FitchRatings

Fitch Rates Massachusetts SBA's $200MM Sub Bonds 'AA+'; Upgrades Sr. Bonds to 'AAA'

Fitch Ratings-New York-03 July 2018: Fitch Ratings has assigned a 'AA+' rating to the following Massachusetts School Building Authority (MSBA) subordinated sales tax bonds:

--$200,000,000 subordinated dedicated sales tax bonds, 2018 series B.

The subordinated bonds are scheduled to be offered by competitive sale on or about July 10, 2018.

Fitch has also affirmed the 'AA+' rating on $679 million in outstanding MSBA subordinate dedicated sales tax bonds.

Simultaneously, Fitch has upgraded the ratings on $5.2 billion in outstanding MSBA senior dedicated sales tax bonds to 'AAA' from 'AA+'.

The Rating Outlook is Stable.

SECURITY

The authority's bonds are secured by an irrevocable dedication of one cent of Massachusetts's 6.25-cent sales tax, with some exclusions.

KEY RATING DRIVERS

SENIOR LIEN UPGRADE: The upgrade of the senior lien bonds reflects expectations for continued strong performance of the sales tax revenue stream and the April 2018 revision to Fitch's criteria for rating state dedicated tax bonds. Given structural protections in place, Fitch did not view the rating on the sales tax bonds as being explicitly capped by the Commonwealth's 'AA+' Issuer Default Rating (IDR) under prior criteria; however, the rating was generally limited by the risk that a state could exercise its sovereign powers to the detriment of bondholders. The revised criteria released in April 2018 provide more specific guidelines for consideration of this risk, and allow a rating up to three notches above the IDR when warranted by the strength of the underlying security. The degree of allowable notching is informed by: the breadth of the dedicated revenues (the narrower the better); the nature of the borrowing program (the more specific the better); and the use of residual revenues (the more segregated the better).

SUBSTANTIAL CUSHION: The ABT provides substantial cushion to ensure coverage of debt service, including under stress scenarios consistent with Fitch's tax supported criteria covering the impact of a moderate, national downturn and based on the highest consecutive historical revenue decline. This cushion is higher for the senior bonds, supporting the one notch rating distinction from the subordinate bonds.

STRONG AND WEALTHY ECONOMY: The Commonwealth has a broad and diverse economy with strong economic fundamentals, including high education levels, solid wealth indicators and population growth approximating national averages during this decade.

STRONG GROWTH PROSPECTS: Performance of the dedicated sales tax securing the bonds is strong and likely to remain so over time, reflecting the strength of the Commonwealth's economy. Sales tax revenues have been subject to some cyclicality, including a steep, three-year decline in the last recession, and Fitch expects future performance to be consistent with this history.

STRONG STRUCTURAL PROTECTIONS: Revenues dedicated for school capital are segregated from the Commonwealth general fund, and the authority has no role in funding school operations. Strong legal covenants protect against diversion of revenues or lowering of the tax rate, although the base can be changed.

COMMONWEALTH CREDIT QUALITY: Massachusetts' 'AA+' Issuer Default Rating (IDR) reflects its considerable economic resources, strong budget controls and a record of careful financial management. The Commonwealth carries a long-term liability burden that is well above average for a U.S. state but remains a moderate burden on resources.

RATING SENSITIVITIES

DEDICATED SALES TAX PERFORMANCE: The rating is sensitive to expectations for strong performance of the dedicated sales tax revenue and continued solid debt service coverage levels.

CREDIT PROFILE

The ratings on the MSBA's dedicated sales tax revenue bonds are based on structural protections that insulate the bonds from the Commonwealth's general operations and on the strong growth prospects and resilience of dedicated sales tax revenues relative to Fitch's expectations for cyclicality.

Most, but not all, of the authority's bonds issued to date have a standard debt service reserve fund, although no reserve will be established for the current series. The debt service reserve level is not a rating factor for Fitch given the strong coverage and structural features of the bonds.

PLEDGED TAXES SEGREGATED FROM COMMONWEALTH OPERATIONS

The one cent sales tax pledged to MSBA's dedicated tax bonds is segregated from the Commonwealth's general fund. Dedicated sales tax receipts are credited to the School Modernization and Reconstruction Trust (SMART) fund, which is held by the Commonwealth treasurer exclusively for the purposes of the authority, and disbursed to the bond trustee on a monthly basis. The revenues in the fund are not commingled with Commonwealth funds and are not subject to appropriation. Bondholders have first claim on the dedicated sales tax. The authorizing legislation specifies that the treasurer shall act as trustee as it relates to the SMART fund and not on account of the Commonwealth.

Dedicated taxes after payment of bonds remain with the MSBA. The authority can choose to transfer excess dedicated sales tax revenues to the Commonwealth, but the Commonwealth has relinquished all claims to the revenue. Strong statutory covenants protect against diversion of revenues or lowering of the dedicated tax rate, although the base can be changed. Dedicated tax revenues support school capital, although MSBA plays no role in funding school operations.

STRONG RESILIENCE TO CYCLICALITY

In addition to assessing the exposure of dedicated tax bond structure to state operations, Fitch's criteria for dedicated tax bonds also incorporates a standalone analysis of the resilience of pledged revenues as well as their growth prospects over time.

The Commonwealth has imposed a sales tax since 1966. Although performance in the last recession was weak, coverage of MADS remained strong.

Additional bond issuance under the authority's $10 billion authorization requires 1.4x maximum annual senior debt service coverage for senior bonds and 1.3x coverage of total MADS for subordinated bonds, providing a substantial cushion to ensure coverage relative to historical revenue cyclicality. Including the new issue being rated, fiscal 2018 revenues provide 2.3x coverage of MADS for the senior bonds, and 1.9x for senior and subordinate bonds, without consideration of the federal interest subsidies associated with Build America Bonds and Qualified School Construction Bonds.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP scenario) and the largest actual decline in revenues over the period covered by the analysis. Based on a 15-year pledged revenue history, Fitch's analytical sensitivity tool (FAST) generated a 1.8% scenario decline in pledged revenues. The largest consecutive decline in this timeframe was 7.9%, based on recessionary losses during the fiscal 2008-2010 period.

Under both scenarios, dedicated revenue remains ample to ensure coverage of MADS. For senior bonds, the coverage cushion assuming issuance to the ABT equates to 15.8x the scenario decline and 3.6x the largest historical decline. On an aggregate basis, the coverage cushion equates to slightly lower 12.8x the scenario decline and 2.9x the largest historical decline.

GROWTH PROSPECTS CONSISTENT WITH COMMONWEALTH'S

Fitch views the growth prospects of the dedicated taxes to be strong, in line with its view of the growth prospects for the economy of Massachusetts. Average annual sales tax growth has been about 6% since the inception of the tax, and dedicated sales tax performance has been strong since the one-cent tax pledge for MSBA was fully phased in, in fiscal 2011. Actual year-over-year growth was 2.3% for fiscal 2017, and forecast growth is 3.6% in fiscal 2018, which ended on June 30. Fiscal 2018 year-to-date data through May show total Commonwealth sales tax receipts about 3.4% above the prior year baseline and 3.8% above benchmark. Coverage would remain high even if actual growth falls below the forecast level.

SUSTAINABLE SYSTEM FOR SCHOOL CAPITAL

The authority was created in 2004 to address a substantial backlog of programs funded under the Commonwealth's prior school building assistance program and create a sustainable system for school capital funding going forward. Pre-existing contract assistance commitments to localities, a declining obligation through 2024, are paid annually from dedicated revenues after payment of debt service. The authority was authorized to fund up to $500 million in new projects annually starting in fiscal 2008 (with the limit adjusted up or down each year by the lesser of the dedicated sales tax revenue increase/decrease or 4.5%); approval of new projects is contingent upon the availability of funds for this purpose. The authority does not have a waiting list.

The authority consists of seven members: the Commonwealth Treasurer (chair), four treasurer appointments, and two ex-officio members.

CREDIT QUALITY OF MASSACHUSETTS

Massachusetts' 'AA+' IDR reflects its considerable economic resources, strong budget controls and a record of careful financial management. The Commonwealth carries a long-term liability burden that is well above average for a U.S. state but remains a moderate burden on resources. The Stable Outlook reflects the expectation that the Commonwealth will continue to act as needed to ensure budget balance and maintain an adequate budgeted reserve position.

For more information on the Commonwealth, see Fitch Research 'Fitch Rates Massachusetts' $735MM GO Bonds 'AA+'; Outlook Stable' dated March 29, 2018, available at www.fitchratings.com.

Contact:

Primary Analyst
Douglas Offerman
Senior Director
+1-212-908-0889
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Kevin Dolan
Managing Director
+1-212-908-0538

Committee Chairperson
Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Sandro Scenga, New York, Tel: +1 212-908-0278, Email: sandro.scenga@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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