MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Massachusetts State College Building Authority's $138.6M Series 2014A; outlook stable

Global Credit Research - 03 Dec 2013

$1.2B of pro-forma rated debt

MASSACHUSETTS STATE COLLEGE BUILDING AUTHORITY, MA
Public Colleges & Universities
MA

Moody's Rating

ISSUE	RATING
Series 2014A Project Revenue Bonds	Aa2

Sale Amount	$138,640,000
Expected Sale Date	12/10/13
Rating Description	Revenue: Public University Broad Pledge

Moody's Outlook STA

Opinion

NEW YORK, December 03, 2013 --Moody's Investors Service has assigned a Aa2 rating to the Massachusetts State College Building Authority's (the authority's or MSCBA's) $138.6 million of fixed-rate Series 2014A Project Revenue Bonds. We have also affirmed the Aa2 ratings on the authority's outstanding bonds. The outlook is stable. The Aa2 rating and stable outlook reflect strong student demand for the auxiliary facilities financed with the authority's bonds combined with strong legal security for the bonds, including reserves and a state appropriation intercept mechanism.

SUMMARY RATING RATIONALE: The Aa2 rating reflects MSCBA's role as a component unit of the Commonwealth of Massachusetts to design and construct auxiliary facility projects (such as housing, parking, and student activity centers) across the nine-member Massachusetts State University System. The rating reflects strong oversight of these auxiliary projects, healthy operating performance of the projects and multi-year enrollment growth across the campuses, presence of an aggregate state appropriation intercept, and a fully funded debt service reserve fund and other available reserves.

STRENGTHS

*The authority's bond-financed auxiliary facilities benefit from a large and growing student body enrolled across nine public state universities located throughout the state of Massachusetts (41,163 total full-time equivalent enrollment in fall 2013, up 1% over fall 2012) and high occupancy in the housing facilities.

*The authority's management team provides strong oversight of the projects and borrowing plans, with a good track record of project completion on time and within budget and ongoing reinvestment in projects with resulting low deferred maintenance backlog.

*The bonds are further secured by the ability of State Comptroller to intercept remaining current-year state appropriations to the universities for payment of debt service or replenishment of joint debt service reserve fund.

*As a component unit of the Commonwealth of Massachusetts (Aa1 G.O. rating), MSCBA has strong political ties and state oversight of its capital program.

*All of MSCBA's debt is fixed rate with no use of derivatives providing for predictable debt service.

CHALLENGES

*MSCBA and the state universities have undertaken significant capital investment on the campuses in recent years and MSCBA'S debt has rapidly increased. MSCBA will have $1.2 billion of pro-forma debt, nearly double the amount of debt in FY 2008, although we expect that the pace of new money borrowing will slow in coming years.

*Public and political resistance to growth of student charges and increased price sensitivity of families limits public universities' capacity to grow student charges longer-term (average combined tuition and fee charges at the 9 Massachusetts state universities have increased rapidly over the past four years, although the increase was modest for the 2013-2014 academic year).

*Demographic projections forecast a decline in the number of high school graduates in Massachusetts which could challenge future enrollment growth at the state, although the universities in aggregate have demonstrated multi-year enrollment growth during the past five years.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The Series 2014A bonds will fund a variety of capital projects including a residential facility and other auxiliary facilities at Salem State University ($77 million of combined bond proceeds), housing additions and renovations at Massachusetts Maritime Academy ($24.3 million of combined bond proceeds), a campus center at Fitchburg State University ($15 million), as well as a variety of other capital improvements. Bond proceeds will also provide capitalized interest ($4 million), a deposit to the debt service reserve fund ($8.3 million), and pay for costs of the bond issuance.

LEGAL SECURITY: The legal provisions under the Trust Agreement (Agreement) provide solid support for the bonds, with the authority pledging as security for the bonds pledged revenues and reserves. MSCBA maintains a Contract for Financial Assistance, Management and Services (Contract) with the State Board of Higher Education, which is empowered by statute to commit the nine state universities to payment of debt service. The authority is required to set the fees and rates for the projects at levels sufficient to pay the debt service associated with each project as well as operating expenses (a rate covenant).

In addition to pledged revenue, each university is required to set aside 25% of the average annual aggregate debt service costs in a Pledged Trust Fund to cover any deficiencies of project revenues for debt service. These Pledged Trust Funds include student fees revenues and other money that each university controls. These pledged funds and the residence hall operating reserves, are held at the university campuses and not recognized on the authority's balance sheet. Management reports that these pledged funds and reserves, plus capital improvement and supplemental reserves held by the authority (but excluding debt service reserve funds) totaled approximately $67 million as of June 30, 2013. The projected balance as of 6/30/2014 is $79 million.

Interest subsidy payments expected to be received by the authority for the Series 2009C and 2010B Build America Bonds are not pledged to bondholders. In FY 2013, MSCBA received a $2.3 million Build America Bond interest rate subsidy from the federal government, down $58,000 from FY 2012. Due to the impact of sequestration, MSCBA expects a further 7% cut to the subsidy in FY 2014. MSCBA has adequate reserves to cover this subsidy reduction, but could charge more to the universities per the Contract to cover the reductions.

Additionally, a joint Debt Service Reserve Fund (DSRF) for all bonds issued under the indenture secures the bonds. In the event this money is utilized to pay debt service, the authority must replenish the fund in 12 equal monthly installments commencing 90 days from withdrawal. The debt service reserve fund requirement is equal to at least: 1) 10% of original net bond proceeds, 2) 125% of average annual debt service, or 3) pro-forma maximum annual debt service ($96.4 million including the Series 2014A bonds as well as Commonwealth-Guaranteed bonds, Series 1994A and Refunding Revenue Bonds Series 2004B). Following this bond issuance, we expect MSCBA will have combined debt service reserve funds equal to $88.2 million (equal to 125% of average annual debt service, including debt service reserve funds for Commonwealth guaranteed bonds as well as non-guaranteed bonds).

The presence of a state appropriations intercept program benefits the authority's revenue bond debt. Under the program, the State Comptroller must transfer unexpended amounts from a state university's appropriation account for the current year to cure any insufficiency of available funds to make debt service payments. Per changes to the Contract for Financial Assistance, Management and Services as well as the statute governing the intercept, if the Pledged Trust Funds and remaining state appropriations of a state university are insufficient to cover that state university's payments under the Contract, then the Board of Higher Education shall pay to the bond trustee state appropriations of the other state universities, ratably according to the percentage of outstanding bonds at each university, to cure the insufficiency.

INTEREST RATE DERIVATIVES: None, all fixed-rate debt structure

MARKET POSITION: ENROLLMENT GROWTH AND HIGH OCCUPANCY LEVELS IN BOND-FINANCED FACILITIES

In Moody's opinion, the credit strength of the state universities in the program and the essentiality of and strong demand for the auxiliary services to the campuses are the key factors underpinning the underlying rating on MSCBA's bonds. All nine campuses host revenue-producing projects financed under this program. The state universities (formerly state colleges) include: Bridgewater, Fitchburg, Framingham, Massachusetts College of Art and Design, Massachusetts College of Liberal Arts, Massachusetts Maritime Academy, Salem, Westfield, and Worcester (campus debt rated A2 with a stable outlook). These institutions comprise an important sector of the Massachusetts higher education system and enrolled 41,163 full-time equivalent (FTE) students in fall 2013, up 1% over fall 2012. Headcount enrollment across the state university system exceeds 52,000 students.

In fall 2013, the authority's debt-financed student housing on these campuses provides 15,716 beds for students which house a combined 42% of the undergraduate student population. Occupancy in the authority's residential facilities is high, with all campuses except Bridgewater State University (97.3%) and Massachusetts College of Liberal Arts (MCLA, 87.9% residential occupancy in fall 2013) having over 100% occupancy as a percentage of residential facility design capacity. MCLA's FTE enrollment declined to 1,601 in fall 2012, from a high of 1,715 in fall 2010 and management is focused on improving recruitment and retention initiatives. With the Series 2014A projects, MSCBA will achieve a goal of being able to provide on-campus housing to freshmen and sophomores across the system. The authority has received approval to support projects on Massachusetts community college campuses and plans to enter into an approximately $3 million direct bank bond purchase which will be backed by auxiliary revenues, reserves, and an intercept of appropriations of only that one community college.

OPERATIONS: GROWTH OF TUITION AND FEES AT THE UNIVERSITIES TO OFFSET CUTS IN STATE FUNDING

Longer-term the universities, similar to most public universities across the US, will be challenged to adjust to slowed growth of state appropriations. Based on data provided by MSCBA, the Commonwealth's budgeted appropriations to the state universities was $191 million in FY 2012, which represented a 7.5% decline in state funding between FY 2011 and FY 2012. State operating support to the state universities in FY 2013 was essentially flat compared to FY 2012, but expected increase materially in FY 2014. In order to compensate for volatility in state funding, the universities must focus on ongoing expense containment and growth of private revenue sources, including tuition and fees. Average combined tuition and fee charges at the state universities (average weighted by number of students at each campus) have increased rapidly over the past four years, with the academic year 2012-2013 combined charges (tuition plus fees) up 29% over academic year 2008-2009. Heightened public and political pricing sensitivity and resistance to increases in student charges will limit the universities' capacity for growing these private revenue streams and will place increased emphasis on expense containment and operating efficiency.

BALANCE SHEET: RAPID INCREASE IN DEBT TO SUPPORT SIGNIFICANT CAPITAL INVESTMENT IN RECENT YEARS

Debt issued by MSCBA on behalf of the nine public universities has increased rapidly in recent years with $1.2 billion of pro-forma debt, up 87% since FY 2009. Management reports they may borrow approximately $80 million over the next year and expects that the pace of new debt issuance in the next few years will slow. MSCBA has grown its unrestricted cash and investments and held approximately $27 million of unrestricted reserves on its balance sheet in FY 2013, an amount which has steadily grown over the past five years. These funds are in addition to the required reserves held at the individual universities.

STATE APPROPRIATIONS INTERCEPT PROGRAM ENHANCES CREDIT QUALITY

The bonds are secured by the ability of State Comptroller to intercept remaining current-year state appropriations to the universities for payment of debt service or replenishment of joint debt service reserve fund. However, this pre-default intercept is limited to remaining appropriation funds and is weaker than an unlimited advance intercept paid for by the commonwealth. MSCBA management reports that the intercept has never been utilized and based on the trend of historical expenditures of the universities, approximately half of state university appropriations typically remain at the end of the second quarter of the fiscal year (December).

Under the intercept provisions, the authority is required to report on the sufficiency of available funds to pay debt service on its outstanding debt to the Board of Higher Education (BHE) and the State Comptroller no later than September 30, in the case of debt service payments due November 1, and no later than January 31, in the case of debt service payments due May 1. If each report is not received by the Comptroller by the specified date, the Comptroller must prevent expenditure from the appropriation account of any state university until the Comptroller has determined whether there is an insufficiency of available funds to pay debt service. If the authority's report indicates an insufficiency or, in the absence of such report, if the Comptroller determines that an insufficiency exists, the Comptroller must transfer amounts from all state universities appropriation accounts (on a pro-rata basis, based on each university's amount of outstanding debt) to cure such insufficiency within five days, but in any event no later than the applicable deposit date (October 10 for the November 1 debt service payment and the last business day of February for the May 1 debt service payment). In addition, the trustee is required to give notice directly to the BHE and the Comptroller within 10 days of the debt service deposit date if there is any insufficiency of funds to pay debt service, and the Comptroller must intercept state appropriations as necessary to ensure debt service is paid on a timely basis.

Per changes made to the Contract for Financial Assistance, Management and Services as well as the Act during 2011, if the Pledged Trust Funds and remaining state appropriations of a state university are insufficient to cover that state university's payments under the Contract, then the Board of Higher Education shall pay to the bond trustee state appropriations of the other state universities, ratably according to the percentage of outstanding bonds, to cure the insufficiency. This cross-collateralization of state intercept funds to cure any deficiency further strengthens the intercept provision.

STRONG MANAGEMENT AND OVERSIGHT OF CAPITAL PROJECTS; FOCUS ON REDUCTION OF DEFERRED MAINTENANCE BACKLOG

MSCBA's strong management and oversight of capital project development, construction, and delivery are key credit strengths. The small, although stable, staff (approximately 15 staff members) has a good track record of delivering projects on time and within budget. MSCBA has outlined a detailed process for the full spectrum of delivering a new project, from the early stages of assessing market and financial feasibility all the way through design, construction, and delivery. Over the past decade, MSCBA has tackled deferred maintenance and reduced estimated deferred maintenance needs from $49 million to an estimated $10.6 million in FY 2012, a credit positive. This careful planning process and significant reduction in deferred maintenance have contributed to strong student demand for MSCBA facilities, as evidenced by high occupancy levels (101.7% occupancy of design capacity in fall 2013). Further, state oversight of the program is bolstered by the authority being required to receive approval of the Board of Higher Education, the Secretary of the Executive Office for Administration and Finance of the Commonwealth, and the Commissioner of the Department of Higher Education to issue debt for projects at the state universities.

Outlook

The stable outlook for the authority's Aa2 rating is based on the strength of the pledged revenues derived from a strong market position with growing enrollment and high occupancy levels, legal provisions including aggregate intercept provision, and reserve fund as well as strong management oversight of project construction and operations.

WHAT COULD MAKE THE RATING GO UP

The rating could be upgraded as a result of significant growth and diversification of pledged revenues, additional unrestricted reserves under the control of the authority and improved credit quality of the commonwealth.

WHAT COULD MAKE THE RATING GO DOWN

The rating could be downgraded as a result of sustained decline in occupancy of facilities or an inability to meet debt service requirements from auxiliary revenues at the campuses, a decline in the credit quality of the commonwealth, or an increase in debt absent growth of reserves and revenues to cover increased debt service responsibilities.

KEY INDICATORS (FY 2013 financial data and fall 2013 enrollment)

-Commonwealth G.O. rating: Aa1 with a stable outlook

-Fall 2013 full-time equivalent (FTE) students: 41,163 FTE

-Pro-forma Direct Debt: $1.2 billion

-MSCBA FY 2013 debt service payment (excluding capitalized interest): $62.6 million (interest, net of capitalized interest, plus principal)

-Pro-Forma Maximum Annual Debt Service (including Series 2014A bonds): $96.4 million

-Unrestricted Net Assets of MSCBA: negative $24.9 million

-Unrestricted Cash and Investments of MSCBA: $27.2 million

RATED DEBT

Project Revenue Bonds, Series 2003A and 2003B: Aa2; insured by Syncora Guarantee

Project Revenue Bonds, Series 2004A: Aa2; insured by National Public Finance Guarantee Corp.

Project Revenue Bonds, Series 2005A: Aa2; insured by FGIC

Project Revenue Bonds, Series 2006A: Aa2; insured by Ambac

Project Revenue Bonds, Series 2008A: Aa2; insured by Assured Guaranty Municipal Corp.

Project Revenue Bonds, Series 2009A, 2009B, 2009C (taxable Build America Bonds), 2010A, 2010B (taxable Build America Bonds), 2011A, 2012A, 2012B, 2012C, 2014A: Aa2

Commonwealth-Guaranteed Bonds, Series 1994: Aa1

Refunding Revenue Bonds, Series 2004B: Aa1 (guaranteed by Commonwealth); insured by National Public Finance Guarantee Corp.

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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