

# RatingsDirect®

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## Summary:

# Massachusetts Bay Transportation Authority; Sales Tax

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## Summary:

# Massachusetts Bay Transportation Authority; Sales Tax

### Credit Profile

US\$510.29 mil sr sales tax bnds (Massachusetts) ser 2023 A-1 due 07/01/2053

*Long Term Rating* AA/Positive New

US\$107.975 mil sr sales tax bnds (Massachusetts) (Sustainability Bnds) ser 2023 A-2 due 07/01/2038

*Long Term Rating* AA/Positive New

#### **Massachusetts Bay Transp Auth, Massachusetts**

Massachusetts

Massachusetts Bay Transp Auth, Massachusetts

Massachusetts Bay Transp Auth (Massachusetts) sales tax

*Long Term Rating* AA/Positive Affirmed

#### **Massachusetts Bay Transp Auth, Massachusetts**

Massachusetts

Massachusetts Bay Transp Auth, Massachusetts

Massachusetts Bay Transp Auth (Massachusetts) sales tax

*Long Term Rating* AA/Positive Affirmed

### Credit Highlights

- S&P Global Ratings assigned its 'AA' rating with a positive outlook to the Massachusetts Bay Transportation Authority's (MBTA) \$618 million senior sales tax bonds, 2023 series A consisting of subseries A-1 and sustainability subseries A-2 bonds.
- We have also affirmed our 'AA' long-term ratings on MBTA's senior and subordinate sales tax-secured bonds as well as our AA / A-1+ dual rating on the authority's variable-rate demand obligations (VRDOs).
- The outlook on all ratings is positive.

### Security

The series 2023 A sales tax bonds and parity debt are secured by a gross pledge of the greater amount of either a statewide sales tax defined as a 1% statewide sales tax which excludes sales tax on meals, plus \$160 million of additional state sales tax per year; or an inflation-adjusted sales tax revenue base amount distributed by the Commonwealth of Massachusetts. The senior sales tax pledge is subordinate to the prior closed-lien general transportation bond obligations outstanding issued before July 2000, to the extent that MBTA does not certify that its general revenues can cover these prior-lien obligations in its annual budget from general revenues. In addition, pledged to the senior sales tax bonds are surplus assessments on 176 cities and towns, after payment of debt service on separate MBTA assessment bonds that have a first lien on those revenues. We understand that both the pledged dedicated sales tax amount and the base amount do not need a legislative appropriation to be used to pay debt

service.

The subordinate sales tax pledge securing the subordinate (second-lien) sales tax bonds consists of the same revenue pledged to the senior sales tax bonds, after payment of senior-lien sales tax bond debt service and senior-lien debt service reserve (DSR) replenishments, if any.

Our long-term rating for MBTA sales tax bond ratings are based on what we perceive to be the stronger pledge of the state-guaranteed base revenue amount or pledged MBTA sales tax revenue. Currently, we view the pledge of state-guaranteed base revenue amount as having a stronger credit quality as it is backed by the commonwealth's guarantee of all sales tax Massachusetts collects. The senior and subordinate sales tax bonds outstanding will continue to have an open lien permitting additional debt issuance using the same additional bonds test (ABT) coverage multiple; as a consequence, we expect debt service coverage (DSC) based on pledged revenue to remain strong and of similar magnitude in the near term for all liens.

The 2023 series A bonds are being issued to fund a portion of the authority's capital investment plan (CIP) and to refund its outstanding commercial paper (CP) notes.

### **Credit overview**

Massachusetts' 'AA' general obligation (GO) rating reflects a strong economy, with the second-highest per capita income level in the nation, partly due to an above-average presence of high-technology companies in the Boston metropolitan statistical area (MSA). The rating further reflects some historical cyclicity in financial results, although recent strong growth in tax collections and federal aid have led to large operating surpluses and reserves, as well as high debt, pension, and other postemployment benefit (OPEB) liabilities, with a history in recent years of funding less than full annual actuarial recommendations to its pension and OPEB funds.

While Massachusetts's revenues have come in much better than the budgetary forecast in the first half of 2023, the state has started to experience softening revenue trends. Through January, fiscal 2023 tax collections for the year to date were up 1.2% over the same period the prior year. Strong tax growth since fiscal 2021 has swelled the commonwealth's budget stabilization fund (BSF) balance, which receives both excess general fund revenue, as well as capital gains tax above an annual benchmark, and certain other lesser revenue sources. The commonwealth's BSF is estimated at \$8.5 billion, or a very strong 12% of expenditures and other uses at the end of fiscal 2023. Its proposed fiscal 2024 budget projects that the BSF will increase to \$9.6 billion at the end of fiscal 2024.

Factors supporting the 'AA' GO rating include what we view as Massachusetts':

- Deep and diverse economy;
- High income levels, with per capita income at 132% of the nation in 2021, the second-highest among the states;
- History of timely monitoring of revenues and expenditures and swift action when needed to make adjustments;
- Strong financial, debt, and budget management policies, including annualized formal debt affordability statements and multiyear capital investment planning; and
- Strong BSF balance, equal to about 10% of expenditures and other uses on a budgetary basis at fiscal year-end 2022.

Offsetting factors include high debt, pension, and OPEB liabilities.

For more information on the Commonwealth, please refer to our most recent summary analysis on Massachusetts, published Oct. 7, 2022, on RatingsDirect.

### **Environmental, social, and governance**

In our view, environmental, social, and governance (ESG) risks reflect those of the Commonwealth of Massachusetts as it pertains to sales tax collection. We consider Massachusetts' environmental risks moderately negative to our credit analysis because of its coastal exposure, with about two-thirds of its population in the Boston MSA and substantial property value in the combined Boston and Cape Cod area. We view social and governance as neutral to the credit analysis.

## **Outlook**

The positive outlook reflects our positive outlook on the commonwealth's GO rating and our view of MBTA's ability to issue future additional parity bonds under its senior- and subordinate-lien ABTs based on the size of base revenue amount. Our outlook also assumes consistently strong DSC over our two-year outlook horizon despite capital pressures.

### **Downside scenario**

Should we lower our GO rating or revise our outlook on the commonwealth, we could lower our ratings on the MBTA sales tax bonds. Significant additional debt leverage that lowers DSC closer to the 1.5x sales tax coverage test portion of the ABT, or a debt structure that included a significant amount of variable-rate or short-term debt in a rising interest rate environment, could also result in our lowering the rating or revising the outlook to stable.

### **Upside scenario**

The rating is limited by our view of Massachusetts' creditworthiness and is constrained at the current level unless the commonwealth GO rating is raised, despite strong DSC. However, if we believe the creditworthiness of MBTA's direct sales tax pledge strengthens enough so that it is stronger than the pledge of the base revenue amount and the ABT provisions are strengthened and we view DSC will likely be sustained at very strong levels on outstanding and future debt, we could raise our ratings above the commonwealth's GO.

## **Credit Opinion**

### **Sales tax pledge**

The senior and subordinated sales tax bonds have been backed by a lien on the 1% statewide sales tax (which excludes sales tax on meals) plus \$160 million per year of commonwealth's sales tax, subordinate to the prior-lien bonds issued before 2000, to the extent that MBTA does not certify that its general revenues can cover these prior-lien obligations in its annual budget from general revenues, with excess sales tax revenues funding subordinate debt service and MBTA general operations.

The 1% pledged sales tax, plus \$160 million per year, are part of the commonwealth's overall 6.25% sales tax rate.

Sales tax revenue declined in the Great Recession, with a cumulative decline of 7.9% in fiscal years 2008-2010. However, as Massachusetts' economy recovered, sales tax has since risen, increasing 0.2% most recently in fiscal 2022.

The ABT requires either 1.0x coverage of combined prior general transportation bonds and combined senior and subordinate sales tax bond MADS by the base revenue amount, or 2.0x coverage and 1.5x coverage of combined senior and subordinated sales tax bond debt service by historical sales tax revenues, net of prior general transportation bond debt service. However, the ABT also allows the authority to issue additional bonds beyond the ABT if it at least equals the base revenue amount. In our view, this could weaken coverage even beyond ABT requirements and weakens our view of the provisions.

Although current DSC is strong, we believe coverage could potentially weaken, in light of the large CIP, and the potential for cost overruns or expanded borrowing. The senior bonds will not have a DSR. MBTA is in process of gathering bondholder consent to convert the senior bond debt service requirement into an aggregate amount, instead of a per series requirement, by voting new bond issues in favor of the amendment.

Combined MADS coverage from all liens on general transportation revenue bonds, senior and subordinate sales tax bonds is very strong, in our opinion, at what we calculate as 2.7x by historical fiscal 2022 pledged actual sales tax revenues, and 2.6x by the 2022 certified state-guaranteed base revenue amount. MBTA anticipates about \$4.4 billion in additional debt in its current CIP through 2028. We believe the lack of a DSR on the bonds is mitigated by strong DSC levels.

### **Base revenue amount**

The commonwealth created a formula for a guaranteed base amount of pledged sales tax revenue should pledged sales tax revenue decline, or not increase as fast as inflation. This base amount was raised by an extra \$160.0 million in fiscal 2015, and subsequently increases annually by the rate of the Boston CPI up to 3% per year, or lower to the extent that the rate the CPI increases is less than 3% but more than the sales tax rate increase (in which case the base amount increase is the rate of increase in sales tax). If neither the CPI nor the sales tax increase in a given year, the base amount is held flat for that year. The base amount has increased to \$1.128 billion, due in fiscal 2023, compared with \$787 million in 2013. MBTA also receives other commonwealth money and federal revenues that are not pledged to the sales tax bonds.

### **Variable-rate debt and swaps**

The authority expects to have \$114.8 million of unhedged sales tax variable-rate demand obligations and authorization for up to \$400 million of CP bond anticipation notes (BANs), all secured by sales tax revenue, which will make up about 4.5% of total sales tax-secured debt.

MBTA has an interest rate swap agreements associated with about \$79.7 million of variable-rate sales tax-secured prior obligation bonds. The authority is not required to begin posting collateral for any of its swap agreements in the event of negative swap valuations until the sales tax rating on MBTA falls below 'A'. Immediate swap termination events with notice do not go into effect unless the rating on MBTA or Massachusetts falls below 'BBB-', although certain swap termination events with notice can occur if the sales tax rating falls below 'A-'. Any swap termination payments would be subordinate to payment of sales tax bond debt service. We believe that termination events are

unlikely at current rating levels.

## **MBTA Operations**

MBTA runs the oldest and fifth-largest transit system in the country, operating subway, bus, and commuter rail service throughout eastern Massachusetts. Prior to the COVID-19 pandemic, it was responsible for an estimated 1.3 million passenger trips each business day and operates more than 38 miles of rapid-transit rail routes, and 26 miles of additional light rail. In addition, MBTA provides a broad range of other passenger services, including commuter boats. Its territorial area has increased to 176 cities primarily in the greater Boston MSA, extending north to the New Hampshire border, west to the city of Worcester, and south into Providence, R.I., with a total service area population of about 4.8 million.

The COVID-19 pandemic severely affected MBTA's operations, with an almost 80% reduction in fares. As a result, the authority had a budget deficit in fiscal 2021 which exceeded \$600 million before emergency federal assistance. The authority has received substantial federal stimulus funding related to the pandemic, including approximately \$827 million from the 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act, approximately \$301 million from the Coronavirus Response and Relief Supplemental Appropriations Act of 2021, and approximately \$860 million from the American Rescue Plan Act of 2021. The federal aid is expected to be used through fiscal 2024 to pay operating costs to maintain service and to make up for lost revenue due to the COVID-19.

In fiscal 2022, the last audited year, MBTA operating expenses less depreciation were \$1.75 billion; this does not include debt service, which is deducted from sales tax before being credited to operating funds. Its unrestricted cash and temporary cash investment position was negative \$3.5million at fiscal year-end. Like most transit systems, MBTA relies heavily on intergovernmental operating subsidies to pay for operations. The 2021 Transportation Bond bill was enacted by the legislature to provide nearly \$5.1 billion in capital support for the authority.

MBTA was created in 1964 and was put under the control of a state oversight board following various operational issues in the winter of 2015. The oversight board expired June 30, 2021. Following dissolution of the control board, MBTA governance devolved onto the Massachusetts Department of Transportation (MassDOT), although MBTA exists as a separate legal entity within the department. However, subject to the enabling act amendment in 2021, MBTA has a separate seven-member governing board, five of whom are appointed by the governor. The enabling act does not provide for MBTA to be a debtor under the federal bankruptcy code.

It estimates a five-year 2024-2028 MBTA CIP of \$9.7 billion. The CIP includes a portion of the funding of the authority's \$2.6 billion Green Line rail extension, which will also receive funding from federal and local sources. MBTA expects approximately \$4.5 billion of its current five-year CIP will be funded with its own sources, \$1.2 billion from state rail enhancement bonds, and \$3.9 billion from federal assistance.

## **Related Research**

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

- ESG Credit Indicator Report Card: U.S. States And Territories, March 31, 2022

Ratings Detail (As Of March 3, 2023)		
Massachusetts Bay Transp Auth sales tax		
<i>Long Term Rating</i>	AA/Positive	Affirmed
Massachusetts Bay Transp Auth sales tax		
<i>Long Term Rating</i>	AA/Positive	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) sales tax		
<i>Long Term Rating</i>	AA/A-1+/Positive	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth, Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) sales tax		
<i>Long Term Rating</i>	AA/Positive	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth, Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) sales tax		
<i>Long Term Rating</i>	AA/Positive	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth, Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) sales tax (AGM) (MBIA)		
<i>Unenhanced Rating</i>	AA(SPUR)/Positive	Affirmed
<b>Massachusetts Bay Transp Auth, Massachusetts</b>		
Massachusetts		
Massachusetts Bay Transp Auth, Massachusetts		
Massachusetts Bay Transp Auth (Massachusetts) sales tax (MBIA) (National)		
<i>Unenhanced Rating</i>	AA(SPUR)/Positive	Affirmed

Many issues are enhanced by bond insurance.

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