S&P Global Ratings

RatingsDirect®

Summary:

Massachusetts; Gas Tax

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Summary:

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Long Term Rating	AA+/Stable	Downgraded

Rationale

S&P Global Ratings has lowered its rating on the Commonwealth of Massachusetts' commonwealth transportation fund (CTF) revenue bonds and special obligation gas tax bonds to 'AA+' from 'AAA'. The outlook is stable.

The downgrade follows the application of our criteria, Priority-Lien Tax Revenue Debt, published Oct. 22, 2018, on RatingsDirect, which factors in both the strength and stability of the pledged revenues, as well as the general credit quality of the commonwealth as issuing obligor. The priority-lien rating on the bonds is limited by our view of Massachusetts' creditworthiness (general obligation [GO] rating: AA/Stable) and is constrained from going higher unless there is an improvement in the state GO rating, despite very strong revenue coverage of debt service. In our view, the CTF bonds do not benefit from limited scope of operations or extraordinary expenditure flexibility of the obligated entity, while we believe pledged revenues could have exposure to operating risk of the state in a distress situation.

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.

Our evaluation of the pledged revenue stream reflects the following factors:

- A very strong and diverse economy of 6.8 million people;
- Low revenue volatility, with historically stable pledged revenues;
- Very strong debt service coverage and liquidity, with 6.53x coverage of future maximum annual debt service (MADS), including combined debt service from prior-lien bonds, by fiscal 2017 pledged revenue, with state projections that annual debt service coverage will remain at approximately 6x even after substantial anticipated additional bonding;
- 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, strong debt service coverage negates the need for a debt service reserve; and
- Our establishment of a one-notch upward limitation on the ratings from that of the GO rating on Massachusetts.

Revenue volatility: Low

We anticipate the pledged revenues to have low revenue volatility based on historical trends.

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 commonwealth 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.

Coverage and liquidity: Very strong

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 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 Massachusetts Bay Transportation Authority (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.

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.

Economic fundamentals: Very strong

Massachusetts' economy has grown steadily in recent years, outpacing national and regional trends by most measures. State personal income rose 3.3% in 2017, rising to 131% of that of the nation (second only to Connecticut) from 130% the year before. The commonwealth's average annual unemployment rate in 2017 was 3.7% compared with 4.4% for the nation. This steady growth has continued into 2018, led by technical services and health care. Massachusetts has an above-average hi-tech employment sector, estimated by IHS Markit at about 10% of state employment, compared to 6.5% for the country as a whole. Following the financial crisis, employment growth was strong relative to that of other states and the commonwealth regained its pre-recession employment peak in 2013, according to the Bureau of Labor Statistics. IHS Markit forecasts continued employment growth at about the same level as the nation in 2018, 2019, and 2020 at 1.6%, 1.6%, and 1.0%, respectively, in those years, compared to its forecast of 1.7%, 1.5%, and 1.2% for the U.S. in those years, respectively. In our view, Massachusetts' economic fundamentals and key anchors, which center on higher education, technology, finance, and health care, should contribute to continued expansion and stable pledged transportation-related revenue.

Linkage to commonwealth general creditworthiness

Because the commonwealth collects the pledged revenues, we view the rating on the CTF and special obligation revenue bonds as linked to Massachusetts' creditworthiness. Although the commonwealth constitution restricts transportation-related revenues to transportation-related purposes, these can be purposes other than specifically the repayment of debt. In our establishment of a one-notch upward limitation on the transportation revenue bond rating compared to the state GO rating, we included our view that the state provides critical public services into our analysis. While we consider that statutory and bond covenant restrictions on the use of CTF revenues as providing some uplift, in our view, the collection and distribution of pledge revenues by the commonwealth exposes the revenues to operating risk if there should be a distress situation. For this reason, under our priority-lien criteria, we consider the linkage between the priority-lien pledge and the commonwealth close.

For more information on our Massachusetts GO rating, please refer to our most recent GO rationale published Aug. 9, 2018, on RatingsDirect.

Outlook

The stable outlook reflects our stable outlook on the commonwealth. Should we raise or lower the commonwealth GO rating or revise the outlook, we could take a similar action on the CTF bond rating or outlook.

Although we do not anticipate it during our two-year outlook horizon, should there be very significant deterioration in CTF bond debt service coverage we could also lower our rating on the CTF bonds. While the rail enhancement program could require substantial new capital funding beyond current authorizations, we feel that the very strong current debt service coverage and very strong ABT should provide strong protection against future debt dilution. We also believe that Massachusetts' substantial and diverse economy will continue to support stability in pledged revenues over time.

Ratings Detail (As Of November 15, 2018)		
Massachusetts gas tax		
Long Term Rating	AA+/Stable	Downgraded
Massachusetts sr lien gas tax		
Unenhanced Rating	AA+(SPUR)/Stable	Downgraded
Massachusetts (Accelerated Bridge Prog) gax tax		
Long Term Rating	AA+/Stable	Downgraded
Massachusetts (Accelerated Br Prog) GASTAX		
Long Term Rating	AA+/Stable	Downgraded
Massachusetts (Rail Enhancement & Accelerated Bridge Progs)		
Long Term Rating	AA+/Stable	Downgraded
Massachusetts (Rail Enhancement & Accelerated Bridge Progs) GASTAX		
Long Term Rating	AA+/Stable	Downgraded

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.