptions and expressions of opinion in this Information Statement are subject to change without notice. Neither the delivery of this Information Statement nor any sale made pursuant to any official statement of which this Information Statement is a part shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth or its agencies, authorities or political subdivisions since the date of this Information Statement, except as expressly stated.

*[Remainder of page intentionally left blank.]*

**AVAILABILITY OF OTHER FINANCIAL INFORMATION**

Questions regarding this Information Statement or requests for additional information concerning the Commonwealth should be directed to Susan E. Perez, Deputy Treasurer, Office of the Treasurer and Receiver-General, 3 Center Plaza, Suite 430, Boston, Massachusetts 02108, telephone (617) 367-3900, or to Jennifer Sullivan, Assistant Secretary for Capital Finance, Executive Office for Administration and Finance, State House, Room 373, Boston, Massachusetts 02133, telephone (617) 727-2040. Questions regarding legal matters relating to this Information Statement should be directed to John R. Regier, Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., One Financial Center, Boston, Massachusetts 02111, telephone (617) 348-1720.

THE COMMONWEALTH OF MASSACHUSETTS

By /s/ Deborah B. Goldberg  
Deborah B. Goldberg  
Treasurer and Receiver-General

By /s/ Michael J. Heffernan  
Michael J. Heffernan  
Secretary of Administration and Finance

March 22, 2018

## PROPOSED FORM OF OPINION OF BOND COUNSEL

Upon delivery of the Bonds described below, Bond Counsel proposes to deliver an opinion in substantially the following form:



111 Huntington Avenue  
 Boston, MA 02199  
 Telephone: 617-239-0100  
 Fax: 617-227-4420  
 www.lockelord.com

[Date of Closing]

The Honorable Deborah B. Goldberg  
 Treasurer and Receiver-General  
 The Commonwealth of Massachusetts  
 State House - Room 227  
 Boston, Massachusetts 02133

\$346,370,000  
 The Commonwealth of Massachusetts  
 General Obligation Refunding Bonds,  
 2018 Series B

We have acted as bond counsel to The Commonwealth of Massachusetts (the “Commonwealth”) in connection with the issuance by the Commonwealth of the above-referenced Bonds. In such capacity, we have examined the law and such certified proceedings and other papers as we have deemed necessary to render this opinion.

As to questions of fact material to our opinion we have relied upon representations and covenants of the Commonwealth contained in the certified proceedings and other certifications of public officials furnished to us, without undertaking to verify the same by independent investigation.

Based on our examination, we are of the opinion, under existing law, as follows:

1. The Bonds are valid general obligations of the Commonwealth and the full faith and credit of the Commonwealth are pledged for the payment of the principal of and interest on the Bonds. It should be noted, however, that Chapter 62F of the General Laws of the Commonwealth establishes a state tax revenue growth limit and does not exclude principal and interest payments on Commonwealth debt obligations from the scope of the limit.

2. Interest on the Bonds is excluded from the gross income of the owners of the Bonds for federal income tax purposes. In addition, interest on the Bonds is not a specific preference item for purposes of the federal individual alternative minimum taxes. Interest on the Bonds is included in computing a corporation’s adjusted current earnings for taxable years beginning before January 1, 2018. In rendering the opinions set forth in this paragraph, we have assumed compliance by the Commonwealth with all requirements of the Internal Revenue Code of 1986 that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, and continue to be, excluded from gross income for federal income tax purposes. The Commonwealth has covenanted to comply with all such requirements. Failure by the Commonwealth to comply with certain of such

requirements may cause interest on the Bonds to become included in gross income for federal income tax purposes retroactive to the date of issuance of the Bonds. We express no opinion regarding any other federal tax consequences arising with respect to the Bonds.

3. Interest on the Bonds and any profit made on the sale thereof are exempt from Massachusetts personal income taxes and the Bonds are exempt from Massachusetts personal property taxes. We express no opinion regarding any other Massachusetts tax consequences arising with respect to the Bonds or any tax consequences arising with respect to the Bonds under the laws of any state other than Massachusetts.

This opinion is expressed as of the date hereof, and we neither assume nor undertake any obligation to update, revise, supplement or restate this opinion to reflect any action taken or omitted, or any facts or circumstances or changes in law or in the interpretation thereof, that may hereafter arise or occur, or for any other reason.

The rights of the holders of the Bonds and the enforceability of the Bonds may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted to the extent constitutionally applicable, and their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.

LOCKE LORD LLP

## FORM OF CONTINUING DISCLOSURE UNDERTAKING

[to be included in bond form]

The Commonwealth of Massachusetts

\$346,370,000

General Obligation Refunding Bonds  
2018 Series B

On behalf of the Commonwealth, the Treasurer and Receiver-General of the Commonwealth hereby undertakes for the benefit of the owners of the Bonds to provide the Municipal Securities Rulemaking Board (the “MSRB”) through its Electronic Municipal Market Access (“EMMA”) system pursuant to the requirements of Rule 15c2-12 of the Securities and Exchange Commission (the “Rule”), no later than 270 days after the end of each fiscal year of the Commonwealth, commencing with the fiscal year ending June 30, 2018, (i) the annual financial information described below relating to such fiscal year, together with audited financial statements of the Commonwealth for such fiscal year if audited financial statements are then available; provided, however, that if audited financial statements of the Commonwealth are not then available, such audited financial statements shall be delivered to EMMA when they become available (but in no event later than 350 days after the end of such fiscal year) or (ii) notice of the Commonwealth’s failure, if any, to provide any such information. The annual financial information to be provided as aforesaid shall include financial information and operating data, in each case updated through the last day of such fiscal year unless otherwise noted, relating to the following information contained in the Commonwealth’s Information Statement dated March 22, 2018 (the “Information Statement”), and substantially in the same level of detail as is found in the referenced section of the Information Statement. The Information Statement has been filed with EMMA.

| Financial Information and Operating Data Category   | Reference to Information Statement for Level of Detail  |
|---|---|
| 1. Summary presentation on statutory accounting and five-year comparative basis of selected budgeted operating funds operations, revenues and expenditures, concluding with prior fiscal year, plus estimates for current fiscal year | “SELECTED FINANCIAL DATA – Statutory Basis Distribution of Budgetary Revenues and Expenditures” |
| 2. Summary presentation on GAAP and five-year comparative basis of governmental funds operations, concluding with prior fiscal year   | “SELECTED FINANCIAL DATA – GAAP Basis”  |
| 3. Summary presentation on a five-year comparative basis of lottery revenues and profits  | “COMMONWEALTH REVENUES – Federal and Other Non-Tax Revenues; <i>Lottery Revenues</i> ”          |
| 4. Summary presentation of payments received pursuant to the tobacco master settlement agreement  | “COMMONWEALTH REVENUES – Federal and Other Non-Tax Revenues; <i>Tobacco Settlement</i> ”        |

| <b>Financial Information and Operating Data Category</b>   | <b>Reference to Information Statement for Level of Detail</b>  |
|--|--|
| 5. So long as Commonwealth statutes impose limits on tax revenues, information as to compliance therewith in the prior fiscal year                                       | “COMMONWEALTH REVENUES – Limitations on Tax Revenues”  |
| 6. Summary description of the retirement systems for which the Commonwealth is responsible, including membership and contribution rates                                  | “PENSION AND OPEB FUNDING – Retirement Systems” and “PENSION AND OPEB FUNDING – Employee Contributions.” |
| 7. Summary presentation of the then-current, statutorily imposed funding schedule for future Commonwealth pension liabilities, if any                                    | “PENSION AND OPEB FUNDING – Funding Schedule.”   |
| 8. Summary presentation on a ten-year comparative basis of actuarial valuations of pension fund assets, liabilities and funding progress                                 | “PENSION AND OPEB FUNDING – Actuarial Valuations.”   |
| 9. Summary presentation on a five-year comparative basis of annual required pension contributions under GAAP and pension contributions made                              | “PENSION AND OPEB FUNDING – Annual Required Contributions.”  |
| 10. Summary presentation on a five-year comparative basis of PRIT Fund asset allocation and investment returns   | “PENSION AND OPEB FUNDING – PRIT Fund Investments.”  |
| 11. Summary presentation of actuarial valuations of OPEB assets, liabilities and funding progress  | “PENSION AND OPEB FUNDING – Other Post-Employment Benefit Obligations (OPEB).”                           |
| 12. If and to the extent otherwise updated in the prior fiscal year, summary presentation of the size of the state workforce   | “STATE WORKFORCE”  |
| 13. Five-year summary presentation of actual capital project expenditures  | “COMMONWEALTH CAPITAL INVESTMENT PLAN”   |
| 14. Statement of general and special obligation long-term debt issuance and repayment analysis on a five-year comparative basis through the end of the prior fiscal year | “LONG-TERM LIABILITIES – General and Special Obligation Long-Term Debt Issuance and Repayment Analysis”  |
| 15. Statement of outstanding Commonwealth debt on a five-year comparative basis through the end of the prior fiscal year   | “LONG-TERM LIABILITIES – Outstanding Long Term Commonwealth Debt”  |
| 16. Annual fiscal year debt service requirements for Commonwealth general obligation and special obligation bonds, beginning with the current fiscal year                | “LONG-TERM LIABILITIES – Debt Service Requirements”  |

| Financial Information and Operating Data Category  | Reference to Information Statement for Level of Detail  |
|--|---|
| 17. Annual fiscal year contract assistance requirements for Commonwealth general obligation contract assistance, beginning with the current fiscal year                        | “LONG-TERM LIABILITIES – General Obligation Contract Assistance Liabilities”                  |
| 18. Annual fiscal year long-term leasing liabilities for Commonwealth, beginning with the current fiscal year  | “LONG-TERM LIABILITIES – Long-Term Operating Leases and Capital Leases”                       |
| 19. Five-year summary presentation of authorized but unissued general obligation debt  | “LONG-TERM LIABILITIES – Authorized And Unissued Debt”  |
| 20. So long as Commonwealth statutes impose a limit on the amount of outstanding “direct” bonds, information as to compliance therewith as of the end of the prior fiscal year | “LONG-TERM LIABILITIES – General Authority to Borrow; <i>Statutory Limit on Direct Debt</i> ” |
| 21. Summary presentation of the then-current, Commonwealth interest rate swap agreements   | “LONG-TERM LIABILITIES – Interest Rate Swaps”   |
| 22. Summary presentation of the then-current, Commonwealth liquidity facilities  | “LONG-TERM LIABILITIES – Liquidity Facilities”  |

Any or all of the items listed above may be included by reference to other documents, including official statements pertaining to debt issued by the Commonwealth, which have been submitted to EMMA. The Commonwealth’s annual financial statements for each fiscal year shall consist of (i) combined financial statements prepared in accordance with a basis of accounting that demonstrates compliance with the Massachusetts General Laws and other applicable state finance laws, if any, in effect from time to time and (ii) general purpose financial statements prepared in accordance with generally accepted accounting principles in effect from time to time and shall be audited by a firm of certified public accountants appointed by the Commonwealth.

On behalf of the Commonwealth, the Treasurer and Receiver-General of the Commonwealth hereby further undertakes for the benefit of the owners of the Bonds to provide in a timely manner, not in excess of ten business days after occurrence of the event, to EMMA notice of any of the following events with respect to the Bonds (numbered in accordance with the provisions of the Rule):

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults, if material;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties; <sup>(1)</sup>
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;

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<sup>(1)</sup> Not applicable to the Bonds, since there is no debt service reserve fund securing the Bonds.

- (vii) modifications to the rights of security holders, if material;
- (viii) bond calls, if material, and tender offers;
- (ix) defeasances;
- (x) release, substitution or sale of property securing repayment of the Bonds, if material;<sup>(2)</sup>
- (xi) rating changes;
- (xii) bankruptcy, insolvency, receivership or similar event of the Commonwealth;<sup>(3)</sup>
- (xiv) the consummation of a merger, consolidation, or acquisition or the sale of all or substantially all of the assets of the Commonwealth, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- (xv) appointment of a successor or additional trustee or the change of name of a trustee, if material.<sup>(4)</sup>

Nothing herein shall preclude the Commonwealth from disseminating any information in addition to that required hereunder. If the Commonwealth disseminates any such additional information, nothing herein shall obligate the Commonwealth to update such information or include it in any future materials disseminated.

To the extent permitted by law, the foregoing provisions of this Bond related to the above-described undertakings to provide information shall be enforceable against the Commonwealth in accordance with the terms thereof by any owner of a Bond, including any beneficial owner acting as a third-party beneficiary (upon proof of its status as a beneficial owner reasonably satisfactory to the Treasurer and Receiver-General). To the extent permitted by law, any such owner shall have the right, for the equal benefit and protection of all owners of Bonds, by mandamus or other suit or proceeding at law or in equity, to enforce its rights against the Commonwealth and to compel the Commonwealth and any of its officers, agents or employees to perform and carry out their duties under the foregoing provisions as aforesaid, provided; however, that the sole remedy in connection with such undertakings shall be limited to an action to compel specific performance of the obligations of the Commonwealth in connection with such undertakings and shall not include any rights to monetary damages. The Commonwealth's obligations in respect of such undertakings shall terminate if no Bonds remain outstanding (without regard to an economic defeasance) or if the provisions of the Rule concerning continuing disclosure are no longer effective, whichever occurs first. The provisions of this Bond relating to such undertakings may be amended by the Treasurer and Receiver-General of the Commonwealth, without the consent of, or notice to, any owners of the Bonds, (a) to comply with or conform to the provisions of the Rule or any amendments thereto or authoritative interpretations thereof by the Securities and Exchange Commission or its staff (whether required or optional), (b) to add a dissemination agent for the information required to be provided by such undertakings and to make any necessary or desirable provisions with respect thereto, (c) to add to the covenants of the Commonwealth for the benefit of the owners of Bonds, (d) to modify the

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<sup>(2)</sup> Not applicable to the Bonds, since there is no property securing repayment of the Bonds that could be released, substituted or sold.

<sup>(3)</sup> As noted in the Rule, this event is considered to occur when any of the following occur: (i) the appointment of a receiver, fiscal agent or similar officer for the Commonwealth in a proceeding under the U.S. Bankruptcy Code or in any proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Commonwealth, or if such jurisdiction has been assumed by leaving the existing governing body and officials in possession but subject to the supervision and orders of a court or governmental authority, or (ii) the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Commonwealth.

<sup>(4)</sup> Not applicable to the Bonds.

contents, presentation and format of the annual financial information from time to time as a result of a change in circumstances that arises from a change in legal requirements, or (e) to otherwise modify the undertakings in a manner consistent with the provisions of state legislation establishing a state information depository or otherwise responding to the requirements of the Rule concerning continuing disclosure; provided, however, that in the case of any amendment pursuant to clause (d) or (e), (i) the undertaking, as amended, would have complied with the requirements of the Rule at the time of the offering of the Bonds, after taking into account any amendments or authoritative interpretations of the Rule, as well as any change in circumstances, and (ii) the amendment does not materially impair the interests of the owners of the Bonds, as determined either by a party unaffiliated with the Commonwealth (such as Commonwealth disclosure counsel or Commonwealth bond counsel) or by the vote or consent of owners of a majority in outstanding principal amount of the Bonds affected thereby at or prior to the time of such amendment.

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**TABLE OF REFUNDED BONDS**

The bonds of the Commonwealth to be refunded from the proceeds of the Bonds are described below.

**General Obligation Bonds, Consolidated Loan of 2000 (Auction Rate Securities), Series D:**

| <u>Maturity Date</u> | <u>Amount</u> |
|----------------------|---------------|
| December 1, 2030     | \$100,000,000 |

\* To be redeemed on June 6, 2018 at a call price of 100%.

**General Obligation Bonds, Consolidated Loan of 2000 (Auction Rate Securities), Series E:**

| <u>Maturity Date</u> | <u>Amount</u> |
|----------------------|---------------|
| December 1, 2030     | \$100,000,000 |

\* To be redeemed on May 31, 2018 at a call price of 100%.

**General Obligation Bonds, Consolidated Loan of 2000 (Auction Rate Securities), Series F:**

| <u>Maturity Date</u> | <u>Amount</u> |
|----------------------|---------------|
| December 1, 2030     | \$100,000,000 |

\* To be redeemed on June 4, 2018 at a call price of 100%.

**General Obligation Bonds, Consolidated Loan of 2000 (Auction Rate Securities), Series G:**

| <u>Maturity Date</u> | <u>Amount</u> |
|----------------------|---------------|
| December 1, 2030     | \$101,500,000 |

\* To be redeemed on June 5, 2018 at a call price of 100%.

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