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Ratings

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Summary:

Massachusetts School Building Authority Massachusetts; Sales Tax

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Summary:

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Credit Profile		
US$300.0 mil sub dedicated sales tax bnds (Massachusetts) ser 2019 A due 02/15/2049		
Long Term Rating	AA/Stable	New
Massachusetts Sch Bldg Auth sales tax		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts Sch Bldg Auth subord sales tax		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating to the Massachusetts School Building Authority's (MSBA) $300 million series 2019A subordinated dedicated sales tax bonds.

S&P Global Ratings also affirmed its 'AA+' rating on the authority's $5.1 billion senior sales tax revenue bonds outstanding, and its 'AA' rating on the authority's $874.6 million subordinated bonds outstanding. The outlook on both the senior and subordinate bonds is stable.

A subordinate lien on the authority's dedicated sales tax revenue, after payment of senior bonds, secures the series 2019A and parity bonds.

The ratings reflect our assessment of:

- A dedicated 1% sales tax that is levied statewide and is not subject to reduction or diversion pursuant to the statute and trust agreement;
- MSBA's pledge of sales tax revenue on a gross basis and not subject to annual legislative appropriation;
- The underlying strength and diversity of the Massachusetts (general obligation [GO] rating: AA/Stable) economy, with approximately 6.9 million residents that have well-above-average income levels;
- Relatively low sales-tax revenue volatility and sustained long-term growth trends. Revenue growth has been healthy following a dip during the 2008-2010 recession years. We expect growth to continue at a healthy pace due to strong economic fundamentals; and
- Good debt service coverage (DSC), which we expect to continue due to statutory caps on the rate of growth of MSBA capital commitments and an adequate 1.4x additional bonds test (ABT) for the senior bonds, and 1.3x for the subordinate bonds.

We understand that MSBA will use the 2019A bond proceeds as part of its long-term capital plan, which provides funds for construction grants to cities, towns, and regional school districts.

A 1% statewide sales tax, excluding sales-tax revenue on meals, and on sales occurring in certain portions of Boston, Cambridge, and the Springfield Convention Center area, secures the senior and subordinate bonds. The pledged 1% tax accounts for a portion of Massachusetts' overall 6.25% sales-tax rate. Pledged sales tax is not subject to annual budget appropriation.

Although the pledged revenue stream has shown some volatility during recessions, we believe MSBA has managed its debt program so as to maintain strong coverage, and we expect it will manage this new debt issuance in a way that preserves what we view as the authority's future strong coverage. MSBA plans to increase the use of pay-as-you-go capital funding to about 20%-30% of its capital spending, reducing somewhat the amount of future bonding needs.

MSBA was created in 2004 to manage and plan reimbursements of Massachusetts' school construction and renovation grant program. Under the enabling legislation, the maximum amount of principal outstanding at any given time backed by this revenue pledge cannot exceed $10 billion, compared with current senior and subordinate debt outstanding of $6 billion as of June 1, 2019. The liability for the authority's remaining waiting list projects and previous grant projects that it inherited on its creation totaled $260 million, while it had entered into new feasibility study agreements and project funding agreements for $5.6 billion of new project grants. Of the new project grant commitments, approximately $1.4 billion of funding commitments are still outstanding. There is a statutory cap on new grants per year, which limits growth to the lesser of the rate of dedicated sales tax growth, or 4.5%.

Revenue volatility: Very low for senior bonds; Low for subordinate bonds

We believe pledged sales-tax revenue will have relatively low volatility, based on the broad nature of the economic activity covered by the pledged sales tax and a statewide economic base. The sales tax has shown good long-term growth trends, with some dips in recession years. Pledged sales-tax revenue fell by a cumulative 7.9% during fiscal years 2008-2010, but has since grown each year, including 5.0% growth in the fiscal year ended June 30, 2015, 4.5% in fiscal 2016, 2.3% in fiscal 2017, and 3.8% in fiscal 2018. The state estimates 4.0% growth in fiscal 2019, and projects 4.0% growth in fiscal 2020 based on a Dec. 2018 state consensus revenue forecast.

Coverage and liquidity: Very strong

We calculate fiscal 2018 pledged revenue of $847.9 million covers estimated combined subordinate and senior-lien maximum annual debt service (MADS) in 2025 of $454.3 million after this issuance by 1.87x, which we consider strong. This calculation of MADS assumes annual debt service is reduced by the release of various series of senior bonds' debt service reserves when those series mature. Without release of reserves, MADS would be $625.1 million in fiscal 2031 and MADS coverage would decline to an adequate 1.36x. The state estimates fiscal 2019 pledged revenue of $882.1 million. Using this figure, coverage of combined senior and subordinate MADS would be 1.94x using debt service reserve releases, and 1.41x without debt service reserve releases. Our base-case analysis assumes that reserves will be available and released on time because of strong annual DSC.

We calculate coverage of senior-lien MADS alone of $386.6 million, assuming use of bond reserves to make individual series' final maturities, is also strong, in our view, at 2.19x based on historical fiscal 2018 pledged revenue. Without availability of senior bond debt service reserve (DSR) releases to reduce net debt service, senior MADS would be $572.7 million in 2031 and MADS coverage would be a good 1.48x.

MSBA next plans to sell about $300 million of additional subordinated debt in about mid-2020.

The senior-lien ABT requires at least 1.4x MADS coverage on the senior-lien bonds by historical revenues, and 1.3x MADS coverage on the subordinate bonds. The subordinate bonds do not have a DSR, and MSBA has established senior bond series' DSRs on a case-by-case basis. There is a pledge of federal interest subsidies received under the Build America Bond (BAB) program and the Qualified School Construction Bond (QSCB) program for certain of the subordinate bonds outstanding. These subsidies have been reduced slightly in the past and could be reduced again, however, we have calculated DSC without regard to the receipt of federal subsidies.

Senior bonds have DSRs securing each of their respective series of debt. In total, these reserves total $513.8 million, and will be released as each series of senior bonds mature and are expected to be used to pay debt service when released. None of the subordinate bonds has a DSR.

Economic fundamentals: Very strong

We view Massachusetts' economic fundamentals as very strong. We believe the Massachusetts economy remains deep and diverse, anchored by a Boston metropolitan area that includes many higher education institutions and associated technology companies.

Massachusetts' labor market fared well in 2018, spurred by above-average growth in the high-paying professional, scientific, and technical services sectors. The average annual unemployment rate declined to a very low 3.3% in 2018, following an already low 3.7% in 2017, and compared with a 2018 federal unemployment rate of 3.9%. The U.S. Census Bureau population estimate for Massachusetts in 2018 is 6.9 million, a 0.6% increase from 2017. Over the past 10 years, the commonwealth's population increased 6.7%, compared with 7.6% for the nation. Although below that of the nation, state population growth has outpaced the region since 2007 and we expect this trend to continue. The commonwealth's age dependency ratio of nonworking-age population to working-age population, at 56.3% in 2017, was better than that of the nation (61.8%).

The commonwealth has always had high income levels. Per capita personal income was 130% of the national level in 2018. We expect that income will remain well ahead of that of other states based on the nature of the jobs being created and the pace of expansion. We view the economy as slightly more concentrated in education and health services than the nation as a whole. The increasing role of services in the economy reflects growth in research laboratories, computer software, management consulting, other business services, and health care. Higher education anchors, a high level of federal research funding, and venture capital give the commonwealth a leading edge in emerging industries, such as biotechnology, software, communications equipment, and surgical instruments.

IHS Markit estimates that about 10% of Massachusetts' employment is in high-technology-related industries, compared with 6.5% for the country as a whole. In addition, Massachusetts' defense-related industries continue to perform well, and the commonwealth ranks high in the value of federal defense and research contract awards. IHS forecasts real GSP to increase 2.3% in calendar 2019, 1.9% in 2020, and 1.8% in 2021, slightly under its respective U.S. forecast of 2.5%, 1.8%, and 1.8% for the same years.

Linkage to state general creditworthiness

We view MSBA sales tax obligations as linked to the commonwealth of Massachusetts' creditworthiness. Pledged sales tax revenues are not subject to annual appropriation by the Massachusetts legislature. However, in our view, the collection and distribution of pledged revenues by Massachusetts itself exposes the revenues to Massachusetts operations. For this reason, under our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018), we consider the linkage between the priority lien pledge and Massachusetts to be close. Given Massachusetts' current creditworthiness (AA/Stable), we don't currently view linkage as a limiting rating factor for the authority's debt.

For more information on the state and its economy, see our most recent Massachusetts GO report, published May 24, 2019, on RatingsDirect.

Outlook

The stable outlook reflects our view of the magnitude and diversity of the statewide tax base supporting the bonds. We believe DSC will remain strong and near current coverage levels. Should coverage decline significantly due to deteriorating revenue or an acceleration of debt issuance, this could negatively pressure the rating. We will not likely raise the rating in the two-year outlook horizon based on the possibility of additional debt issuance.