

# RatingsDirect®

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## Summary:

# Massachusetts; Federal or state grant programs

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## Summary:

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### Credit Profile

US\$330.0 mil fed hwy GANs ser 2014 A due 6/15/2027

*Long Term Rating* AAA/Stable New

Massachusetts fed hwy GANs (ASSURED GTY)

*Unenhanced Rating* AAA(SPUR)/Stable Affirmed

Massachusetts spl oblig

*Long Term Rating* AAA/Stable Affirmed

Massachusetts GANs (Accelerated Br Prog)

*Long Term Rating* AAA/Stable Affirmed

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services has assigned its 'AAA' rating to Massachusetts' pro forma \$330 million series 2014A federal highway grant anticipation notes (GANs). At the same time, Standard & Poor's affirmed its 'AAA' rating on the commonwealth's GANs and special obligation notes outstanding. The outlook is stable.

Bond proceeds will continue funding repair of Massachusetts' structurally deficient bridges under its Accelerated Bridge Program, in tandem with Commonwealth Transportation Fund (CTF) bonds. Massachusetts has total authorization authority for about \$1.1 billion of GANs and \$1.88 billion of CTF bonds. The program has a scheduled completion date of September 2016, and management reports it is on schedule.

The ratings reflect our opinion of the creditworthiness of the GAN program structure, which has strong debt service coverage (DSC), a subordinate backup pledge of dedicated state transportation funds, and sound bond provisions.

In 2010, Massachusetts issued new-money and refunding GANs. It issued the former under a 2010 trust agreement (2010 TA), while the refunding GANs and special obligation notes outstanding at the time were issued under a 1998 trust agreement (1998 TA), which is now closed. The 2013A GANs are also issued under 2010 TA.

We believe specific credit strengths include the following factors:

- In the case of the special obligation and refunding GANs, a senior position on federal highway reimbursements from the state, a closed lien, and maturity occurring in 2015, and which has now been legally defeased;
- In the case of all GANs issued under 2010 TA, an additional pledge of excess CTF revenues under the 2010 TA -- funded from gas taxes and vehicle-registration fees -- that are pledged to the CTF bonds, which Massachusetts must first pay;
- Strong maximum annual debt service (MADS) coverage of 3.75x based on budgeted 2015 federal highway reimbursements to the commonwealth, and very strong projected coverage of nearly 14x incorporating excess CTF revenues assumed for the 2015 year. Both figures include full issuances of the GAN and CTF program through 2018;

- A requirement in both the 1998 and 2010 TAs that debt service payments be funded with the trustee a year in advance;
- Sound bond provisions that prohibit additional 2010 TA GAN issuances unless the commonwealth meets an effectively 4x pro forma MADS test; and
- Variable-but-generally-positive trends in obligation authority and receipts of Title 23 federal aid money, a track record of maximizing federal grants, and effective management of the grant reimbursement process.

In our opinion, credit weaknesses are similar to those of other grant anticipation revenue vehicle (GARVEE) notes, and include possibly lower pledged revenues resulting from a decline in funds for states from the Highway Trust Fund (HTF) or in Congressionally appropriated amounts, changes to the federal aid highway program, and delays to congressional reauthorization or the commonwealth's failure to prudently manage the reimbursement process.

The 2003A and 2010A refundings have a final maturity of 2015, and based on the year-in-advance requirement, have now been defeased. The 2010A new money GANs have a final maturity of 2023, with interest-only payments until 2016. We understand Massachusetts has structured debt service payments in this manner due to the 1998A TA GANs holding a senior position. However, we do not view the 2010 TA GANs' subordinate nature negatively. The commonwealth also has outstanding 2013A GANs (about \$250 million) that mature in 2027, and the GANs issued at this time will mature in 2028. Subsequently, Massachusetts plans to make additional GAN issuances totaling \$330 million through 2018.

Unlike many grant-anticipation structures, both the 1998 and 2010 TAs include an additional pledge. In the case of the 1998 agreement, the pledge is both a debt service reserve (10% of MADS) and 13 cents of the commonwealth's 24-cent gas tax, following payment of CTF bonds. However, these are accessible only in the event of a true-up condition, defined as the nationwide, Congressionally appropriated amount for highway aid from the HTF being less than \$17.1 billion in the current federal fiscal year and the GANs' DSC ratio for the next fiscal year being below 1.2x. Standard & Poor's considers either possibility unlikely and the combination to be extremely remote.

As stated, the 2010 TA has an additional backup pledge in the form of excess CTF pledged revenues, after payment of bonds backed by such revenues. The commonwealth most recently issued estimates that about \$1.1 billion in excess CTF money will be available annually to pay 2010 TA GANs, if necessary, through 2027. Although the legislature can appropriate excess CTF revenues if needed, these revenues are frozen in the event they are not, and may not be used for any other purpose. Furthermore, with respect to the DSC calculations given earlier, debt service is essentially level starting in 2017 (and is lower before that), although pro forma MADS occurs in 2023 at about \$111.4 million.

We believe potential delays in authorizations, changes in law, declining HTF balances, or Congressional or administrative modifications to grant programs will not end the long-standing practice of federal aid for transportation on which we base our grant anticipation ratings. However, program rule changes, constrained funding sources, and federal budget pressures could lead to lower authorization and appropriation levels and diminish coverage, which we currently view as very strong for most transportation grant-backed bonds we rate.

On July 31, 2014, Congress approved a bill to provide \$10.8 billion in short-term funding to address the dwindling balance in the HTF. Without this, funding for states and other transportation agencies would have been curtailed by 28% as of Aug. 1, and the HTF would have run out of money promised to states for highway and transit programs by

September. However, this patch provides only enough money to sustain the highway and transit programs through May 2015. We will continue to monitor the situation.

Although Standard & Poor's believes this congressional action alleviates the immediate pressure on GARVEE issuers, the delay and uncertainty regarding renewal authorizations to the surface transportation bill highlight the key credit weakness of GARVEE ratings. The likelihood that federal transportation funding will be discontinued is remote, in our view, but we carefully evaluate the risks to state programs that leverage these funds, including the timing of receipts, level of funding, and erosion in dollars either due to lower authorized or appropriated levels or programmatic changes that negatively affect recipients. In our opinion, both the history of the program and its vital role in preserving and expanding the national highway system, as well as the significant funding needs facing surface transportation and the lack of resources to fund those needs, support continued reauthorization of the program for the foreseeable future. We will closely monitor the sector both during and after reauthorization to evaluate how issuers of federal grant-backed bonds alter their debt programs.

We rate Massachusetts's GAN program 'AAA', one notch above the U.S. (AA+/Stable/A-1+). By applying our "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions" criteria, we view the commonwealth's federal highway receipts pledged to the bonds being locally derived as a credit strength. This, coupled with the backup pledge of excess CTF revenues yields, projected DSC of more than 14x based on 2015 budgeted revenues mitigates the bond's exposure to federal revenue volatility. There is also a constitutional prohibition against the use of federal gas tax revenues for any purpose other than transportation and traffic-related investments, as well as important legal tenets of Massachusetts's GAN program.

## Outlook

The stable outlook reflects our expectation that the long-standing federal aid highway program will continue to receive significant funding during the next two years and thereafter, and that Massachusetts will continue to receive its historical share of annual Title 23 distributions. The outlook is further predicated on net CTF funds continuing to provide sharply higher DSC when coupled with federal highway funds. Should there be a significant decline in DSC or should the state fail to prudently manage the reimbursement process, we could lower the rating.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Methodology And Assumptions: Rating U.S. Federal Transportation Grant-Secured Obligations, May 29, 2009
- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013

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