S&P Global
Ratings

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Summary:
Massachusetts; Miscellaneous Tax

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Table Of Contents

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Credit Profile		
Massachusetts misc tax (wrap of insured) (FGIC & BHAC) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Massachusetts misc tax (FGIC) (National)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Massachusetts misc tax (FGIC) (National) (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rating Action

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

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 upgrade reflects recent recovery in pledged revenues, as evidenced by a strong rebound in monthly pledged revenues during fiscal 2022, following significant declines in pledged tax revenue in fiscal 2021 as a result of pandemic-related restrictions on economic activity. Pledged revenue coverage of maximum annual debt service (MADS) in fiscal 2021 was only 0.87x, a large drop from 2.75x in fiscal 2020, and 3.01x in fiscal 2019, the last full fiscal year before the onset of COVID-19 pandemic. However, fiscal year-to-date pledged revenue collected in the first 10 months of fiscal 2022 already shows good 1.97x coverage of MADS on an unaudited basis, despite a 26% revenue drop from the comparable (pre-pandemic) 10-month period in fiscal 2020. One-month April 2022 pledged revenue was 11% below pre-pandemic one-month April 2019 collections. The Massachusetts Convention Center Authority re-opened at the end of May 2021, which helped boost hotel taxes, which are the largest portion of pledged revenue. Based on recent trends, and S&P Global Ratings' national outlook for the hospitality industry (see "U.S. Lodging Trends Move Toward Normal As Macro Risks Rise," published May 4, 2022, on RatingsDirect), we believe debt service coverage should revert to levels comparable with those pre-pandemic over the course of the next year.

Even when debt service coverage fell below 1x in fiscal 2021, the bond trustee did not dip into a pledged capital reserve fund, sized at MADS, and funded with $53 million of cash in place of an earlier unrated surety with National Public Finance Guarantee Corp., as a result of the commonwealth withholding extra revenue in fiscal 2020 in anticipation of its use in fiscal 2021 to meet potential pledged revenue shortfalls. We anticipate that reserves will remain intact.

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;
- A gross pledge of hotel and car rental taxes that is not dependent on net revenue of the Massachusetts Convention Center Authority, and debt service payments that are not subject to annual legislative appropriation;
- Anticipated increases in pledged coverage that should bring annual debt service coverage close to 2x on an ongoing basis, based on recent monthly revenue collections and renewed Boston hotel activity, following less than 1x coverage in fiscal 2021;
- Our assessment that the U.S. lodging sector has completed its recovery from the effects of the recent pandemic (see "U.S. Lodging Trends Move Toward Normal As Macro Risks Rise," May 4, 2022); and
- A good 1.50x additional bonds test (ABT).

Offsetting factors include:

- The narrow and cyclical nature of the pledged revenues that have experienced decline in recessionary periods, apart from the recent pandemic; and
- Although on hold for now, there is the potential for significant additional parity bonding to accommodate a previously proposed $1.1 billion Boston Convention & Exhibition Center expansion, although such additional bonding would likely be offset by additional state pledged revenues.

Environmental, social, and governance

Pledged revenues reflect business and tourism activity in the state's major cities. Environmental factors are a moderately negative consideration in our credit rating analysis due to the link to business activity within the state. The state has coastal exposure, with about two-thirds of its population in the Boston MSA. However, we note that the commonwealth has been addressing environmental risks since 2004 through its Climate Protection Plan.

Stable Outlook

Downside scenario

Should audited fiscal 2022 pledged revenue not show significant recovery, as indicated by unaudited year-to-date monthly fiscal 2022 revenue figures, or revenue dip materially in future years, we could lower our rating.

Upside scenario

If we believe audited pledged revenue will show sustained debt service coverage at very high levels, and there continues to be no near-term plans for significant additional parity bonding, 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 legislation was not approved at that time. Should additional parity debt be authorized, we believe Massachusetts is likely to increase tax revenue to support the additional debt service.

Economic fundamentals: Strong to very strong

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: Moderate

Pledged revenues increased strongly for 10 years following the Great Recession, rising 11.8% alone in fiscal 2019, the fiscal year preceding the pandemic, to $164.2 million. However, pledged revenue fell 11.2% to $145.8 million in fiscal 2020, and fell 68.6% to $45.7 million in fiscal 2021, the last audited year, as a result of pandemic-related restrictions on economic activity. From peak to trough, pledged revenues fell 72.1% from fiscal years 2019 to 2021.

However, unaudited commonwealth monthly revenue collections have shown a strong rebound so far in in the fiscal year ending June 30, 2022. Year-to-date pledged revenue collections through April 2022, were $104.5 million, or 220% above the same year-to-date period the previous year.

While revenue volatility in fiscal 2021 might be considered high, we have made an analytical adjustment to reflect what we believe will be moderate volatility, reflecting the temporary and unique nature of the pandemic, and the strong rebound in pledged revenue so far in fiscal 2022 and that expected to continue on an ongoing basis.

Room occupancy taxes have historically been the majority of pledged revenues, comprising 60% of pledged revenue in the first ten months of fiscal 2022, and slightly higher percentages in pre-pandemic periods. Sales, meals, and sales services comprised the next highest revenue at 30%.

Coverage and liquidity: Weak to adequate

Until the COVID-19 pandemic, combined pledged revenue increased strongly, more than doubling over 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 went into effect after 2019, MADS coverage was 3.10x. Fiscal 2020 still produced strong 2.79x annual debt service coverage because pandemic restrictions only went into effect toward the end of the fiscal year ended June 30, 2020. However, 2021 coverage of annual debt service in fiscal 2021 was only 0.87x, and coverage of MADS was slightly less at 0.86x. The state was able to make debt service payments without dipping into the capital reserve fund by withholding extra revenue during fiscal 2020 in anticipation of its use for debt service in fiscal 2021.

Recent renewed economic activity as pandemic restrictions have eased have helped pledged revenue bounce back. Unaudited cumulative pledged revenue in fiscal 2022 collected year to date only through April 2022 totaled $104.5 million, covering MADS of $53,014 by 1.97x, and by 2.37x on a pro forma annualized basis.

Massachusetts reports that as of April 30, 2022, the convention center revenue fund had a balance of $142.9 million, although the revenue fund can legally have outflows to pay convention center expenses as long as the current fiscal year's debt service is funded. 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.

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 with 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 & Exhibition Center

The Boston Convention & Exhibition 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 $5.3 million in fiscal 2021 to $651.7 million, and its unrestricted net position was negative $15.1 million, with unrestricted cash and cash equivalents of $26.3 million, according to the commonwealth's fiscal 2021 comprehensive annual financial report. In addition, Massachusetts must certify annually that current receipts, or current receipts plus retained receipts, cover 1.5x MADS. A held over portion of the retained receipts in fiscal 2020 were required to meet the 2021 annual coverage requirement of 1.5x MADS in fiscal 2021; in fiscal 2010, a similar retention occurred in order to meet the coverage requirement.

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%).

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Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022