S&P Global
Ratings

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Summary:
Massachusetts; Miscellaneous Tax

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Summary:

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Massachusetts misc tax (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Negative	Downgraded
Massachusetts misc tax (FGIC) (National)		
Unenhanced Rating	BBB+(SPUR)/Negative	Downgraded
Massachusetts misc tax (FGIC) (National) (AGM)		
Unenhanced Rating	BBB+(SPUR)/Negative	Downgraded

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings has lowered its rating on the Commonwealth of Massachusetts' special obligation dedicated tax revenue bonds series 2004 and revenue refunding bonds series 2005 to 'BBB+' from 'A'. The outlook is negative.

Securing the bonds are pledged revenues, which include certain room occupancy taxes, vehicle rental surcharges, and sales tax and sightseeing surcharges that Massachusetts collects within the cities of Boston, Cambridge, Springfield, Worcester, and Chicopee, as well as the town of West Springfield.

The downgrade reflects a significant drop in pledged tax revenue as a result of pandemic-related restrictions on economic activity, and S&P Global Ratings' assessment that national hotel-related economic activity might take until 2023 to recover (see "The U.S. Lodging Sector: A Slower Recovery Could Take Until 2023," published Nov. 5, 2020, on RatingsDirect). The Massachusetts Convention Center Authority projects pledged revenue in fiscal 2021 at a level that will only barely cover annual debt service at 1.03x, while we calculate that if full-year 2021 pledged revenue matched the 75% drop in one-month September 2020 revenue compared with one-month September 2019 revenue, coverage of annual debt service in fiscal 2021 would be only 0.77x. This is a large turnaround from the high 3.01x coverage of annual debt service that occurred in fiscal 2019.

The rating is not lower because we expect the commonwealth's hotel- and entertainment-related activity to recover as the nation emerges from the COVID-19 pandemic, while the bonds' revenue fund fund currently has enough money to pay the next three semiannual debt service payments through July 1, 2022, even if no further pledged revenue is received, not counting an additional convention center capital reserve fund sized at maximum annual debt service (MADS) and funded with $53 million of cash in place of an earlier unrated surety with National Public Finance Guarantee Corp. The negative outlook reflects at least a one-in-three chance we could lower the rating further if a recovery in hotel and related economic activity becomes substantially delayed from our current expectations, or if there is a significant debt service reserve draw in January 2021, the next semiannual debt service due date, without likelihood of near-term replenishment.

Credit overview

The bonds are rated under our priority-lien tax revenue debt criteria , published Oct. 22, 2018.

We base our rating on what we view as:

- Massachusetts' role as a national and international commercial and tourism center;
- Good 3.10x historical coverage of MADS by fiscal 2019 pledged gross revenues, which are available to service debt regardless of convention center operating performance, and a covenant to increase the pledged hotel tax in Boston, if necessary, under certain instances;
- Once the pandemic recedes, coverage should recover to near formerly high levels, and reserves can cover at least the next three semiannual debt service payments in order to allow time for that to happen;
- Stringent covenants that permit the release of excess revenues from the convention center fund only under limited circumstances, after meeting projected debt coverage tests and consent of both the state treasurer and secretary of administration and finance;
- Debt service payments that are not subject to annual legislative appropriation; and
- A good 1.50x additional bonds test (ABT).

Offsetting factors include:

- Pandemic-related declines in pledged revenues are expected to lower annual debt service coverage in fiscal 2021 to a slim 1.03x, based on the convention center's forecast, and to less than 1x coverage if September 2020 revenue levels prevail throughout the fiscal year;
- S&P Global Ratings' forecast that a recovery of the national hotel industry will likely extend into 2023;
- The narrow and cyclical nature of the pledged revenues that have experienced decline in recessionary periods, apart from the current pandemic, and
- Although on hold for now, there is the potential for significant additional parity bonding to accommodate a planned $1.1 billion Boston Convention Center expansion, although such additional bonding would likely also be offset by additional state pledged revenues.

Environmental, social, and governance factors

We view the decline in pledged hotel, vehicle rental, and related sales tax to be directly related to changes in economic activity related to the COVID-19 pandemic. We consider Massachusetts' environmental, social, and governance 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.

Negative Outlook

Downside scenario

Should we believe that recovery in pledged revenues will take longer than the 2023 time frame we foresee for national recovery of the hotel industry, keeping coverage of debt service by pledged revenue at low levels into fiscal 2022, or resulting in a significant near-term draw on the debt service reserve, we could lower the rating.

Upside scenario

If we believe current-year revenues can cover annual debt service, there is no draw on the debt service reserve in January 2021, and we believe coverage of debt service will sustainably rise above the 1.5x ABT in following years, we could make a positive revision to our outlook or raise the rating.

Credit Opinion

Bond authorizations

There have been two bond issues to date under this lien. Series 2004, since retired, funded the construction of a 1.6 million-square-foot convention and exhibition facility in Boston, and provided funds for renovations of convention centers in Springfield and Worcester. The series 2005 bonds refunded certain 2004 bonds for net present value savings.

In 2014, the governor approved legislation that would provide for a $1.1 billion expansion of the Boston

Convention Center, financed by additional parity debt. In October 2019, additional legislation was filed modifying the 2014 expansion plan, which did not contain authorization for additional parity debt, but this new legislation has not been approved at present. Should additional parity debt be authorized, we believe Massachusetts is likely to increase tax revenue to support the additional debt service.

Economic fundamentals: Strong

Apart from the effects of the COVID-19 pandemic, we view the large economic base generating the tax as strong and diverse. Although the economic base does not cover the whole commonwealth, it covers Massachusetts' major metropolitan areas of Boston, Cambridge, Springfield, Worcester, and Chicopee, as well as the town of West Springfield. In normal times, this generates significant visitor traffic for business purposes and tourism.

Revenue volatility: Moderately high

Pledged revenues grew strongly for 10 years following the Great Recession, rising 11.8% alone in fiscal 2019, the last audited year, to $164.2 million. However, the Massachusetts Convention Center Authority, in conjunction with third-party consultants, now forecasts that pledged revenue in the fiscal year ending June 30, 2021, will fall to $53.7 million, a large 67.3% decline from fiscal 2019's level.

Recent monthly revenues so far in fiscal 2021 look even worse. Fiscal year-to-date pledged revenue for the three months through September 2020 were 84% below the comparable period the year before. One-month September 2020 pledged revenue was 75% below the one-month September 2019 level.

Once the pandemic is over and revenue returns to normal, we believe the pledged revenue stream will remain subject to some cyclicality, based on historical fluctuations. Pledged revenue declined 17.6% in fiscal 2002, 1.7% in 2003, 6.4% in 2009, and 0.8% in 2017. However, long-term average pledged revenue growth has been strong. Revenue grew 11.8% in fiscal 2019 and 9.8% in 2018, and increased in total 122.2% from 2009-2019. Room occupancy taxes were historically the majority of pledged revenues, comprising 69% of pledged revenue in the first three months of fiscal 2020, but since the pandemic started, sales taxes on meals have been the greater part of pledged revenue. For the first three months of fiscal 2021 sales taxes on meals comprised 50% of pledged revenue, and room occupancy taxes only

43%.

Coverage and liquidity: Weak

Until the COVID-19 pandemic, combined pledged revenue increased strongly, more than doubling in the past 10 years and producing rising debt service coverage. Pledged revenue produced what we view as strong 3.01x annual debt service coverage in fiscal 2019, and using the new lower MADS that occurs after 2019, MADS coverage was 3.10x.

However, the Convention Center Authority, in conjunction with third-party consultants, now forecasts that pledged revenue will fall 67.3% from 2019 levels to $53.7 million in fiscal 2021. This level of revenue would provide only slim 1.03x coverage of fiscal 2021 annual debt service and in our view could potentially trigger a reserve draw at the next semi-annual debt service due date in January when both principal and interest are due six months into fiscal 2021. Only $8.6 million of pledged revenue was collected in the first three months of fiscal 2021. Assuming the one-month September 2020 revenue decline of 75% compared with the year earlier period were to continue throughout the whole 2021 fiscal year, we calculate annual debt service coverage would be only 0.77x.

The authority reports that as of Sept. 30, 2020, the revenue fund had a balance of $99.4 million, or enough to cover the combined Jan. 1, 2021, semiannual debt service payment of $38.4 million; the following July 1, 2021, semiannual interest payment of $13.2 million; and the following Jan. 1, 2022, principal and interest payment of $39.2 million; assuming no pledged revenue collection at all. In addition, the convention center reported a capital reserve fund balance cash funded at $53 million (MADS), in place of an earlier unrated surety agreement from National Public Finance Guarantee Corp., as successor to Financial Guaranty Insurance Co. The capital reserve fund may only be used to pay debt service, if necessary. We view these levels of reserves as providing potential time for pledged revenue to recover once the pandemic ends, although the revenue fund can legally have outflows to a convention center fund as long as the current fiscal year's debt service is funded. The convention center fund currently holds $321.9 million, and is used to pay convention center expenses, although it can also be used to pay debt service. Fiscal 2021 annual debt service is $52.3 million, and fiscal 2022 annual debt service is $52.4 million.

The current ABT requires either 1.5x historical coverage of MADS after additional debt issuance, or a projected 1.5x revenue test in the fifth year after new bond issuance, if each rating agency that maintains a rating on the bonds affirms the then current rating.

Linkage to commonwealth general creditworthiness

Because the commonwealth collects the pledged revenues, we view the rating on the convention center bonds as linked to Massachusetts' creditworthiness. In our establishment of a one-notch upward limitation on the convention center revenue bond rating compared to the state GO rating, we included our view that Massachusetts provides critical public services into our analysis. While we consider that statutory and bond covenant restrictions on the use of convention center fund 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. However, because our GO rating on Massachusetts is substantially higher than our priority-lien rating on the convention center bonds, we do not see the commonwealth rating as a limitation on the rating on the convention center bonds.

The Boston Convention Center

The Boston Convention Center project is a joint financing project (although separately secured) between the city through its Boston Redevelopment Authority, and the commonwealth through its Massachusetts Convention Center Authority. In accordance with the Convention Center Act that created the financing authority in 1997, Massachusetts has been collecting and segregating excess pledged receipts in the convention and exhibition center fund. The convention center's net position declined by $13.9 million in fiscal 2019 to $679.5 million, and its unrestricted net position was negative $7.0 million, with unrestricted cash and cash equivalents of $32.4 million, according to the commonwealth's fiscal 2019 comprehensive annual financial report. In addition, Massachusetts must certify annually that current receipts, or current receipts plus retained receipts, cover 1.5x MADS. A portion of the retained receipts in fiscal 2010 were required to meet the annual coverage requirement of 1.5x MADS.

In addition, and in accordance with the authorizing legislation and bond trust agreement, if on the last day of any fiscal year the balance on deposit in the capital reserve fund is lower than the capital reserve fund requirement, the 2.75% convention center financing fee imposed within Boston shall be increased to the maximum rate permitted by law until the balance on deposit in the capital reserve fund again equals the capital reserve fund requirement. However, the overall hotel tax rate in Boston cannot exceed 14% (it is currently 12.2%).

(For more information on the Commonwealth of Massachusetts, please see our most recent GO rationale, published Nov. 10, 2020, on RatingsDirect.)

Related Research

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