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CREDIT OPINION
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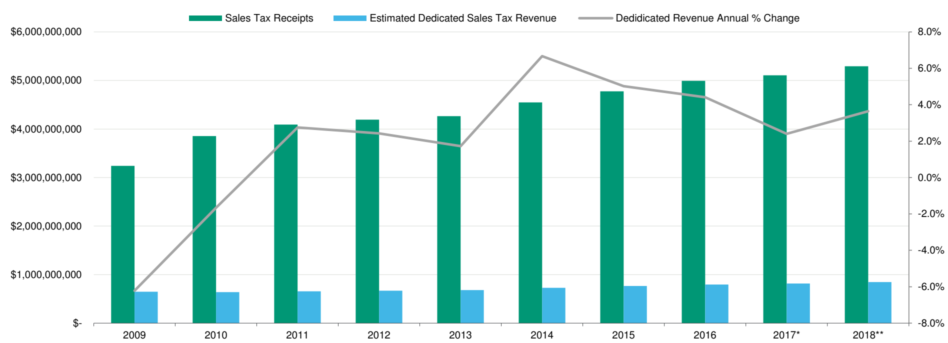
# Massachusetts School Building Authority, MA

Update to credit analysis

## Summary

Massachusetts School Building Authority's (senior lien Aa2; subordinated lien Aa3; stable) credit benefits from a gross one percent sales tax revenue pledge collected statewide. The commonwealth's healthy economy has resulted in year-over-year pledged revenue growth, which will help support the authority's future issuance plans.

Exhibit 1
**Annual pledged revenue growth tied to statewide economy**




*Estimated data for 2017; **Projected data for 2018
*Source: Massachusetts School Building Authority; Moody's Investors Service*

## Credit strengths

» An economic base characterized by high wealth and high levels of educational attainment

» Statutory pledge to not reduce the sales tax rate or divert pledged revenue

» Sales tax allocation does not require appropriation, flows to trustee for benefit of bondholders before allocation to capital program or administrative costs of authority

## Credit challenges

» Economically sensitive pledged revenue source

» Planned additional leverage

» Potential for legislation to increase current $10 billion issuance cap

## Rating outlook

The stable outlook reflects our expectation that this revenue stream will continue to perform well over the long term, as indicated by its historical pattern of solid sales tax growth during periods of economic vitality. Given MSBA's multi-billion dollar borrowing plan, we expect the authority to leverage the program close to the additional bonds test.

## Factors that could lead to an upgrade

» Upgrade of the commonwealth's general obligation rating

» Increase in MADS coverage, including expected future issuances

» Changes in legal covenants that strengthen bondholder protection

## Factors that could lead to a downgrade

» Downgrade of commonwealth's general obligation rating

» Economic or statutory changes to the commonwealth's sales tax base that negatively affect pledged revenues

» Significant issuance of short term debt that is not included in leverage or debt service coverage calculations

## Key indicators

Exhibit 2

| Massachusetts School Building Authority Senior Dedicated Sales Tax Bonds | FY 2012 | FY 2013 | FY 2014 | FY 2015 | FY 2016 |
|---|---|---|---|---|---|
| Coverage of Maximum Annual Debt Service (x) | 1.7x | 1.9x | 2.1x | 2.3x | 2.3x |
| Total Debt Outstanding (Mil.) | 5,000 | 5,200 | 5,200 | 5,345 | 5,255 |
| Pledged Revenue (Mil.) | 670 | 682 | 728 | 764 | 798 |
| Additional Bonds Test (x) | 1.4x | 1.4x | 1.4x | 1.4x | 1.4x |

*Debt table reflects senior lien debt
*Source: Massachusetts School Building Authority; Moody's Investors Service*

## Profile

The Massachusetts School Building Authority (MSBA) is an independent authority that was created by the Massachusetts Legislature in July 2004 to replace the commonwealth's former school building assistance program. The purpose of the program is to sustainably finance grants to cities, towns, and regional school districts for school construction and renovation projects.

The Commonwealth of Massachusetts is the 15th largest state by population, boasting an estimated 6.8 million residents in 2016. Its gross domestic product, reaching $505.8 billion, ranks 11th among the states. Per capita income was 131.4% of the national average in 2016, the 2nd highest.

## Detailed credit considerations

### Tax base and nature of the pledge

The MSBA bonds are secured by a gross pledge of one cent of dedicated statewide sales taxes. The dedicated sales tax allocation includes the general sales tax, excluding food but including motor vehicles. The tax does not apply to vendors in the vicinity of the Boston (Aaa stable) convention center and the Springfield (A2 stable) civic and convention center.

The state has taken steps to enhance the pledge, including an expansion in 2009 to include alcoholic beverages that was repealed by voters effective January 1, 2009 and a guaranteed sales tax allocation between fiscals 2005 and 2009. During this time the MSBA received amounts that were greater than the actual pledge level, thereby insulating it to some extent from the impact of the recession. Beginning in fiscal 2011, the MSBA received 100% of the dedicated amount with no floor or ceiling.

A voter petition to reduce the state's total sales tax rate from 6.25% to 5.0% is currently pending certification by the state legislature. Any reduction, however, is not expected to negatively impact collections securing the authority's debt.

## Debt service coverage and revenue metrics

Using a 2% annual growth estimate for pledged sales tax revenues, MADS coverage is 2.4x across all pledged revenues. Fiscal 2017 revenues are projected to provide satisfactory debt service coverage of approximately 1.9 times maximum annual debt service across both senior and second lien bonds. This figure includes federal subsidies on prior bonds for the Build America Bonds (BABs) and Qualified School Construction Bonds (QSCBs), as well as expected debt service reserve fund releases and interest income.

Fiscal 2016 pledged sales tax revenues were $798.6 million, representing 4.4% annual growth over fiscal 2015. Estimated fiscal 2017 revenues reached $816.8 million, or a 2.4% year-over-year increase, with the authority projecting a 3.6% increase in fiscal 2018. Year-to-date total statewide sales tax collections were 3.1% over previous year's collections as of November 2017.

### LIQUIDITY

The pledged sales tax stream provides timely and ample liquidity for the payment of debt service.

## Debt and legal covenants

Given the magnitude of MSBA's capital program and borrowing plan, we expect debt issuance will likely be leveraged closely to the additional bonds tests. The MSBA will have slightly over $6.0 billion amount outstanding, post sale, well below the statutory limit of $10 billion. Of this total, approximately $5.3 billion are secured by a senior lien, while $688.4 million are secured by a subordinated lien. The authority also plans to continue cash funding of significant numbers of projects, as well as continuing its annual practice of defeasing debt as opportunities arise.

The additional bonds tests for both the senior and subordinated liens bonds are relatively weak at 1.4x and 1.3x, respectively. The tests are further diluted by permitting either a historical or a projected revenue test. The master trust provides for a debt service reserve for long-term bonds, but the required level, if any, is set by each supplemental trust agreement. The current issuance will not benefit from a reserve fund.

The strength of the one cent sales tax pledge is enhanced by additional covenants of the commonwealth. First, Massachusetts has agreed to not reduce the sales tax rate or divert the revenue stream, although the sales tax base could be altered by state statute or federal actions beyond the commonwealth's control. For example, legislation passed by the US Congress in 2004 exempted certain telecommunications services from the Massachusetts sales tax. The impact on the sales tax dedicated to MSBA was modest, at less than 1% of its allocation. Additionally, state law limits future grants to the lesser of sales tax growth or 4.5%.

### DEBT STRUCTURE

Post sale all of the authority's debt is long-term and fixed rate. The Authority issued two short-term debt sales in fiscal 2015 but both have been retired and the Authority does not expect to issue additional short-term debt over the near term. It may enter into a new commercial paper program, though a final decision has not been made.

### DEBT-RELATED DERIVATIVES

The authority does not have any derivative products outstanding.

### PENSIONS AND OPEB

Pensions and OPEB are not a major factor in Moody's special tax methodology.

## Governance

MSBA governance consists of the state treasurer, as chairperson the secretary of administration and finance, and the commissioner of elementary and secondary education (or their designees) and four other members appointed by the treasurer, each of whom serve two-year terms. The treasurer also appoints the MSBA's executive director. It is prohibited from filing for bankruptcy.

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