Massachusetts; Gas Tax; Miscellaneous Tax

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Credit Profile		
US$200.0 mil rev bnds (rail enhancement program) (sustainability bnds ser 2022 A due 06/01/2052		
Long Term Rating	AA+/Stable	New
US$100.0 mil rev bnds (rail enhancement program) ser 2022 B due 06/01/2052		
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 $200 million 2022 series A (rail enhancement sustainability bonds) commonwealth transportation fund (CTF) revenue bonds, and estimated $100 million 2022 series B (rail enhancement) CTF revenue bonds. At the same time, S&P Global Rating affirmed its 'AA+' rating on the state's $2.88 billion parity bonds outstanding. 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 commonwealth also issued special obligation gas tax bonds, which were secured by a first lien on 6.86 cents of the state-levied gas tax. However, the special obligation bonds final maturity occurred June 1, 2022.

We rate the bonds based on our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018, on RatingsDirect), 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 and South Coast Rail and pay costs of issuance.

Credit overview

Coverage has remained very strong for the pledged CTF revenues, albeit moderately lower than historical levels. The commonwealth has seen improvement from the material decline in pledged CTF revenues in in fiscal 2020 as a result of the COVID-19 pandemic. In fiscal 2020, pledged CTF revenues declined 8.8% to $1.26 billion from $1.39 billion in fiscal 2019, but grew slightly by 1.3% in fiscal 2021. Fiscal 2021 pledged revenues at $1.28 billion remained about 7.6% below pre-pandemic levels. However, year-to-date fiscal 2022 pledged revenues have improved by 3.2% compared with same period for 2021 and about 95% of fiscal 2019 levels. 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 and during the 2020 holiday season as infection rates escalated. Overall, we expect ongoing recovery in pledged CTF revenues given continued reopening of the commonwealth's economy.

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 over 5x coverage of pro forma maximum annual debt service (MADS) following the series 2022 bonds by fiscal 2021 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 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

We view the decline in pledged CTF revenues to be directly related to changes in economic activity within the state. We consider Massachusetts' environmental risks elevated because of the state's coastal exposure, while social and governance risks are being neutral to our credit analysis of its general creditworthiness. The commonwealth has historically maintained a stable management and policy framework to respond to developing risks. For more information about our rating on the state, please see our summary analysis on Massachusetts, published Jan. 20, 2022.

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 (GO rating: 'AA/Stable') and is constrained at the current level unless the state GO rating is raised, despite very strong DSC.

Downside scenario

We could lower the rating if we lower our GO rating on Massachusetts. 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

Economic fundamentals: Very strong

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

The commonwealth's economy had a steeper decline than the nation during the initial stages of the COVID-19 pandemic due to stricter lockdown restrictions, but has since come back strongly. Per capita income has increased slightly faster than that of the nation, and is the second highest in 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%. IHS Markit forecasts continued employment growth slightly slower than the nation in 2022 at 3.1% compared to its forecast of 3.8% for the U.S.

The U.S. Census Bureau population estimate for Massachusetts in 2020 slightly under 7 million, with the five year compound growth rate of 0.2%, trailing the nation's 0.5%. In our view, the state's economic fundamentals and key anchors, which center on higher education, technology, finance, and health care, should contribute to continued expansion and stable pledged transportation-related revenue.

Revenue volatility: Low

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Based on the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles, it is used to inform our opinion on expectations of future volatility.

We view the pledged revenues as having low volatility based on historical trends despite recent declines. The major revenues supporting the bonds include a portion of motor fuels tax revenue, which accounted for 52% of total pledged funds (chapter 64A, chapter 64E, and chapter 64F receipts) in fiscal 2021, 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 prior-lien special obligation gas tax bonds, which have now matured, on a first-lien basis. The gas tax rate remains below the average gas tax rates charged in the Northeast region. Massachusetts collects gas taxes monthly from gasoline distributors.

The other key revenue supporting the program is motor vehicle registry fees (48% 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.

Due to the effects of the pandemic, pledged revenue declined 8.8% in fiscal 2020. The revenues showed a slight rebound in fiscal 2021, growing about 1.3%. Overall, we expect revenues will generally recover to near pre-pandemic levels as the commonwealth's economy recovers but note they may lag historical levels in the near term. The commonwealth expects a general recovery to pre-pandemic levels by fiscal 2023. We believe it has a history of increasing both pledged gas tax and registration fees when necessary to meet its transportation capital program.

Coverage and liquidity: Very strong

Fiscal 2021 pledged revenue of $1.28 billion covers pro forma MADS of $229.4 million in 2024 after this issue, by what we consider a very strong 5.7x, not including BAB subsidy revenues.

The commonwealth anticipates issuing an additional $1.08 billion of parity CTF debt by the end of fiscal 2026 for both the rail and accelerated bridge programs. We believe there could be significant additional debt, beyond the proposed 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 GO bonds or special obligation bonds. However, the commonwealth indicates the capital authorization covers all of the projected project costs before anticipated federal reimbursements, which could reduce the amount of actual bonds needed.

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 commuter rail line South Coast Rail. Nevertheless, the commonwealth projects DSC will remain very strong, through 2056, based on current anticipated future debt issuance and no increase in the projected fiscal 2021 revenue, 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 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.

Linkage to commonwealth general creditworthiness

Because the commonwealth collects the pledged revenues, we view the rating on the CTF 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.

Related Research

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

Ratings Detail (As Of June 1, 2022)		
Massachusetts gas tax		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts (Accelerated Bridge Prog) gax tax		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts (Accelerated Br Prog) GASTAX		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts (Rail Enhancement & Accelerated Bridge Progs)		
Long Term Rating	AA+/Stable	Affirmed
Massachusetts (Rail Enhancement & Accelerated Bridge Progs) GASTAX		
Long Term Rating	AA+/Stable	Affirmed