

RatingsDirect®

Summary:

Massachusetts; Gas Tax

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Credit Profile

US\$225.0 mil transportation fund rev bnds (Rail Enhancement & Accelerated Bridge Prog) ser 2018A due 06/01/2048

Long Term Rating AAA/Stable New

Massachusetts Spl Oblig Gas Tax

Long Term Rating AAA/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' long-term rating, and stable outlook, to the Commonwealth of Massachusetts' \$225 million commonwealth transportation fund (CTF) revenue bonds (rail enhancement and accelerated bridge programs) 2018 series A.

At the same time, S&P Global Ratings has affirmed its 'AAA' rating, with a stable outlook, on the commonwealth's \$2.6 billion CTF parity revenue bonds outstanding, and \$105.2 million closed prior-lien special obligation gas tax bonds outstanding.

The CTF bonds are secured by pledged revenues that include motor fuel/gasoline taxes and motor vehicle registration fees levied statewide. The special obligation gas tax bonds are secured by a first lien on 6.86 cents of the state-levied gas tax.

We base the ratings on what we view as the following credit strengths:

- A strong and diversified revenue mix that is collected statewide (population of 6.8 million) and has been relatively stable through economic cycles;
- The commonwealth's strong economic fundamentals, with a diverse economy and high income levels;
- Very strong 6.53x coverage of future maximum annual debt service (MADS), including combined debt service from prior-lien bonds, after this sale by fiscal 2017 pledged revenue, with state projections that annual debt service coverage will remain at approximately 6x even after substantial anticipated additional bonding; and
- Very strong bond covenants, including a very strong CTF additional bonds test (ABT) requiring 4x coverage of MADS by historical pledged revenues, a closed lien on prior-lien bonds, and a covenant not to allow changes in the rate of motor fuels tax or registry fees unless pledged revenues equal at least 4x MADS.

In our view, the lack of a debt service reserve is offset largely by the high debt service coverage.

Bond proceeds will finance various bridge and rail capital projects, including a contribution for the Massachusetts Bay Transportation Authority's (MBTA) green line extension relating to certain contracts already underway. In recent years, Massachusetts has also begun to issue CTF bonds to fund a portion of MBTA's capital program. In our view, MBTA bonding represents a significant expansion of CTF bonding plans, although this is mitigated by expected

continued high debt service coverage.

The fuel tax and registration fees pledged to the bonds are deposited in a revenue account of the CTF, where it is subject to annual appropriation by the state before transfer to the bond debt service account. We believe appropriation risk is mitigated by trust agreement covenants that prevent the large amount of surplus pledged revenue available (estimated at \$1.212 billion in fiscal 2018) from being used for other purposes until debt service is paid first. Since the first issuance of special obligation bonds in 1992, the legislature has never failed to make the required appropriations.

The major revenues supporting the bonds include a portion of motor fuels tax revenue, which accounted for 56.2% of total pledged funds (chapter 64A, chapter 64E, and chapter 64F receipts) in fiscal 2017, not including federal Build America bond (BAB) interest subsidies. The fuel tax rate was increased to 24 cents from 21 cents in 2013, with 6.86 cents of that amount pledged to the closed-lien special obligation gas tax bonds on a first-lien basis. Excess revenues not needed to cover debt service on the closed first-lien special obligation bonds, flow to the CTF revenue bonds. Before 2013, the gas tax rate had not been increased since 2000, and still remains below the average gas tax rates charged in the Northeast region. Massachusetts collects gas taxes monthly from gasoline distributors.

The other key revenue supporting the program is motor vehicle registry fees (43.8% of total revenues in fiscal 2017), which are collected daily by the Registry of Motor Vehicles and swept daily by the state treasury and credited to various fee accounts. Passenger vehicle registration fees rose to \$60 from \$50 in fiscal 2015. Registry fees were also adjusted in fiscal 2009, which offset flat-to-declining revenue performance in previous years. We believe the commonwealth has a history of increasing both pledged gas tax and registration fees when necessary to meet Massachusetts' transportation capital program.

Combined total pledged revenues in fiscal 2017 were \$1.367 billion, not including \$11.5 million of BAB subsidies. This represented a 1.6% increase from the year before, following a 0.7% increase in 2016, and a 5.7% increase in 2015 when registry fees were raised. The state projects fiscal 2018 pledged revenues will rise 1.0% to \$1.380 billion, not including the BAB subsidy. Before fiscal 2014, revenue performance was relatively flat in our view, with small increases in most years and a decline of 1.1% in fiscal 2009 due to the recession, and an earlier 4.7% decline in 2006. We anticipate future revenue increases consistent with population growth and Massachusetts' currently strong economy. In calendar 2017, state population rose 0.5% to 6.86 million. The commonwealth gross product grew slightly faster than that of the nation in 2017, while IHS Markit forecasts employment growth slightly slower than that of the nation through 2021.

Fiscal 2017 pledged revenue covers combined future MADS after this issue, on combined prior- and parity-lien CTF debt, by what we consider a very strong 6.53x, not including BAB subsidy revenues. MADS coverage on only prior-lien debt secured by only the 6.86-cent fuel tax is also very strong at 6.48x as of fiscal 2017, the most recent available reported year.

Currently, the commonwealth anticipates issuing an additional \$815 million in par amount of parity CTF debt by the end of fiscal 2022 for both the rail and accelerated bridge program after this issuance. Also anticipated over the next five fiscal years is issuance of federal grant anticipation notes (GANs) that have a junior lien on CTF revenues, including \$50 million of subordinate GANs that are expected to be sold by the end of fiscal 2021. After issuance of the series 2018A CTF bonds, Massachusetts expects to issue an additional \$225 million of parity CTF bonds in fiscal 2019,

\$300 million in fiscal 2020, \$225 million in 2021, and \$65 million in fiscal 2022.

We believe there could be additional bonding related to either bridge repair or mass transit, beyond the \$815 million described above, but that the very strong 4x ABT and the need to use surplus CTF funds for transportation operations provide significant protection against debt service coverage dilution from future debt issuance. In particular, \$30 million of a previous series 2017A bond issue went to fund certain MBTA Green Line capital improvements. This line has seen cost increase estimates ranging from \$700 million-\$1 billion over the original \$2 billion estimated project cost. Subsequently, planned line improvements have been scaled back to bring the total cost estimate down to \$2.3 billion, including a \$232 million contribution from localities and a \$996 million contribution from the federal transit administration. MBTA is also planning to extend its Orange and Red mass transit lines. Nevertheless, the commonwealth projects debt service coverage, including BAB subsidies, will remain strong, at least at 6x through 2049, based on current anticipated future debt issuance and assuming no future revenue growth beyond estimated 2018 revenue of \$1.362 billion.

Massachusetts' CTF bonds are eligible to be rated above the sovereign because we believe the commonwealth can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, the institutional framework in the U.S. is predictable with significant state autonomy, and flexibility is demonstrated by high debt service coverage and serial bond amortization as well as independent treasury management.

(For more information on Massachusetts' economy, please see the most recent full GO analysis published April 9, 2018, on RatingsDirect.)

Outlook

The stable outlook reflects what we view as the strong credit structure supporting the bonds, which insulates bondholders from future volatility or deterioration of pledged revenues. One long-term risk is that the rail enhancement program could require substantial new capital funding beyond current authorizations. However, we feel that the currently very strong debt service coverage and very strong ABT should provide strong protection against future debt dilution. Over our two-year outlook time horizon, we do not see the potential for lowering the rating under our current criteria because we expect coverage levels to remain very strong, despite planned additional debt issuance. Furthermore, we believe that Massachusetts' substantial and diverse economy will continue to support stability in pledged revenues over time.

Ratings Detail (As Of June 4, 2018)		
Massachusetts gas tax		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Massachusetts sr lien gas tax		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed

Ratings Detail (As Of June 4, 2018) (cont.)

Massachusetts (Accelerated Bridge Prog) gas tax		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Massachusetts (Accelerated Br Prog) GASTAX		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Massachusetts (Rail Enhancement & Accelerated Bridge Progs)		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Massachusetts (Rail Enhancement & Accelerated Bridge Progs) GASTAX		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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