FitchRatings

RATING ACTION COMMENTARY

Fitch Rates MBTA $618MM Senior Sales Tax Bonds 'AAA'; Outlook Stable

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Fitch Ratings - New York - 03 Mar 2023: Fitch Ratings has assigned an 'AAA' rating to the following senior sales tax bonds to be issued by the Massachusetts Bay Transportation Authority (MBTA):

--$540 million 2023 series A, subseries A-1;

--$120 million 2023 series A, subseries A-2 (sustainability bonds).

The bonds will sell by negotiation on or about March 15, 2023. Bond proceeds will fund the MBTA's ongoing capital plan and pay down CP.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING

Massachusetts, Commonwealth of (MA) [General Government]

Massachusetts Bay Transportation Authority (MA) /Dedicated Sales Tax Revenues/1 LT	LT	AAA Rating Outlook Stable	New Rating

VIEW ADDITIONAL RATING DETAILS

SECURITY

The bonds are paid from a dedicated sales tax that is equal to the greater of a base revenue amount (BRA) or 1% of the 6.25% commonwealth sales tax plus an additional $160 million annually (dedicated tax sales tax amount, or DSTRA). The lien on the pledged revenues is prior to the payment of operating expenses and is not contingent upon the authority's provision of transportation services. The bonds are further backed by assessments levied on municipalities in the MBTA service area after payment of debt service on separately secured assessment bonds.

ANALYTICAL CONCLUSION

The 'AAA' rating on the MBTA's senior dedicated sales tax bonds reflects strong standalone credit quality of the dedicated portion of the commonwealth's sales tax allocated to the MBTA. The rating incorporates leverage limitations that provide structural resilience in light of a sizeable ongoing borrowing program and relatively strong revenue growth. The bonds are insulated from the both the operations of the MBTA and the commonwealth, allowing for a rating that is distinct from MBTA operations and linked to, but not capped by, the commonwealth's 'AA+' Issuer Default Rating (IDR).

Fitch views the statute and bond documents as meeting the conditions necessary for a dedicated tax to be rated above the commonwealth IDR based on the narrow nature of the statutory dedication, the specific purpose of the borrowing program, and the use of residual revenues for MBTA capital and operating expenses.

KEY RATING DRIVERS

Solid Revenue Growth Prospects: Performance of the dedicated sales tax securing the senior lien bonds is solid and likely to continue to increase a rate higher than long-term inflation, reflecting the broad nature of the sales tax and the fundamental strength of the commonwealth's economy and supportive of the 'aa' growth prospects assessment.

Resilient Bond Structure: Sales tax revenues have been subject to cyclicality, including a steep three-year decline in the Great Recession. While the structure benefits from a revenue floor provided by the BRA, future revenues can still fluctuate with the economy and decline to that floor. Given the leverage limitation of the 2x maximum annual debt service (MADS) additional bonds test, the senior lien bond structure provides substantial cushion to address both a moderate downturn scenario and one equivalent to the largest historical decline, warranting the 'aaa' assessment for resilience.

Strong Structural Protections: Dedicated revenues are segregated from the commonwealth general fund and are not exposed to MBTA operations. Strong legal covenants protect against diversion of revenues or lowering of the tax rate, although the base can be changed.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not relevant with 'AAA' rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A longer term slowing of dedicated revenue growth to below long-term inflation, reflecting erosion of the tax base and lowered expectations for long-term economic gains;

--Negative rating action on the commonwealth's 'AA+'/Outlook Stable IDR, although it would not necessarily move with a downgrade.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

DEDICATED TAX CREDIT PROFILE

Fitch views MBTA's dedicated sales tax bonds as having limited exposure to the operations of the commonwealth and the MBTA. Dedicated tax receipts are credited to the MBTA State and Local Contribution Fund, a state trust fund, which is held by the commonwealth treasurer exclusively for the purposes of the MBTA and disbursed to the bond trustee on a monthly basis prior to release to the MBTA for its operations. The pledge and receipt of the Dedicated Sales Tax, whether calculated according to the DSTRA or the BRA, is not contingent upon provision of transportation services.

State and Local Contribution Fund revenues are not commingled with other commonwealth funds and are not subject to appropriation. Bondholders have a first claim on the dedicated sales tax. Strong statutory covenants protect against diversion of revenues or lowering the dedicated tax rate, although the base can be changed.

The commonwealth has imposed a sales tax since 1966. Total annual sales tax growth has averaged about 6.7% since the inception of the tax, inclusive of rate and base changes that have been relatively frequent. Consistent with the broader sales tax, the pledged sales tax share reflects the commonwealth's fundamentally strong economic profile, with solid revenue growth over time.

Dedicated sales tax revenues are deposited monthly in the MBTA State and Local Contribution Fund (a state trust fund, held by the state), and then disbursed monthly to the bond trustee. Payments for a Railroad Rehabilitation and Improvement Financing (RRIF) loan from the U.S. Department of Transportation are subordinate to both liens of MBTA's sales tax revenue bonds, but the RRIF loan has a springing lien - if MBTA defaults on the RRIF loan, the obligation springs to parity with the senior lien sales tax revenue bonds. Similarly, debt service payments for prior obligations become senior to senior lien debt service in the event the authority does not certify in advance that it has provided for their payment in the annual budget.

The monthly deposit is 1/12 of the DSTRA and the controller of the commonwealth conducts a quarterly calculation of the BRA and DSTRA. If the DSTRA is lower than the BRA, the MBTA receives a true-up payment at the end of each quarter. The BRA therefore provides a floor of revenues in support of the bonds. Semi-annual debt service payments are timed to accommodate this potential true-up. The BRA is calculated as a base amount of sales tax revenues that increases with inflation, up to 3%, and cannot be reduced. As of fiscal 2022, the BRA was $1.195 billion while the DSTRA was $1.349 billion.

Fiscal 2022 pledged revenues covered MADS for senior lien sales tax bonds by 4.2x and MADS for all pledged obligations (senior lien, subordinate lien, RRIF loan and prior obligations) by 3.1x. On a pro forma basis, inclusive of the series 2023 bonds, sales tax coverage remains strong at 3.5x for pro forma MADS on senior bonds and 2.8x for pro forma MADS on all pledged obligations.

Bonds are cross-collateralized, with excess revenues from separately-secured assessment bonds available to cure any deficiencies in the dedicated sales tax bond structure (rated 'AAA' by Fitch under State Revolving Fund and Municipal Finance Pool Program Rating Criteria. See 'Fitch Rates MA Bay Trans Auth's Assessment Revs Series 2022 'AAA'; Outlook Stable', 25 March 2022 on www.fitchratings.com).

Solid Growth Prospects

Given the broad nature of the commonwealth's sales tax, Fitch considers growth prospects for the dedicated revenues supporting the bonds to be solid, similar to the economic and revenue growth prospects supporting the commonwealth's IDR. Over the 10 years ending in fiscal 2022, the state sales tax grew at a 5.9% CAGR, a figure which has been driven both by underlying economic trends prior to the coronavirus as well as by periodic expansions of the sales tax base, including the extension of the tax to online sellers that began in late 2019. Fitch anticipates future growth rates will moderate to between our long-term expectations for national economic growth and inflation.

Ample Resilience and Limited Downside Risk

To test the resilience of a dedicated tax, Fitch stresses the revenue stream under two scenarios. The first is a moderate recession scenario based on the Fitch Analytical Stress Test (FAST) model, which relates historical collections to GDP and the second is the largest historical revenue decline.

Of the two potential revenue streams, the BRA provides a floor of revenues and therefore limits the downside risk. From 2002 to 2017, the BRA was higher than the DSTRA, but recent strong growth in the sales tax has brought the DSTRA above the BRA. Since both of these revenues are incorporated in the definition of the dedicated tax, and since the MBTA receives the higher of the two on an annual basis, FAST similarly considers the higher of the two revenues on an annual basis in this analysis. However, for the purpose of assessing the largest decline, only the sales tax itself is considered since there can be volatility in the performance of the sales tax when it is above the BRA.

Resilience of the structure to potential cyclicality is ample given the limits on leverage with the 2x MADS ABT and the revenue floor that has limited downside performance historically. Revenues could decline 50% while maintaining sum sufficient coverage of MADS at the 2x ABT. The cushion provided by fiscal 2022 pledged revenues ($1.3 billion) is 50x the FAST output based on a moderate recession foreseeing a 1% revenue decline, and 6.3x the largest historical decline in the overall state sales tax experienced during the Great Recession. These results warrant a 'aaa' assessment for resilience.

Given the springing lien on the RRIF loan that could move it into parity with the senior lien and the potential for the prior debt to also move above the senior lien, Fitch's analysis of the resilience of the senior lien bonds' security structure also includes an all-obligations assessment with senior, subordinate, RRIF loans and prior obligations. Based on the 1.5x MADS ABT for the subordinate lien and the current MADS on the RRIF loan and prior obligations, Fitch estimates fiscal 2022 pledged revenues could decline 33.3% while maintaining sum sufficient coverage. This is 33x the FAST output and more than 4x the largest historical decline, also supporting a 'aaa' resilience assessment.

DATE OF RELEVANT COMMITTEE

02 March 2023

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Massachusetts Bay Transportation Authority (MA)	EU Endorsed, UK Endorsed

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