KPMG

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Financial Statements and Required
Supplementary Information

June 30, 2013

(With Independent Auditors' Report Thereon)

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

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KPMG LLP
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Independent Auditors' Report

The Board Members
Massachusetts School Building Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Massachusetts School Building Authority (the Authority), a blended component unit of the Commonwealth of Massachusetts (the Commonwealth), as of and for the year ended June 30, 2013, and the related notes to the financial statements which collectively comprise the Authority's basic financial statements as listed in the accompanying table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Authority, as of June 30, 2013, and the respective changes in financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 - 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 23, 2013 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

KPMG LLP

October 23, 2013

This section of the Massachusetts School Building Authority's (the MSBA) annual financial report presents a discussion and analysis of the MSBA's financial performance during the fiscal year ended June 30, 2013. Please read it in conjunction with the MSBA's financial statements, which follow this section.

Background

Chapter 208 of the Acts of 2004 (Chapter 208, together with Chapter 70B of the Massachusetts General Laws, Section 35BB of Chapter 10 of the Massachusetts General Laws, and Chapter 210 of the Acts of 2004, all as most recently amended, collectively referred to as the Act) eliminated the former school building assistance program and created the MSBA to administer and fund a new program (the New Program) for grants to cities, towns, and regional school districts for school construction and renovation projects.

The MSBA's major revenue source is the portion of the Commonwealth of Massachusetts (the Commonwealth)'s sales tax revenue dedicated to the MSBA. Pursuant to the Act, all moneys received by the Commonwealth raised by a one percent (1%) statewide sales tax (drawn from the existing statewide 6.25% sales tax, excluding sales tax revenues on meals and from certain additional statutorily exempted revenues from sales (Dedicated Sales Tax Revenue)) are deposited into the School Modernization and Reconstruction Trust (SMART) Fund, and are available to the MSBA without further appropriation or allotment. The Dedicated Sales Tax Revenue is pledged for payment of outstanding debt service.

Under the former program, the Commonwealth was reimbursing cities, towns and regional school districts for 728 previously approved projects (Prior Grant projects). In addition, under the former program, 428 school projects were maintained on a waiting list for funding (the Waiting List). Pursuant to the Act, the MSBA became responsible for funding the Commonwealth's share of the 728 Prior Grant projects and 428 Waiting List projects. The Commonwealth's share ranged from 50% to 90% of approved, eligible costs for each project. As of June 30, 2013, the MSBA had paid in full its share of 389 of the 428 Waiting List projects and 436 of the 728 Prior Grant projects.

In fiscal year 2008, the MSBA began approving grants under the New Program for school construction and renovation projects. Under the New Program, no city, town or regional school district or independent agricultural and technical school has any entitlement to funds from the MSBA. Grants approved by the MSBA for projects may range from 31% to 80% of approved eligible project costs. Under the New Program, the MSBA is limited by statute in the amount of grants it can approve in a fiscal year. The limit established for fiscal year 2008 was $500 million. The limit may change annually by the lesser of 4.5% of the limit for the prior fiscal year or the percentage change in the Dedicated Sales Tax Revenue Amount (see note 3) over the prior fiscal year. The aggregate grant limit for fiscal years 2008 through 2013 totals approximately $2.9 billion.

Financial Highlights

- The government-wide net position at June 30, 2013 was a deficit of $6.0 billion. The MSBA's government-wide net position decreased by $166.0 million in fiscal year 2013 primarily due to cash used for discounted one-time payments to Districts for inherited grant projects and cash defeasance of outstanding MSBA Dedicated Sales Tax Bonds.
- Total government-wide liabilities at June 30, 2013 were approximately $7.3 billion, a decrease of $393.6 million from the prior year. Total liabilities include grants payable to municipalities totaling

approximately $1.5 billion to fund school construction and renovation projects. The grants payable liability decreased by $373.9 million in fiscal year 2013 due to grant payments made to municipalities during the year and reductions of grant payment obligations due to MSBA audits and debt refundings by the local communities in which the MSBA shares in the savings based on the reimbursement rate of the project. In addition, total liabilities include $5.2 billion of outstanding Dedicated Sales Tax Bonds to fund school construction and renovation projects.

- During the year, the MSBA had general revenues of $743.5 million, comprised of $735.5 million of sales tax revenue, $(15.5) million of interest income (loss), and $23.6 million of grant income as compared to general revenues of $770.9 million in fiscal year 2012. Total revenues decreased by $27.4 million primarily due to a decrease in interest income of $92.3 million, offset by an increase of $65.0 million in dedicated sales tax revenue, and a decrease in grant income of $107 thousand. The decrease in interest income of $92.3 million is primarily related to the MSBA investments in U.S. Treasuries and municipal bonds which are recorded at fair value. Fluctuations in the market value of these investments are recorded as interest income (loss). In fiscal year 2013, the change in the fair value of these investments was ($20.1) million versus an interest income of $54.7 million in fiscal year 2012. The MSBA intends to hold these U.S. Treasuries and municipal bonds to maturity. The Fiscal Year 2013 sales tax revenue reflects a current year change in the process of estimating the amount of sales taxes due to the MSBA from the Commonwealth. This change resulted in an additional of $51.3 million of sales taxes being recognized in revenue in 2013. The decrease in grant income is related to the reduction in interest subsidy payments from the federal government in connection automatic budget cuts imposed through sequestration required pursuant to the Budget Control Act of 2011.

- As of June 30, 2013, the value of the grants payable liability totaled $1.5 billion, consisting of Prior Grant projects of $1.2 billion, Waiting List projects of $174.6 million, and $131.7 million of New Program projects. The MSBA funds New Program projects on a progress payment basis. Under this process, communities submit monthly requests for reimbursement. Upon review, the MSBA processes payment for its share of eligible costs incurred. The New Program liability of $131.7 million represents costs incurred in the New Program prior to June 30, 2013 but paid after June 30, 2013. The MSBA has approximately $1.4 billion of commitments related to the New Program, which are not reflected in the MSBA's financial statements.

- As of June 30, 2013, the value of the outstanding Waiting List projects totaled approximately $205.6 million, composed of the Waiting List liability of $174.6 million and commitments of $31.0 million. The $31.0 million is not currently reflected in the MSBA's financial statements, but is reflected as a commitment in the notes to the financial statements (see note 8).

- Total assets of the Special Revenue Fund at June 30, 2013 were $1.1 billion compared to $1.8 billion at June 30, 2012. Cash and cash equivalents decreased by $712.9 million due to the payments to Districts from unrestricted sales tax revenues and bond proceeds for grants to projects in the MSBA's capital pipeline and inherited programs, as well as cash defeasance of dedicated sales tax bonds. The MSBA issued $1.7 billion of refunding bonds during fiscal year 2013 which will primarily be used to refund higher coupon debt.

- Special Revenue Fund operations expenditures for the year ended June 30, 2013 were approximately $14.3 million. Operations expenditures consisted of two major categories. Administrative expenditures

(Continued)

totaling $6.7 million consisted primarily of payroll and employee related benefits, and rent and utilities. Project related expenditures totaling $7.6 million consisted primarily of expenses relating to commissioning consultants.

- The Special Revenue Fund reported a fund balance of $998.7 million at June 30, 2013 as compared to a fund balance of $1.7 billion at June 30, 2012 primarily because cash and investments decreased by $712.9 million. Cash and investments decreased due to discounted one-time payments to Districts for inherited grant projects and cash defeasance of outstanding MSBA Dedicated Sales Tax Bonds. Expenditures consisted of grant payments of $1.0 billion, debt service of $393.1 million, operations expenditures of $14.3 million and bond issuance costs of $9.6 million.
- Assets of the Special Revenue Fund included cash and cash equivalents of $130.8 million; restricted cash and investments of $699.8 million; an amount due from the Commonwealth related to the Dedicated Sales Tax Revenue totaling $113.2 million, 100% of which was collected subsequent to year-end; loans receivable of $114.8 million in connection with the MSBA's intergovernmental loan program for cities and towns; and, an interest receivable of $9.3 million.
- In Fiscal Year 2012, the MSBA established an OPEB Trust Fund for the purposes of accumulating assets to pay for future other post-employment benefits. During Fiscal Year 2013, the MSBA made no additional transfers from the Special Revenue Fund to the OPEB Trust Fund because the Trust Fund was fully funded.

Overview of the Financial Statements

The financial section of this report consists of the following parts: management's discussion and analysis (this section), the basic financial statements, the notes to the financial statements, and required supplementary information.

This report consists of six financial statements presented on three pages. The first two financial statements are the Governmental Fund Balance Sheet/Statement of Net Position found on page 10. The second two financial statements are the Statement of Revenues, Expenditures and Changes in Fund Balance/Statement of Activities found on page 11. The final two financial statements are the Statement of Fiduciary Net Position and the Statement of Changes in Fiduciary Net Position found on page 12. The OPEB Trust Fund is an irrevocable trust fund established for the purpose of accumulating assets to pay for future other post-employment benefits. The assets are funded from operations and accumulate to reduce the unfunded actuarial liability of health care and other related post-employment benefits. Currently, the MSBA has no retired employees; thus, the assets of the Trust Fund are currently not used for direct payment of benefits.

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* requires entities to classify fund balances as restricted, committed, assigned, or unassigned. The MSBA Board of Directors has the ability to commit and un-commit funds while financial management of the MSBA has the ability to assign and un-assign funds. Restricted balances are restricted in their use by bond covenants and statute.

In Fiscal 2013, the MSBA implemented GASB Statement 63: *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and GASB Statement No. 65: *Items Previously Reported as Assets and Liabilities*. In accordance with GASB 65, losses on bond refundings are classified as

(Continued)

deferred outflows of resources and bond issue costs are recorded as an expense when incurred. The impact of implementing GASB 63 was not material to the financial statements.

Reporting the MSBA's Governmental Funds

The fund financial statements provide detailed information about the MSBA's Governmental Funds – not the MSBA as a whole. The fund financial statements are prepared using a different approach than the government-wide financial statements. The MSBA's expenditures are reported in its Governmental Funds, which focuses on cash inflows and outflows in the funds and the balance left at year-end that are available for spending. The Governmental Funds are reported using modified accrual accounting, which measures revenues as they become both measurable and available and are expected to be collected within the next fiscal year. Expenditures are recorded in the period the liability is incurred and expected to be paid within the next fiscal year. The Governmental Fund Statements provide a detailed short-term view (less than one year) of the MSBA's government operating requirements for the year ended June 30, 2013.

The MSBA as a Whole

The Statement of Net Position and the Statement of Activities provide information about the activities of the MSBA as a whole and present a longer-term view of the MSBA's finances by focusing on total available resources and changes therein. The fund financial statements tell how operations are financed in the short term as well as what remains for future spending.

Condensed Financial Information

Summary of Net Position

(In thousands)

		2013	2012
Cash and investments	$	882,095	1,616,179
Receivables		240,707	192,407
Other assets		117	35,325
Total assets		1,122,919	1,843,911
Deferred outflow of resources		161,371	—
Total assets and deferred outflows		1,284,290	1,843,911
Current liabilities		615,854	629,700
Noncurrent liabilities		6,704,071	7,083,835
Total liabilities		7,319,925	7,713,535
Net position	$	(6,035,635)	(5,869,624)

(Continued)

Summary of Activities

(In thousands)

	2013	2012
Dedicated sales tax	$ 735,450	670,494
Interest income	(15,524)	76,746
Grant income	23,565	23,672
Total general revenues	743,491	770,912
Grant payments and operations	653,439	588,432
Debt Service and related expenses	256,063	238,883
Total expenses	909,502	827,315
Change in net position	(166,011)	(56,403)
Net position, beginning of year	(5,869,624)	(5,813,221)
Net position, end of year	$ (6,035,635)	(5,869,624)

These statements report the MSBA's net position and changes to the MSBA's net position. Annual changes in the MSBA's net position – the difference between assets and liabilities – are one way to measure the MSBA's health or financial position. Over time, increases or decreases in the MSBA's net position are one indicator of whether its financial health is improving or deteriorating. The MSBA's major revenue source is the portion of the Commonwealth's sales tax revenue dedicated to the MSBA. Pursuant to the Act, all moneys received by the Commonwealth raised by a one percent (1%) statewide sales tax (drawn from the existing statewide 6.25% sales tax, excluding sales tax revenues on meals and from certain additional statutorily exempted revenues from sales (Dedicated Sales Tax Revenue), are available to the MSBA without further appropriation or allotment. The Commonwealth has covenanted that the Dedicated Sales Tax Revenue will not be diverted from the control of the MSBA and has pledged not to reduce the sales tax rate below that prescribed by the Act. The Act states that, under the New Program, no project can be approved for funding unless the MSBA determines that the school project is within the capacity of the MSBA to finance with revenues projected to be available to the MSBA.

The MSBA reports a deficit in its net position primarily due to the fact that the MSBA has $5.2 billion of Dedicated Sales Tax Bonds outstanding for the purposes of funding school construction and renovation projects. The MSBA also assumed responsibility for funding the Commonwealth's share of the 428 Waiting List and 728 Prior Grant school construction and renovation projects. As of June 30, 2013, the MSBA had paid in full its share of 389 of the 428 Waiting List projects and 436 of the 728 Prior Grant projects. This net position, a deficit of $6.0 billion, will be eliminated primarily through the receipt of Dedicated Sales Tax Revenue.

The change between currently expendable resources and total available resources is identified in the adjustment columns found in the financial statements (pages 10 and 11). To arrive at the Statement of Net Position, there are adjustments for deferred outflows as well as long-term and short-term liabilities that are not reported as fund assets and liabilities. Further, to arrive at the Statement of Activities, transactions relating to assets and long-term liabilities are added to or eliminated from the Statement of Revenues, Expenditures and Changes in Fund Balances. Amounts relating to the aforementioned transactions are displayed in the Adjustments column to the left of the Statement of Net Position and the Statement of Activities and in note 7 to the basic financial statements.

Debt

The Act provides the MSBA with the power to issue bonds and notes. The MSBA may issue either general obligation or special obligation bonds. Pursuant to the Act, the aggregate outstanding principal amount of the bonds shall not exceed $10 billion. To date, the MSBA has issued a total of $7.6 billion of Dedicated Sales Tax Bonds, including $1.7 billion of refunding bonds, for the purpose of funding school construction and renovation projects. As of June 30, 2013, the MSBA had $5.2 billion of Dedicated Sales Tax Bonds outstanding plus approximately $502.4 million of unamortized premiums for the purpose of funding school construction and renovation projects. Coupons on the bonds range from 2.00% to 5.715% and each series is payable semiannually with the last maturity occurring in fiscal year 2042. The $5.2 billion of debt outstanding includes $293.4 million of Subordinated Dedicated Sales Tax Bonds. The Dedicated Sales Tax Revenue is pledged for payment of outstanding debt service on these bonds.

On August 16, 2012, the MSBA refunded $808.2 million of 2005 Dedicated Sales Tax Bonds by issuing $766.1 million of Senior Sales Tax Refunding Bonds (2012 Series A Bonds). The Bonds mature at various dates through August 15, 2030 and the interest on the bonds is payable semi-annually each August 15th and February 15th. The interest rates on the bonds range from 3% to 5%. The refunding resulted in reduced debt service of $77.1 million and a present value savings of $56.6 million over the life of the debt.

On October 30, 2012, the MSBA refunded $987.3 million of 2005 Dedicated Sales Tax Bonds by issuing $916.4 million of Senior Sales Tax Refunding Bonds (2012 Series B Bonds). The Bonds mature at various dates through August 15, 2030 and the interest on the bonds is payable semi-annually each August 15th and February 15th. The interest rates on the bonds range from 3% to 5%. The refunding resulted in reduced debt service of $115.7 million and a present value savings of $93.4 million over the life of the debt.

In April 2013, the MSBA used funds on hand to advance refund $26.9 million of the 2007 Series A Bonds outstanding.

The proceeds and funds on hand were deposited into irrevocable trusts with escrow agents in amounts which will provide for payment of the principal of and interest on the defeased bonds to the redemption date. The defeased portion of such debt, accrued interest thereon, and related unamortized issuance costs and bond premiums were removed from the statement of net position.

On July 2, 2013, the MSBA issued $549 million of Senior Sales Tax Bonds (2013 Series A Bonds). The Bonds mature at various dates through May 2033 and interest is due semi-annually each November 15th and May 15th. The coupons on the bonds range from 3% to 5%.

A portion of the interest on the Dedicated Sales Tax Bonds is reimbursed by the federal government. Of the $5.2 billion of debt outstanding as of June 30, 2013, $450 million is taxable Build America Bonds for which the MSBA is eligible to receive a 35% interest subsidy directly from the United States Treasury. In addition, $293.4 million of the Subordinated Dedicated Sales Tax Bonds, 2010 Series A Bonds and 2011 Series A Bonds, were issued as "Qualified School Construction Bonds" for which the MSBA is eligible to receive a 100% interest subsidy payment directly from the United States Treasury. During fiscal year 2013, the federal government implemented automatic budget cuts imposed through sequestration required pursuant to the Budget Control Act of 2011. Subsidy payments received from March 1, 2013 through September 30, 2013 are being reduced by 8.7% (5.1% on an annualized basis) due to sequestration. This reduction was approximately $662 thousand on the 2010 Series A Bonds and the 2011 Series A Bonds in Fiscal Year 2013. On September 30, 2013, the Internal Revenue Service (IRS) published a notice indicating that subsidy payments processed on or after October 1, 2013 and on or before September 30, 2014 will be reduced by the fiscal year 2014 sequestration rate of 7.2 percent. The notice states that the sequestration reduction rate will be applied unless and until a law is enacted that cancels or otherwise impacts the sequester.

As of June 30, 2013, the ratings assigned to the MSBA's Dedicated Sales Tax Bonds are as follows: AA+ by Fitch Ratings, Aa2 by Moody's Investor Services, and AA+ by Standards & Poor's Investor Services. As of June 30, 2013, the ratings assigned to the MSBA's Subordinated Dedicated Sales Tax Bonds are as follows: AA by Fitch Ratings, Aa3 by Moody's Investor Services, and AA by Standards & Poor's Investor Services.

Contacting the MSBA's Financial Management

This financial report is designed to provide citizens, taxpayers, investors and creditors with a general overview of the MSBA's finances and to show the MSBA's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Massachusetts School Building Authority at 40 Broad Street, Suite 500, Boston, MA 02109.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Governmental Fund Balance Sheet/Statement of Net Position

June 30, 2013

(Dollars in thousands)

Assets		**Special Revenue Fund**	**Debt Service Fund**	**Adjustments (note 7)**	**Statement of net position**
Current assets:					
Cash and cash equivalents (note 4)	$	130,764	—	—	130,764
Restricted cash and investments (note 4)		699,808	51,523	—	751,331
Amount due from Commonwealth (note 3)		113,172	—	—	113,172
Interest receivable		9,317	—	—	9,317
Grant receivable		—	—	3,426	3,426
Loan receivable (note 9)		6,464	—	—	6,464
Noncurrent assets:		—	—	—	—
Other assets		—	—	117	117
Loan receivable (note 9)		108,328	—	—	108,328
Total assets		1,067,853	51,523	3,543	1,122,919
Deferred Outflows of Resources					
Loss on bond refunding		—	—	161,371	161,371
Total assets and deferred outflows	$	1,067,853	51,523	164,914	1,284,290
Liabilities					
Current liabilities:					
Accounts payable	$	1,374	—	—	1,374
Accrued interest		—	—	85,662	85,662
Current portion of grants payable (notes 5 and 6)		62,741	—	309,277	372,018
Current portion of long-term debt (note 5)		—	—	111,690	111,690
Current portion of compensated absences (note 5)		—	—	286	286
Current portion of bond premium		—	—	39,824	39,824
Current portion of other liabilities (note 11)		5,000	—	—	5,000
Long-term liabilities:					
Long-term debt (note 5)		—	—	5,083,470	5,083,470
Grants payable (notes 5 and 6)		—	—	1,147,750	1,147,750
Bond premium		—	—	462,613	462,613
Compensated absences (note 5)		—	—	216	216
Arbitrage rebate (note 5)		—	—	10,022	10,022
Total liabilities		69,115	—	7,250,810	7,319,925
Fund Balance/Net Position					
Restricted		688,728	51,523	(740,251)	—
Assigned		310,010	—	(310,010)	—
Total fund balance		998,738	51,523	(1,050,261)	—
Total liabilities and fund balance	$	1,067,853	51,523		
Restricted for debt service					723,750
Unrestricted					(6,759,385)
Commitments and contingencies (notes 8 and 10)					
Net position				$ (6,035,635)	(6,035,635)

See accompanying notes to financial statements.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Statement of Revenues, Expenditures, and Changes in Fund Balance/Statement of Activities

Year ended June 30, 2013

(Dollars in thousands)

	Special Revenue Fund	Debt Service Fund	Adjustments (note 7)	Statement of activities
General revenues:				
Dedicated sales tax (note 3)	$ 735,450	—	—	735,450
Interest income	(13,097)	—	(2,427)	(15,524)
Grant income	23,551	—	14	23,565
Total revenues	745,904	—	(2,413)	743,491
Expenditures/expenses:				
Grant payments (note 6)	1,036,795	—	(397,746)	639,049
Operations	14,267	—	123	14,390
Bond issuance costs	9,554	—	—	9,554
Loss on refunding	—	—	7,153	7,153
Debt service	393,087	—	(153,731)	239,356
Total expenditures/expenses	1,453,703	—	(544,201)	909,502
Other financing sources (uses):				
Bond proceeds (note 5)	1,682,490	—	(1,682,490)	—
Payments to escrow agent	(2,045,838)	—	2,045,838	—
Bond premium	356,742	—	(356,742)	—
Transfer to (from) funds (note 2)	(16,501)	16,501	—	—
Total other financing sources (uses)	(23,107)	16,501	6,606	—
Change in fund balance/net position	(730,906)	16,501	548,394	(166,011)
Fund balance/net position, beginning of year	1,729,644	35,022	(7,634,290)	(5,869,624)
Fund balance/net position, end of year	$ 998,738	51,523	(7,085,896)	(6,035,635)

See accompanying notes to financial statements.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Fiduciary Fund

June 30, 2013

(Dollars in thousands)

Statement of Fiduciary Net Position

June 30, 2013

		OPEB Trust Fund
Assets:		
Cash and cash equivalents (note 4)	$	1,778
Total assets		1,778
Net position – held in trust for OPEB benefits	$	1,778

Statement of Changes in Fiduciary Net Position

Year ended June 30, 2013

Additions:		
Contributions:		
Employer	$	—
Total contributions		—
Net position, beginning of period		1,778
Net position, end of period	$	1,778

See accompanying notes to financial statements.

(1) Organization and Background

Chapter 208 of the Acts of 2004 (Chapter 208, together with Chapter 70B of the Massachusetts General Laws, Section 35BB of Chapter 10 of the Massachusetts General Laws and Chapter 210 of the Acts of 2004, all as most recently amended, collectively referred to as the Act), eliminated the former school building assistance program and created the Massachusetts School Building Authority (the MSBA) to administer and fund a new program (the New Program) for grants to cities, towns, and regional school districts for school construction and renovation projects.

Under the former program, the Commonwealth of Massachusetts (the Commonwealth) was reimbursing cities, towns and regional school districts for its share of 728 previously approved projects (Prior Grant Projects). In addition, under the former program, 428 school projects were maintained on a waiting list for funding (the Waiting List). Pursuant to the Act, the MSBA became responsible for funding the Commonwealth's share of the 728 Prior Grant projects and 428 Waiting List projects. The Commonwealth's share ranged from 50% to 90% of approved eligible costs. As of June 30, 2013, the MSBA had paid in full its share of 389 of the 428 Waiting List projects and 436 of the 728 Prior Grant projects.

Under the New Program, no city, town or regional school district or independent agricultural and technical school has any entitlement to funds from the MSBA. Grants approved by the MSBA for projects may range from 31% to 80% of approved eligible project costs. Under the New Program, the MSBA is limited in the amount of grants it can approve in a fiscal year. The limit may change by the lesser of 4.5% of the limit for the prior fiscal year or the percentage change in the Dedicated Sales Tax Revenue Amount (see note 3) over the prior fiscal year.

The MSBA is mandated with achieving the effective planning, management and financial sustainability of a school building assistance program. The MSBA is an independent public Authority not subject to the supervision and control of any other executive office, department, agency or political subdivision of the Commonwealth. The MSBA is funded by a dedicated portion of the Commonwealth's statewide sales tax revenue. The Commonwealth has covenanted that the Dedicated Sales Tax Revenue will not be diverted from the control of the MSBA and has pledged not to reduce the sales tax rate below that prescribed by the Act. The Act prohibits the MSBA from filing for bankruptcy. The Act provides the MSBA with the power to issue bonds and notes. The MSBA may issue either general obligation or special obligation bonds. Pursuant to the Act, the aggregate outstanding principal amount of the bonds shall not exceed $10 billion.

Under the Act, the MSBA Board shall consist of the Treasurer and Receiver General of the Commonwealth (the Treasurer), the Secretary of Administration and Finance, and the Commissioner of Education, each *ex officio*, or such persons' designees, and four other members appointed by the Treasurer, each of whom shall serve two year terms and shall be eligible for reappointment. Of the four members appointed by the Treasurer, two are required to have practical experience in educational facilities planning, school building construction or architecture and school design, and two are required to be persons in the field of education with demonstrated knowledge of the Commonwealth's curriculum frameworks and other relevant federal and state educational standards. The Treasurer serves as the chairperson of the MSBA. The Executive Director of the MSBA serves as Secretary of the MSBA Board, *ex officio*.

(2) Summary of Significant Accounting Policies

(a) Reporting Entity and Basis of Presentation

The accompanying financial statements of the MSBA have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The MSBA has prepared government-wide financial statements titled “Statements of Net Position” and “Statement of Activities” as well as the required supplementary information titled “Management’s Discussion and Analysis” and “Schedule of Funding Progress” which precedes and follows, respectively, the financial statements. The MSBA also prepares the fund financial statements, which are the Special Revenue Fund and Debt Service Fund “Balance Sheet” and “Statement of Revenues, Expenditures and Changes in Fund Balance.” The MSBA’s basic financial statements which include both the government-wide and the fund financial statements have been combined together and presented on the same pages.

Fund Financial Statements – The MSBA utilizes the modified accrual basis of accounting, which focuses on changes in current financial resources, in the preparation of the fund financial statements. Revenues and related receivables are recognized when they become both measurable and available. “Available” means collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures and related liabilities are recorded in the period in which the liability is incurred. However, expenditures related to compensated absences and grants payable are recorded only to the extent that the liabilities mature (come due for payment).

Operating expenditures are direct costs incurred by the MSBA and are categorized into administrative expenditures, such as payroll related benefits and legal fees, and project related expenditures such as professional consultants and other related costs.

Nonoperating revenues and expenditures, classified as other financing sources (uses), primarily relate to the issuance of long-term debt.

The MSBA reports the following funds:

The Special Revenue Fund is the MSBA’s primary operating fund. It accounts for all financial resources of the MSBA, except those required to be accounted for in another fund.

The Debt Service Fund is a sinking fund related to the 2010 Series A Bonds and 2011 Series A Bonds. The amounts in the Debt Service Fund will be used to pay the principal of the 2010 Series A Bonds and 2011 Series A Bonds at maturity. Periodically, money is transferred from the Special Revenue Fund to the Debt Service Fund to meet sinking fund requirements. During fiscal year 2013, there was a transfer of $16.5 million from the Special Revenue Fund to the Debt Service Fund. As of June 30, 2013, the total amount in the Debt Service Fund totaled $51.5 million.

Fiduciary Fund – During fiscal year 2012, the MSBA established the OPEB Trust Fund, an irrevocable trust fund established to accumulate assets for the purpose of paying for future other post-employment benefits. The assets are funded from operations and accumulate to reduce the unfunded actuarial liability of health care and other related post-employment benefits. Currently, the MSBA has no retirees; thus, the assets of the trust are currently not used for direct payment of benefits. The Trust Fund financial statements focus on the changes in total economic resources and utilize the full accrual basis of accounting.

Government-Wide Financial Statements – The MSBA utilizes the full accrual basis of accounting, which focuses on changes in total economic resources, in the preparation of the government-wide financial statements. Under the full accrual basis of accounting, changes in long-term assets and liabilities are incorporated into the financial statements. Since the fund financial statements are prepared on a different measurement focus and basis of accounting than the government-wide financial statements, an "Adjustments Column" is presented to convert the fund basis financial statements into the government-wide financial statements. Details supporting amounts in the Adjustments Column are presented in note 7.

Due to its relationship with the Commonwealth, the MSBA is considered a blended component unit for financial statement purposes and is presented as a special revenue fund in the Commonwealth's financial statements. The MSBA has no relationship with other entities that could be considered component units.

In Fiscal 2013, the MSBA implemented GASB Statement 63: *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and GASB Statement No. 65: *Items Previously Reported as Assets and Liabilities*. In accordance with GASB 65, losses on bond refundings are classified as deferred outflows of resources and bond issue costs are recorded as an expense when incurred. The impact of implementing GASB 63 was not material to the financial statements.

(b) Investments

All investments are recorded at fair value. The MSBA has investments in U.S. Treasuries, municipal bonds, money markets, an external investment pool and a Guaranteed Investment Contract. The fair value of the Guaranteed Investment Contract is determined based on contract value.

The MSBA invests in the Massachusetts Municipal Depository Trust (MMDT), which is an external investment pool and is not SEC-registered. The fund is state regulated and is valued at current share price.

Fluctuations in the fair value of U.S. Treasuries and municipal bonds are recorded as interest income (loss). Interest income (loss) related to fluctuations in value of these investments was $(20.1) million in fiscal year 2013. The MSBA intends to hold these investments to maturity.

(c) Capital Assets

Capital assets are defined by the MSBA as classes of assets with an initial aggregate cost of more than $100,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

Leasehold improvements exceeding $100,000 are capitalized and amortized over the life of the lease which is seven years. The net book value of capitalized leasehold improvements associated with the MSBA's lease at June 30, 2013 was approximately $117,000.

(d) Compensated Absences

Employees earn the right to be compensated during absences for vacation and illness. Vested or accumulated vacation and sick leave expected to be liquidated with expendable available financial resources are reported as expenditures and liabilities. Employees are granted vacation and sick leave in varying amounts based on years of service. Upon retirement, termination, or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their then-current rate of pay. At June 30, 2013, approximately $502,000 of accrued compensated absences has been recorded.

(e) Deferred Inflows and Outflows

The MSBA accounts for certain transactions that result in the consumption or acquisition of one period that are applicable to future periods as deferred outflows and deferred inflows, respectively, to distinguish them from assets and liabilities. For fiscal 2013, the MSBA has reported deferred outflows pertaining to the deferred losses on its debt refunding transactions.

(f) Revenue Recognition

The MSBA's major revenue source is the portion of the Commonwealth's sales tax revenue dedicated to the MSBA. Pursuant to the Act, all moneys received by the Commonwealth raised by a one percent (1%) statewide sales tax (drawn from the existing statewide 6.25% sales tax, excluding sales tax revenues on meals and from certain additional statutorily exempted revenues from sales (Dedicated Sales Tax Revenue)) are deposited into the School Modernization and Reconstruction Trust (SMART) Fund, and are available to the MSBA without further appropriation or allotment. The use of the SMART Fund is exclusively restricted for the purposes of the MSBA. Revenue is recognized and a corresponding "Amount due from Commonwealth" is recorded when the Dedicated Sales Tax Revenue or other funds from the Commonwealth are deposited into the SMART Fund. The Dedicated Sales Tax Revenue is pledged for repayment of outstanding debt service.

100% of the interest on the $293.4 million of Subordinated Dedicated Sales Tax Bonds and 35% of the interest on the $450.0 million of Build America Bonds is eligible to be reimbursed by the federal government and recorded as grant income. During fiscal year 2013, the federal government implemented automatic budget cuts imposed through sequestration required pursuant to the Budget Control Act of 2011. Subsidy payments received from March 1, 2013 through September 30, 2013 are being reduced by 8.7% (5.1% on an annualized basis) due to sequestration. This reduction was approximately $662 thousand on the 2010 Series A Bonds and 2011 Series A Bonds in Fiscal Year 2013. On September 30, 2013, the IRS published a notice indicating that subsidy payments processed on or after October 1, 2013 and on or before September 30, 2014 will be reduced by the fiscal year 2014 sequestration rate of 7.2 percent. The notice states that the sequestration reduction rate will be applied unless and until a law is enacted that cancels or otherwise impacts the sequester.

The Fiscal Year 2013 sales tax revenue reflects a current year change in the process of estimating the amount of sales taxes due to the MSBA from the Commonwealth. This change resulted in an additional of $51.3 million of sales taxes being recognized in revenue in 2013.

(g) Grants Payable

The MSBA records a liability for its share of total eligible project costs differently depending on the type of project. However, for all projects, the MSBA recognizes a liability for its estimated share of total eligible project costs when the applicable eligibility requirements have been met.

Prior Grants – All of the 728 Prior Grant projects had been receiving an annual payment under the former program. The liability for these projects will be reduced over time through annual payments, and savings from debt refundings by the local communities in which the MSBA shares in the savings based on the reimbursement rate of the project.

Waiting List – The MSBA funds Waiting List projects using two different methods, lump sum and progress payments. Each funding method has different eligibility requirements.

Waiting List projects that will receive lump sum payments are recognized as a liability once construction has started. The liability for these projects will be reduced over time through annual payments, and savings from debt refundings by the local communities in which the MSBA shares in the savings based on the reimbursement rate of the project.

The MSBA’s share of costs incurred for Waiting List projects that will be funded on a progress payment basis are generally recognized as a liability once a grantee requests reimbursement from the MSBA. Waiting List projects that are not currently recognized as a liability are considered commitments of the MSBA.

Under the Act, the MSBA is committed to paying for its share of projects on the Waiting List once communities meet all applicable eligibility requirements for receiving such grants. As of June 30, 2013, the amount of commitments outstanding for the Waiting List projects is $31.0 million and is anticipated to be funded under the progress payment method.

New Program – The MSBA funds New Program projects on a progress payment basis. Under this process, communities submit monthly requests for reimbursement. Upon review, the MSBA processes payment for its share of eligible costs incurred. The MSBA’s share of costs incurred for New Program projects are recognized as a liability once a grantee requests reimbursement from the MSBA. The MSBA has recorded a liability of $131.7 million for the reimbursements due for these projects. New Program projects that are not currently recognized as a liability are considered commitments of the MSBA. As of June 30, 2013, the amount of commitments outstanding for the New Program projects is $1.4 billion and will be funded under the progress payment method.

For all projects, regardless of the funding mechanism, costs incurred by the grantees are subject to audit by the MSBA. Completion of these audits will allow the MSBA to determine the final approved cost of these projects, and the MSBA will adjust the payments it makes for these projects, as necessary, in accordance with the results of those audits.

(h) Employee Benefits

The Commonwealth is responsible by statute for the pension benefits for members of the State Employees’ Retirement System (SERS) including employees of the MSBA. The SERS is a single employer defined benefit public employee retirement system, covering substantially all employees of the Commonwealth and certain employees of independent authorities and agencies. The SERS is administered by the Commonwealth and is part of its reporting entity; no stand-alone financial report is issued. The employee retirement contributions for the year ended June 30, 2013 transferred by the MSBA were approximately $429,600. The MSBA has not recorded any pension costs in these financial statements. The MSBA share of the retiree pension expense is included in the Commonwealth's financial statements. The value of the MSBA's share was not available as of June 30, 2013, and therefore, is not reported in these financial statements.

The MSBA provides employment benefits other than pensions, including health care and life insurance benefits for active and retired employees through participation in the Commonwealth's Group Insurance Commission. MSBA employees may become eligible for post-employment benefits if they reach normal retirement age while working for the MSBA and retire from the MSBA. The MSBA records other post-employment benefits (OPEB) as expenses when earned by the employee. The MSBA currently funds OPEB based on an actuarial funding schedule, which was fully funded as of June 30, 2013. As of June 30, 2013, the MSBA did not have any retirees.

(i) Use of Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses and expenditures during the reporting period. Actual results could differ from those estimates.

(j) Fund Balances

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* requires entities to classify fund balances as restricted, committed, assigned, or unassigned. The MSBA Board of Directors has the ability to commit and un-commit funds while financial management of the MSBA has the ability to assign and un-assign funds. Restricted balances are restricted in their use by bond covenants or statute.

(Continued)

As of June 30, 2013, the MSBA had the following fund balances (in thousands):

		Amount
Fund balance:		
Restricted:		
Grants to cities, towns, and regional school districts	$	16,501
Debt service*		723,750
Subtotal		740,251
Assigned:		
Arbitrage rebate		10,022
Grants and loans to cities, towns, and regional school districts		299,988
Subtotal		310,010
Total fund balance	$	1,050,261

* $51.5 million relates to the debt service fund.

(3) Amount due from Commonwealth

Coincident with the establishment of the MSBA, the Commonwealth established the SMART Fund for the purpose of receiving the transfer of Dedicated Sales Tax Revenue and other funds from the Commonwealth to the MSBA. Amounts held in this Fund are for the exclusive purpose of the MSBA. In fiscal year 2013, $735.5 million of Dedicated Sales Tax Revenue was earned and recorded as revenue. Of that amount, $113.2 million was received subsequent to year-end and is recorded as a receivable on the MSBA's financial statements. The Dedicated Sales Tax Revenue is pledged for repayment of outstanding debt service.

(4) Deposits and Investments

Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, requires that entities disclose essential risk information about deposits and investments.

(a) Investment Policy

Pursuant to the Act, the MSBA is authorized to invest in obligations of the U.S. Treasury, its agencies and instrumentalities, bonds, or notes of public agencies or municipalities, bank time deposits, guaranteed investment contracts, money market accounts, and repurchase agreements. These investments are recorded at fair value. The MSBA has an investment policy that establishes minimum credit quality for certain instruments, outlines investment procedures and provides for periodic reporting. The MSBA's investment policy does not specifically limit the amount the MSBA may invest in any one issuer.

The assets of the MSBA's OPEB Trust Fund are invested in the State Retiree Benefits Trust Fund, which is part of the Massachusetts Pension Reserves Investment Trust Fund and follows the investment policy of the Massachusetts Pension Reserves Investment Management Board.

(b) Custodial Credit Risk

Custodial credit risk is the risk that in the event of bank failure, the MSBA's deposits may not be returned. The MSBA does not have a formal investment policy for custodial credit risk. As of June 30, 2013 all MSBA deposits in excess of the Federal Deposit Insurance Corporation (FDIC) insured limit were fully collateralized.

(c) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the MSBA's investments. The MSBA's investment policy does not specifically limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The MSBA intends to hold its fixed income investments to maturity.

As of June 30, 2013, the MSBA had $226.5 million invested in a collateralized guaranteed investment contract (GIC) and $321.5 million invested in U.S. Treasury Bonds and municipal bonds. These investments all have a fixed interest rate and are included in restricted cash and investments on the balance sheet. The GIC matures August 15, 2030 while the U.S. Treasury Bonds and municipal bonds mature from 2019 to 2040.

The following is a list of the MSBA's investments and related maturity schedule as of June 30, 2013 (dollars in thousands).

		Fair	Investment maturities			
Investment type		**value**	**< 1 Year**	**1-5 Years**	**6-10 Years**	**>10 Years**
Money Market Funds	$	203,414	203,414	—	—	—
U.S. Treasuries		253,643	—	—	18,720	234,923
Municipal Bonds		67,823	—	—	—	67,823
GIC		226,451	—	—	—	226,451
Total	$	751,331	203,414	—	18,720	529,197

(d) Credit Risk

As of June 30, 2013, the MSBA had $226.5 million invested in a GIC for which collateral equal to 105% of the principal value of the contract is held by a third party. This investment is not rated.

As of June 30, 2013, the MSBA had $253.6 million invested in Treasury STRIPS and other U.S. obligations are backed by the full faith and credit of the U.S. government.

As of June 30, 2013 the MSBA had $203.4 million invested in money market funds.

As of June 30, 2013, the MSBA had $67.8 million invested in municipal bonds. These investments were rated AA+ or above.

(e) Concentration of Credit Risk – Investments

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The issuers where investments as of June 30, 2013 exceeded 5% of the MSBA's total investments, other than investments in U.S. government obligations and money market funds, are as follows:

	Percentage of total investments
FSA Capital Management Services, LLC	30%
Commonwealth of Massachusetts (Series 2011 B Bonds)	6

(5) Long and Short-Term Obligations

Following is a summary of the long-term obligations of the MSBA as of June 30, 2013 (amounts in thousands):

	Outstanding, beginning of year	Additions	Reductions*	Outstanding, end of year	Due within one year
Grants payable:					
Prior Grant projects	$ 1,511,510	—	298,012	1,213,498	209,736
Waiting List projects	244,689	45,778	115,916	174,551	30,562
New Program projects	137,447	629,394	635,121	131,720	131,720
	1,893,646	675,172	1,049,049	1,519,769	372,018
Long-term debt:					
Dedicated Sales Tax Bonds (2005)	2,172,840	—	1,858,830	314,010	66,355
Dedicated Sales Tax Bonds (2007)	1,435,145	—	43,710	1,391,435	11,710
Dedicated Sales Tax Bonds (2009A)	91,900	—	18,000	73,900	14,000
Dedicated Sales Tax Bonds (2009B) – Build America Bonds	450,000	—	—	450,000	—
Subordinated Dedicated Sales Tax Bonds (2010A) – Qualified School Construction Bonds	151,000	—	—	151,000	—
Subordinated Dedicated Sales Tax Bonds (2011A) – Qualified School Construction Bonds	142,380	—	—	142,380	—

	Outstanding, beginning of year	Additions	Reductions*	Outstanding, end of year	Due within one year
Dedicated Sales Tax Bonds (2011B)	$ 1,000,000	—	10,055	989,945	19,625
Dedicated Sales Tax Bonds (2012A)	—	766,140	—	766,140	—
Dedicated Sales Tax Bonds (2012B)	—	916,350	—	916,350	—
	5,443,265	1,682,490	1,930,595	5,195,160	111,690
Other liabilities:					
Compensated absences	495	21	14	502	286
Arbitrage rebate	7,595	2,427	—	10,022	—
	8,090	2,448	14	10,524	286
Total long-term obligations	$ 7,345,001	2,360,110	2,979,658	6,725,453	483,994

* Includes reductions in grants payable due to MSBA audits and debt refundings by the local communities of $12.3 million and $7.4 million for Prior Grant projects and Waiting List projects, respectively.

Maturity of Bond Indebtedness

Bond indebtedness outstanding at June 30, 2013 matures as follows (amounts in thousands):

	Principal	Interest	Interest subsidy	Total
Year ending June 30:				
2014	$ 111,690	255,975	(23,519)	344,146
2015	116,555	251,113	(24,213)	343,455
2016	115,375	244,886	(24,213)	336,048
2017	128,420	239,237	(24,213)	343,444
2018	132,665	233,026	(24,213)	341,478
2019 – 2023	736,570	1,062,596	(121,065)	1,678,101
2024 – 2028	919,530	869,231	(112,809)	1,675,952
2029 – 2033	1,277,485	571,627	(46,751)	1,802,361
2034 – 2038	1,257,705	282,481	(24,171)	1,516,015
2039 – 2043	399,165	36,011	(2,289)	432,887
	$ 5,195,160	4,046,183	(427,456)	8,813,887

As of June 30, 2013, the MSBA had outstanding approximately $5.2 billion of Dedicated Sales Tax bonds, plus approximately $502.4 million of unamortized premiums, for the purpose of funding school construction and renovation projects. Coupons on the bonds range from 2.000% to 5.715% and each series is payable semi-annually with the last maturity occurring in fiscal year 2042. The $5.2 billion of debt outstanding includes $293.4 million of Subordinated Dedicated Sales Tax Bonds.

On August 16, 2012, the MSBA refunded $808.2 million of 2005 Dedicated Sales Tax Bonds by issuing $766.1 million of Senior Sales Tax Refunding Bonds (2012 Series A Bonds). The Bonds mature at various dates through August 15, 2030 and the interest on the bonds is payable semi-annually each August 15th and February 15th. The interest rates on the bonds range from 3.000% to 5.000%. The refunding resulted in reduced debt service of $77.1 million and a present value savings of $56.6 million over the life of the debt.

On October 30, 2012, the MSBA refunded $987.3 million of 2005 Dedicated Sales Tax Bonds by issuing $916.4 million of Senior Sales Tax Refunding Bonds (2012 Series B Bonds). The Bonds mature at various dates through August 15, 2030 and the interest on the bonds is payable semi-annually each August 15th and February 15th. The interest rates on the bonds range from 3.000% to 5.000%. The refunding resulted in reduced debt service of $115.7 million and a present value savings of $93.4 million over the life of the debt.

In April 2013, the MSBA used funds on hand to advance refund $26.9 million of the 2007 Series A Bonds outstanding.

The bond proceeds and funds on hand were deposited in irrevocable trusts with escrow agents in amounts which will provide for payment of the principal of and interest on the defeased bonds to the redemption date. The defeased portion of such debt, accrued interest thereon, and related unamortized issuance costs and bond premiums were removed from the statement of net position.

A portion of the interest on the Dedicated Sales Tax Bonds is reimbursed by the federal government. Of the $5.2 billion of debt outstanding as of June 30, 2013, $450 million is taxable Build America Bonds for which the MSBA is eligible to receive a 35% interest subsidy directly from the United States Treasury. In addition, $293 million of the Subordinated Dedicated Sales Tax Bonds were issued as "Qualified School Construction Bonds" for which the MSBA is eligible to receive a 100% interest subsidy payment directly from the United States Treasury. During fiscal year 2013, the federal government implemented automatic budget cuts imposed through sequestration required pursuant to the Budget Control Act of 2011. Subsidy payments received from March 1, 2013 through September 30, 2013 are being reduced by 8.7% (5.1% on an annualized basis) due to sequestration. This reduction was approximately $662 thousand on the 2010 Series A Bonds and 2011 Series A Bonds in Fiscal Year 2013. On September 30, 2013, the IRS published a notice indicating that subsidy payments processed on or after October 1, 2013 and on or before September 30, 2014 will be reduced by the fiscal year 2014 sequestration rate of 7.2 percent. The notice states that the sequestration reduction rate will be applied unless and until a law is enacted that cancels or otherwise impacts the sequester.

(6) Grants Payable

As of June 30, 2013, the liability for future payments related to the Prior Grant and Waiting List projects is as follows (amounts in thousands):

		Prior Grants	Waiting List	Total
Year ending June 30:				
2014	$	209,736	30,562	240,298
2015		197,710	16,771	214,481
2016		185,633	16,771	202,404
2017		172,331	16,771	189,102
2018		140,065	15,778	155,843
2019 – 2023		308,023	72,396	380,419
2024 – 2025		—	5,502	5,502
Total	$	1,213,498	174,551	1,388,049

The amounts to be reimbursed for the Prior Grant and Waiting List projects may decrease as a result of debt refundings by the local communities in which the MSBA shares in the savings based on the reimbursement rate of the project.

The MSBA will also fund its share of eligible project costs for Waiting List projects and New Program projects that are not currently recognized as a liability. For these projects, which will be funded on a progress payment basis, a liability will be recognized as costs are incurred and submitted to the MSBA for reimbursement. The MSBA has estimated the amount of outstanding Waiting List commitments and New Program commitments at June 30, 2013 to be approximately $31.0 million and $1.4 billion, respectively.

Upon completion of the projects, all costs incurred by the grantees are subject to audit by the MSBA and, based on the results of the audits, the estimated approved eligible costs and the related liability may either increase or decrease.

(7) Adjustments Column

(a) Explanation of Certain Differences between the Governmental Fund Balance Sheet and the Statement of Net Position

Long-term liabilities of the MSBA's activities are not due and payable in the current period and therefore are not reported as fund liabilities. Also, some assets used in governmental activities are not financial resources and therefore are not reported as fund assets. All assets and liabilities, both current and long-term, are reported in the statement of net position. The difference between the governmental fund balances and governmental activities net position at June 30, 2013 were as follows (amounts in thousands):

Total fund balance – governmental funds	$	1,050,261
Amounts reported for governmental activities in the statement of net position are different because:		
Leasehold improvements are capitalized in the government-wide statement of net activities		117
Grant receivable is capitalized in the government-wide statements		3,426
Loss on bond refundings is classified as deferred outflows in the government-wide statements		161,371
Some liabilities are not due and payable in the current period and therefore are not reported in the governmental funds. Those liabilities consist of:		
Dedicated sales tax bonds		(5,195,160)
Grants payable to local communities		(1,457,027)
Bond premiums		(502,437)
Accrued interest		(85,662)
Other liabilities		(10,022)
Compensated absences		(502)
Net position of governmental activities	$	(6,035,635)

(b) Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance and the Statement of Activities

In the statement of activities prepared on the full accrual basis all revenues and expenses are recognized in the year they are earned or incurred regardless of when they are paid and will therefore be reflected in the statement of activities. Additionally, in the Governmental Funds, payments and receipts contribute to the change in fund balance while the same payments and receipts decrease and increase liabilities in the statement of net position. These differences in measurement recognition affect both the reported fund balance and the reported net position. Adjustments required to be made to the reported Governmental Funds to arrive at the statement of activities are as follows (amounts in thousands):

Net change in fund balances – governmental funds	$	(714,405)
Amounts reported for governmental activities in the statement of activities are different because:		
Payments and adjustments on grants decrease long-term liabilities in the statement of net position but are included as expenditures in the governmental funds.		397,747
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This amount represents the change in compensated absences, interest payable and other liabilities.		9,437
Proceeds of long-term debt ($1,682,490) and premiums ($356,742) increase long-term liabilities in the statement of net position but are included in the operating statement of the governmental funds.		(2,039,232)
Repayment of bond principal ($137,017) and payments to escrow agents ($2,045,838) are expenditures in the governmental funds, but reduce long-term liabilities on the statement of net position.		2,182,855
Adjustment of revenues reported in the statement of activities on a different basis than in the governmental funds.		(2,413)
Change in net position of governmental activities	$	(166,011)

(8) Commitments and Contingencies

(a) Grant Commitments

The MSBA has estimated the amount of outstanding Waiting List commitments and New Program commitments at June 30, 2013 to be $31.0 million and $1.4 billion, respectively.

(b) Related Parties

The MSBA enters into various related party transactions with the Commonwealth. All significant or material transactions have been properly disclosed in the accompanying financial statements.

(c) Operating Lease

The MSBA leases its office space. The lease terminates on January 31, 2015 with future minimum lease payments totaling $1,559,505 as follows:

Fiscal year		Amount
2014	$	980,687
2015		578,818
Total	$	1,559,505

Rent expense recorded during fiscal year 2013 was approximately $801,540.

(9) Intergovernmental Loans

The MSBA has entered into various loan agreements with municipalities at a 2% interest rate with principal to be paid in equal installments for varying terms. Currently, the longest repayment schedule has a final payment in fiscal year 2041. This program is designed to assist a limited number of school districts with unanticipated inflationary construction costs over the districts' original project budget. The loans outstanding as of June 30, 2013 were $114.8 million, of which $6.5 million is due in FY14. During FY13, the MSBA executed no new loans and collected $6.5 million of scheduled principal payments.

On September 25, 2013, the MSBA executed an inter-governmental loan for $6.25 million to a district under its existing loan program. The final maturity date on this loan is November 2042.

(10) Other Post-Employment Benefits

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions*, requires governments to account for other post-employment benefits, primarily healthcare, on an accrual basis rather than on a pay-as-you-go basis. The effect is the recognition of an actuarially required contribution as an expense on the statement of revenues, expenses, and changes in net assets when a future retiree earns their post-employment benefit rather than when they use their post-employment benefit. To the extent that an entity does not fund their actuarially required contribution, a post-employment benefit liability is recognized on the balance sheet over time.

(a) Plan Description

The MSBA will provide post-employment health care, life insurance and other post-employment benefits (OPEB) for employees who meet the eligibility criteria and retire directly from the MSBA through the Group Insurance Commission (GIC). The GIC is a state agency that administers an agent multi-employer defined benefit OPEB plan. As of December 31, 2012, the actuarial valuation date, the MSBA had no retirees and 55 active plan members. There are 6 terminated employees that have a vested interest to benefits. The plan does not issue a separate financial report.

(b) Benefits Provided

As part of the MSBA employee benefits package administered by the GIC, the MSBA provides health and life insurance to employees who retire from the MSBA and their covered dependents. All active employees who retire from the MSBA, meet the eligibility criteria, and opt for the plan will receive these benefits.

(c) Funding Policy

Subject to statutory requirement, future retirees will contribute 20% of the cost of the premium of the health plan, as determined by the GIC, and the MSBA will contribute the remainder of the health plan costs. The MSBA plans to keep the plan fully funded on an annual basis.

(d) Annual OPEB Costs and Net OPEB Obligation/(Asset)

The MSBA's fiscal year 2013 OPEB expense is calculated based on the value of benefits earned during the year (Normal Cost) and a one-year amortization of the Unfunded Actuarial Accrued Liability (UAAL), as actuarially determined in accordance with the parameters of GASB Statement No. 45. The Annual Required Contribution (ARC) in the table below reflects the full recognition of the UAAL as of June 30, 2013. For future years, the ARC will be limited to changes in membership, the benefit plans and inflation rates. The following table shows the components of the MSBA's OPEB cost for the year ending June 30, 2013, the amount actually contributed to the plan, and the change in the MSBA's net OPEB obligation/(asset) based on an actuarial valuation as of December 31, 2012 (amounts in thousands):

Annual required contribution (ARC)	$	(183)
Adjustment to ARC		—
Annual OPEB cost		(183)
Contributions made		—
Change in net OPEB obligation/(asset)		(183)
Net OPEB obligation/(asset) – beginning of year		—
Net OPEB obligation/(asset) – end of year	$	(183)

The MSBA's OPEB cost, the percentage of OPEB cost contributed to the plan, and the net OPEB obligation were as follows (amounts in thousands):

Fiscal year ended		OPEB cost	Percentage of OPEB cost contributed	Net OPEB obligation/ (asset)
2013	$	(183)	Note 1	(183)
2012		(1,633)	Note 1	—
2011		478	—%	3,411
2010		53	—%	2,933

Note 1: During fiscal year 2012, the MSBA established an irrevocable trust to accumulate assets to pay for future other post-employment benefits. In June, 2012, the MSBA transferred $1,778,000 to

the Trust to fully fund it. There were no additional transfers in fiscal year 2013, as the Trust was fully funded.

(e) Funded Status and Funding Progress

The funded status of the plan as of January 1, 2013, based on an actuarial valuation as of January 1, 2013, was as follows (amounts in thousands):

Actuarial accrued liability (AAL)	$	1,668
Actuarial value of plan assets		1,909
Unfunded/(Overfunded) actuarial accrued liability (UAAL)	$	(241)
Funded ratio (actuarial value of plan assets/AAL)		114.5%
Covered payroll (active plan members)	$	4,490
UAAL as a percentage of covered payroll		—

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the MSBA are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(f) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the plan as understood by the MSBA and the plan members and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the MSBA and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2013 actuarial valuation, the projected unit credit cost method was used. The actuarial value of assets was determined to be $1.9 million based on the fair market value of the assets. The actuarial assumptions included an 8.0% investment rate of return and an initial annual healthcare cost trend rate of 7.0% which decreases to a 5% long-term trend rate for all healthcare benefits after four years. The MSBA has chosen to amortize its AAL over 1 year.

(11) Subsequent Events

On July 2, 2013, the MSBA issued $549 million of Senior Sales Tax Bonds (2013 Series A Bonds). The Bonds mature at various dates through May 2043 and interest is due semi-annually each November 15th and May 15th. The coupons on the bonds range from 3% to 5%. In connection with this bond sale, the MSBA received a $5 million refundable deposit from the bond underwriter in June 2013. This amount has been presented as an other liability at June 30, 2013.

On September 25, 2013, the MSBA executed an inter-governmental loan for $6.25 million to a district under its existing loan program. The final maturity date on this loan is November 2042.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Schedule of Funding Progress – Required Supplementary Information

June 30, 2013

(Unaudited)

(Dollars in thousands)

Other postemployment benefits

Actuarial valuation	**Assets (a)**	**Actuarial accrued liability (AAL) – (b)**	**Unfunded AAL (UAAL) (b-a)**	**Funded ratio (a/b)**	**Covered payroll (c)**	**UAAL as a percentage of covered payroll ((b-a)/(c))**
January 1, 2013	$ 1,909	1,668	(241)	115.0%	$ 4,490	—%
January 1, 2009*	1,778	1,778	—	100.0	3,880	—
January 1, 2009	—	2,491	2,491	—	3,013	83.0
January 1, 2008	—	2,471	2,471	—	2,633	94.0

* Updated as of June 30, 2012

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Schedule of Employer Contributions – Required Supplementary Information

June 30, 2013

(Unaudited)

(Dollars in thousands)

Other postemployment benefits

Fiscal year ending June 30,	**Annual OPEB costs**	**Actual contributions**	**Percentage contributed**
2013	$ (183)	$ —	—%
2012	(1,633)	1,778	(108.9)
2011	478	—	—
2010	53	—	—

See accompanying independent auditors’ report.

KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board Members
Massachusetts School Building Authority:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Massachusetts School Building Authority (the Authority), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated October 23, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of Authority's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

October 23, 2013