S&P Global Ratings

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Massachusetts; Gas Tax

Primary Credit Analyst:
Scott Shad, Centennial (1) 303-721-4941; scott.shad@spglobal.com

Secondary Contact:
David G Hitchcock, New York + 1 (212) 438 2022; david.hitchcock@spglobal.com

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US$310.0 mil commonwealth transp fd rev rfdg bnds ser 2021A due 06/01/2051		
Long Term Rating	AA+/Stable	New
US$232.0 mil commonwealth transp fd rev bnds (Rail Enhancement Prog) ser 2021B due 06/01/2051		
Long Term Rating	AA+/Stable	New
US$168.0 mil commonwealth transp fd rev bnds (Rail Enhancement Program (sustainability Bnds)) ser 2021A due 06/01/2051		
Long Term Rating	AA+/Stable	New
Massachusetts gas tax		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' rating to the Commonwealth of Massachusetts' estimated $168 million 2021 series A (rail enhancement and sustainability bonds) commonwealth transportation fund (CTF) revenue bonds, estimated $232 million 2021 series B (rail enhancement) CTF revenue bonds, and estimated $310 million 2021 series A CTF revenue refunding bonds. At the same time, S&P Global Rating affirmed its 'AA+' rating on the $2.88 billion parity bonds outstanding, as well as bonds secured by the first-lien special obligation. The outlook is stable.

The CTF bonds are secured by pledged revenues that include motor fuel and gasoline taxes and motor vehicle registration fees levied statewide. The special obligation gas tax bonds are secured by a first lien on 6.86 cents of the state-levied gas tax.

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

Bond proceeds will be used to fund a portion of the Massachusetts Bay Transportation Authority's (MBTA) extension of its Green Line, fund significant rail improvement projects, refund certain maturities of the 2012 series A and 2013 series A CTF bonds for annual interest rate savings, and pay costs of issuance.

Credit overview

Despite a material decline in pledged CTF revenues due to the effects of the COVID-19 pandemic, we expect coverage will remain very strong, albeit moderately lower than historical levels in the near term. More specifically, in fiscal 2020, pledged CTF revenues declined 8.8% to $1.27 billion from $1.39 billion in fiscal 2019, and as of April, year-to-date fiscal 2021 pledged revenues are down 3.4% and 6.9% compared with fiscal years 2020 and 2019, respectively.

Material declines in pledged CTF revenues were highly correlated with statewide COVID-19 restrictions that limited mobility and travel, with more notable declines at the onset of the pandemic (April to June 2020 due to a month lag in collections) and during the 2020 holiday season as infection rates escalated. Nevertheless, the commonwealth's pledged CTF revenues improved significantly in April 2021, up 40% from fiscal 2020 and down a modest 2% from April 2019. Overall, we believe it is likely there will be a recovery in pledged CTF revenues given a general reopening of the commonwealth's economy expected on May 29, ongoing vaccination progress, and easing COVID-19 restrictions, although we note the economy may not recover to pre-pandemic levels in the near term.

Key credit considerations include our view of the following:

- A very strong and diverse economy of 7 million people generating pledged revenues;
- Low revenue volatility, with historically stable pledged revenues prior to the pandemic;
- Very strong debt service coverage (DSC) and liquidity, with 6x coverage of pro forma maximum annual debt service (MADS) following the series 2021 bonds, including combined debt service from prior-lien bonds, by fiscal 2020 pledged revenue that captures revenue loss due to the effects of the pandemic;
- Very strong bond covenants, including a very strong CTF additional bonds test (ABT) requiring 4x coverage of MADS by historical pledged revenues, a closed lien on prior-lien bonds, and a covenant not to allow changes in the rate of motor fuels tax or registry fees unless pledged revenues equal at least 4x MADS. In our view, strong DSC mitigates the lack of a debt service reserve; and
- Our establishment of a one-notch upward limitation on the ratings from that of the GO rating on Massachusetts.

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

Environmental, social, and governance (ESG) factors

We view the decline in pledged CTF revenues to be directly related to changes in economic activity related to the COVID-19 pandemic. We consider Massachusetts' ESG risks as otherwise being generally in line with the state sector, and the commonwealth has historically maintained a stable management and policy framework to respond to developing risks.

Stable Outlook

Upside scenario

We do not expect to raise the rating during the two-year outlook horizon. The rating is limited by our view of Massachusetts' creditworthiness (general obligation [GO] rating: AA/Stable) and is constrained at the current level unless the state GO rating is raised, despite very strong DSC.

Downside scenario

Although unlikely, should there be very significant deterioration in CTF bond DSC we could also lower our rating on the CTF bonds. While the commonwealth's capital program for rail, bridges, and roads could require substantial new capital funding, we feel that the very strong current DSC and very strong ABT should provide strong protection against future debt dilution. We also believe that Massachusetts' substantial and diverse economy will continue to support stability in pledged revenues over time following a recovery from the pandemic.

Credit Opinion

Revenue volatility: Low

We view the pledged revenues as having low volatility based on historical trends despite declines in fiscal 2020 and budgeted declines in fiscal 2021 due to the effects of the pandemic.

The major revenues supporting the bonds include a portion of motor fuels tax revenue, which accounted for 55.7% of total pledged funds (chapter 64A, chapter 64E, and chapter 64F receipts) in fiscal 2020, not including federal Build America bond (BAB) interest subsidies. The fuel tax rate was increased to 24 cents from 21 cents in 2013, with 6.86 cents of that amount pledged to the closed prior-lien special obligation gas tax bonds on a first-lien basis. Excess revenues not needed to cover debt service on the closed first-lien special obligation bonds flow to the CTF revenue bonds. Before 2013, the gas tax rate had not been increased since 2000, and remains below the average gas tax rates charged in the Northeast region. Massachusetts collects gas taxes monthly from gasoline distributors. Due to the effects of the pandemic, motor fuels tax revenue declined 8.7% to $706.3 million from $773.8 million in fiscal 2020, and are conservatively projected to be $577 million in fiscal 2021, or 18.5% lower than in fiscal 2020. Nevertheless, year-to-date actual results are outperforming the conservative estimate with receipts through April 30, 2021 up $45 million, or 9.1% above the budgeted figure. Overall, we expect motor vehicle tax revenues will generally recover to near pre-pandemic levels as the commonwealth's economy reopens and the recovery is sustained, but note they may lag historical levels in the near term. The commonwealth expects a general recovery to pre-pandemic levels by fiscal 2023.

The other key revenue supporting the program is motor vehicle registry fees (44.3% of total revenues in fiscal 2020, excluding BAB subsidies), which are collected daily by the Registry of Motor Vehicles and swept daily by the state treasury and credited to various fee accounts. Passenger vehicle registration fees rose to $60 from $50 in fiscal 2015. Registry fees were also adjusted in fiscal 2009, which offset flat-to-declining revenue performance in previous years. Similar to motor fuels tax revenue, motor vehicle registry fees also declined 8.9% to $561.9 million from $616.8 million in fiscal 2020 due to the effects of the pandemic. While there is no forecast for fiscal 2021 motor vehicle registry fees, year-to-date actual results through April 30, 2021 are trending favorably, up 9.5% compared with fiscal 2020 and 4.3% compared with fiscal 2019 during the same period.

Combined total pledged revenues in fiscal 2020 were $1.27 billion, not including BAB subsidies. This represented an 8.8% decline from the year before due to the effects of the pandemic, following a 0.8% increase in 2019, a 1.0% increase in 2018, and a 1.6% increase in 2016. In fiscal 2015, pledged revenues increased 5.7% when registry fees were substantially raised. Before fiscal 2014, revenue performance was relatively flat, in our view, with small increases in most years and a decline of 1.1% in fiscal 2009 due to the recession, and an earlier 4.7% decline in 2006. We believe the commonwealth has a history of increasing both pledged gas tax and registration fees when necessary to meet Massachusetts' transportation capital program.

Coverage and liquidity: Very strong

Fiscal 2020 pledged revenue of $1.27 billion covers combined first- and second-lien pro forma MADS of $212.2 million in 2024 after this issue, by what we consider a very strong 6.0x, not including BAB subsidy revenues. If pledged CTF revenues recover to 2019 levels, MADS coverage would be 6.6x. MADS coverage on only prior-lien debt secured by only the 6.86-cent fuel tax is also very strong at 5.85x by fiscal 2020 revenue.

The commonwealth anticipates issuing $1.36 billion of parity CTF debt by the end of fiscal 2025 for both the rail and accelerated bridge program, including this issuance, raising $1.75 billion in net bond proceeds including original issue premiums.

We believe there could be significant additional debt, beyond the proposed $1.36 billion of additional debt described above, following the January 2021 transportation bond bill, Chapter 383 of the Acts of 2020, which authorizes $16.2 billion of capital authorization for the commonwealth's transportation infrastructure, expected to be issued as either general obligation bonds or special obligation bonds. The $16.2 billion of capital authorization includes the following:

- $5.1 billion to support the MBTA, proposed as special obligation bonds backed by the CTF, although this is eligible to be issued as GO bonds;
- $1.25 billion of federal highway grant anticipation notes (GANs) for rehabilitation and replacement of bridges;
- $5.4 billion for highway, rail and #transit, planning and multi-modal transportation, #transportation IT, and grant programs and local projects, and is #eligible to be issued as either GO #bonds or special obligation bonds; and
- $4.4 billion for federally aided highway projects, with $880 million eligible to be issued as either GO or special obligation bonds.

Despite the potential additional issuance, we view the very strong 4x ABT and the need to use surplus CTF funds for transportation operations as providing significant protection against DSC dilution from future debt issuance. However, we believe the potential remains for the CTF to become a regular contributor to the MBTA's very significant capital plans as the authority continues to work on extending and improving its Green, Orange, and Red mass transit lines as well as extending the South Coast Rail which is part of the commuter rail.

Nevertheless, the commonwealth projects DSC will remain very strong, at least 4.9x through 2054 (down modestly from the 5.1x minimum coverage projection made at the time of the last sale of bonds), based on current anticipated future debt issuance and no increase in the projected fiscal 2020 revenue of $1.27 billion, excluding federal BAB interest subsidies, although we note the potential for a recovery in pledged CTF revenues following the pandemic could modestly improve DSC levels.

The fuel tax and registration fees pledged to the bonds are deposited in a revenue account of the CTF, where it is subject to annual appropriation by the state before transfer to the bond debt service account. We believe appropriation risk is mitigated by trust agreement covenants that prevent the large amount of surplus pledged revenue available ($1.27 billion in fiscal 2020 excluding BAB subsidies) from being used for other purposes until debt service is paid first. Since the first issuance of special obligation bonds in 1992, the legislature has never failed to make the required appropriations.

Economic fundamentals: Very strong

We view Massachusetts' economic fundamentals as very strong. We believe the Massachusetts economy, anchored by a Boston metropolitan area that includes many higher education institutions and associated technology companies, represents an important credit strength.

Massachusetts' recent economic experience has mirrored national trends, although per capita income has increased slightly faster than that of the nation, spurred by growth in the high-paying professional, scientific, and technical services sector that suffered less in the recent recession than lower-paying service sector jobs. The average annual unemployment rate hit a low of 3.0% in 2019, compared with 3.7% for the U.S., before jumping up to 8.9% in the 2020 recession year, compared with a national rate of 8.1%.

The U.S. Census Bureau population estimate for Massachusetts in 2020 is 7 million, comparable with 2019, and the five- and 10-year compound growth rate of 0.3% and 0.5%, respectively, trailed the nation's 0.5% and 0.6%, respectively. The commonwealth's age dependency ratio of nonworking age population to working age population, at 57.8% in 2019, was better than that of the nation (63.1%).

The commonwealth has always had high income levels. Per capita personal income of $79,721 nudged up to 133% of the U.S. in 2020, from 132% in 2019, and 127% in 2014, in spite of economic restrictions imposed by the pandemic. State per capita income ranks second highest among all the states. We expect that income will remain well ahead of that of other states based on the highly educated workforce that has jobs more conducive to telecommuting. IHS Markit estimates that real gross state product (GSP) has mirrored national trends recently, despite initially a very high unemployment rate due to restrictions imposed on economic activity as the pandemic began. IHS Markit forecasts real GSP to rise 6.7% in 2021, 4.2% in 2022, and 2.2% in 2023, comparable with the respective U.S. forecasts of 6.2%, 4.3%, and 2.2% for the same years. In 2020, GSP per capita of $84,722 was strong at 133% of that of the nation's GDP.

We view the economy as slightly more concentrated in education and health services than the nation as a whole. Education and health services accounted for 22.5% of total state nonfarm employment in 2020 according to the Bureau of Labor Statistics, compared with 16.4% for the nation. This is followed by professional business services (17.2% versus 14.4%), and trade and transport (15.7% versus 18.8% nationally). The manufacturing and construction sectors, known for their cyclicality, represented only 6.8% and 4.5% of employment, respectively.

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 gives the commonwealth a leading edge in emerging industries, such as biotechnology, software, communications equipment, and surgical instruments. IHS Markit has estimated about 10% of state employment is in high-technology-related industries. In addition, Massachusetts has defense-related industries that have ranked high in the value of federal defense and research contract awards.

Linkage to commonwealth general creditworthiness

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

For more information on our Massachusetts GO rating, see our most recent analysis, published April 27, 2021, on RatingsDirect.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020