MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Massachusetts State College Building Authority's Ser. 2014B, C, and D bonds; outlook stable

Global Credit Research - 24 Nov 2014

$1.3B rated debt

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

Moody's Rating

ISSUE		RATING
Project Revenue Bonds Series 2014 C		Aa2
Sale Amount	$37,200,000	
Expected Sale Date	12/09/14	
Rating Description	Revenue: Public University Broad Pledge	
Refunding Revenue Bonds Series 2014 D		Aa2
Sale Amount	$36,500,000	
Expected Sale Date	12/09/14	
Rating Description	Revenue: Public University Broad Pledge	
Project Revenue Bonds Series 2014B (Green Bonds)		Aa2
Sale Amount	$66,000,000	
Expected Sale Date	12/09/14	
Rating Description	Revenue: Public University Broad Pledge	

Moody's Outlook STA

Opinion

NEW YORK, November 24, 2014 --Moody's Investors Service assigns a Aa2 rating to the Massachusetts State College Building Authority's (MSCBA) fixed rate Series 2014B, C, and D. We have also affirmed the Aa2 ratings on the authority's outstanding bonds. The outlook is stable.

SUMMARY RATING RATIONALE: The Aa2 rating reflects MSCBA's role as a component unit of the Commonwealth of Massachusetts (Aa1 GO rating) 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, project revenue adequately covering debt service, the strength of an aggregate state appropriation intercept, and growing unrestricted reserves held at both the individual campuses and the authority which are available to cover debt service should there be a revenue shortfall.

STRENGTHS

*The authority's bond-financed auxiliary facilities benefit from a large and diversified student body enrolled across nine public state universities located throughout Massachusetts and high occupancy in the student housing. Project-generated revenue (including student fees) has always adequately covered annual debt service, and the state appropriation intercept, joint debt service reserve, or unrestricted and available reserves of MSCBA and the universities have never been used to pay debt service.

*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 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 the joint debt service reserve fund. While the debt service reserve fund could be eliminated in the future per an amendment in the Supplemental Trust Agreement, aggregate state appropriations grew significantly in FY 2014 and would provide good coverage of debt service if intercepted.

*As a component unit of the Commonwealth of Massachusetts, 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 $1.3 billion of pro-forma debt, although we expect that the pace of new money borrowing will slow.

*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.

*Demographic projections for the number of high school graduates in Massachusetts are relatively flat, and enrollment growth across the university system will likely slow.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The Series 2014B and C bonds will fund a variety of capital projects including a parking structure at Salem State, replacement student housing at Framingham State (net 30-bed increase on campus), and several other smaller projects including ongoing renovations to existing facilities. The Series 2014B bonds are expected to be designated as Green Bonds as they will finance environmentally sustainable projects. The Series 2014B bonds have the same legal security and are on parity with outstanding Project Revenue Bonds. Proceeds from the Series 2014D bonds will be used to refund all or a portion of outstanding Series 2005A and 2006A bonds. Bond proceeds will also be used to make a contribution to the debt service reserve fund ($4.3 million deposit), pay for capitalized interest and pay for the costs of the 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 its average annual aggregate debt service costs in a Pledged Trust Fund to cover any deficiencies of project revenue for debt service. These Pledged Trust Funds include student fees revenue 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. These pledged funds and reserves are internally designated for use for the projects and would be required to be used to pay debt service if project revenue is insufficient. 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 $72 million as of June 30, 2014.

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 2014, MSCBA received a $2.16 million Build America Bond interest rate subsidy from the federal government, down from FY 2013 due to the impact of federal sequestration.

Currently, a joint Debt Service Reserve Fund (DSRF) for all bonds issued under the indenture secures the Project Revenue Bonds. However, with the issuance of the Series 2014B, C, and D bonds, the authority has eliminated the debt service reserve fund requirement, per language in the Supplemental Trust Agreement for these bonds. This amendment of the Trust Agreement requires consent of the bondholders of at least a majority of principal amount of bonds outstanding. Following this bond issuance, the joint debt service reserve fund will total $96.8 million including the reserve fund for Series 2004B Commonwealth-Guaranteed bonds, compared to pro-forma maximum annual debt service of approximately $103.2 million. If the reserve fund requirement is eliminated in the future, management would anticipate using the reserve funds to pay down outstanding debt.

The presence of a state appropriations intercept program also benefits the authority's revenue bond debt, as described below.

INTEREST RATE DERIVATIVES: None, all fixed rate debt structure

MARKET POSITION: LARGE AGGREGATE STUDENT BODY AND HIGH OCCUPANCY IN BOND-FINANCED FACILITIES

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 key factors underpinning the underlying rating on MSCBA's bonds. All nine campuses host revenue-producing projects financed under this program. The state universities include: Bridgewater, Fitchburg, Framingham, Massachusetts College of Art and Design, Massachusetts College of Liberal Arts, Massachusetts Maritime Academy, Salem, Westfield, and Worcester (Worcester State University debt rated A2 with a stable outlook). These institutions comprise an important sector of the Massachusetts higher education system and enrolled 41,227 full-time equivalent (FTE) students in fall 2013. Preliminary undergraduate enrollment data suggest a very modest increase in aggregate undergraduate FTE enrollment across the nine universities in fall 2014. Headcount enrollment across the state university system was nearly 52,000 students in fall 2013. The percentage of FTE-to-headcount enrollment has steadily grown over time (79% in fall 2013), with full-time undergraduate students representing a growing proportion of the student body.

The authority's debt-financed student housing on these campuses provides close to 16,500 beds in fall 2014 and house a combined 40% of the undergraduate student population. Occupancy in the authority's residential facilities is high with residential facility occupancy over 90% at most campuses in fall 2014. Massachusetts College of Liberal Arts (89.3% occupancy) and Worcester State (90.4%) have the lowest occupancy rates in the system for fall 2014.

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

The universities, similar to most public universities across the US, will be challenged to adjust to slowed growth of state appropriations. Based on aggregate data provided by MSCBA, the Commonwealth's operating appropriations to the state universities grew a strong 20% in FY 2014 compared to both FY 2012 and FY 2013. However, FY 2014 aggregate funding was only 3% more than in FY 2009, with the universities absorbing past cuts in state funding. Aggregate state funding for FY 2014 was $229 million.

Heightened public and political scrutiny of tuition increases and an increasingly price sensitive student market will constrain future net tuition revenue growth for most of these universities. Similar to other public universities across the US, as government funding declines, the MA state universities are increasingly reliant on revenue from private sources, including tuition and auxiliary revenue. Average combined tuition and fee charges at the state universities (average weighted by number of students at each campus) have steadily increased, with the academic year 2014-2015 combined charges (tuition plus fees) up 4.5% over the prior year.

BALANCE SHEET: HIGH LEVERAGE TO SUPPORT SIGNIFICANT CAPITAL SPENDING; FUTURE PACE OF BORROWING EXPECTED TO SLOW

Debt issued by MSCBA on behalf of the nine public universities has increased rapidly in recent years with $1.3 billion of pro-forma debt, nearly double the amount outstanding at FYE 2009. Management has not reported any concrete additional borrowing plans over the next year, and the affirmation of the Aa2 rating heavily incorporates an expectation that the pace of new money borrowing will slow significantly in coming years, with no additional student housing currently planned.

MSCBA has grown its unrestricted cash and investments, and the authority had approximately $29 million of unrestricted reserves on its balance sheet at FYE 2014, 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 and could be used for debt service, if needed. Total cash and investments on MSCBA's balance sheet is much higher at $263.9 million, including debt service reserve funds and unspent bond proceeds. The authority's cash and investments are extremely liquid, including cash and fixed income securities (such as checking and deposit accounts, money market funds, US treasuries and agencies, commercial paper, and bonds). Under the Supplemental Trust Agreement for the Series 2014B, C, and D bonds, the authority has expanded the Trust Agreement's definition of "Investment Obligation" to include certain comingled investment funds. Per these expanded investment guidelines, MSCBA could choose to invest in new cash and fixed income funds that meet the revised definition of Investment Obligation.

The authority has received approval to support projects on Massachusetts community college campuses and during FY 2014 MSCBA issued a $3 million bond which is backed by auxiliary revenue, reserves, and an intercept of appropriations of only that one community college. This bond does not have any claim on the revenue or reserves of the 9 state universities.

STATE APPROPRIATIONS INTERCEPT PROGRAM ENHANCES CREDIT QUALITY

The bonds are secured by the ability of the State Comptroller to intercept remaining current-year state appropriations to the universities for payment of debt service or replenishment of the joint debt service reserve fund. This pre-default intercept is limited to remaining appropriation funds and is therefore only meaningful if there are sufficient funds on account when and if needed to pay debt service.

The advance timing and notification of the intercept mechanism further strengthen it. 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.

The cross-collateralization of state intercept funds to cure any deficiency further strengthens the intercept provision. 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).

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). In fact, in FY 2014 $58.8 million of aggregate appropriations were unspent as of March 31, 2014, in excess of the $50.5 million debt service payment to be made on May 1, 2014 (funds, if needed, would be intercepted no later than last business day in February).

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 $9 million in FY 2014, 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.

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. The governor's appointment of MSCBA's nine member board of trustees further strengthens government linkages.

Outlook

The stable outlook is based on our expectation that pledged revenue will remain sufficient to pay debt service due to strong student demand for the bond-financed facilities and high aggregate occupancy levels as well as our expectation that the commonwealth appropriations to the nine universities that participate in the bond program will remain at least sufficient to cover debt service in the event of a revenue shortfall.

WHAT COULD MAKE THE RATING GO UP

The rating could be upgraded as a result of significant growth and diversification of pledged revenue, additional unrestricted reserves under the control of the authority coupled with 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 revenue at the campuses, a decline in the credit quality of the commonwealth, a material reduction of interceptable state funding, or an increase in debt absent growth of reserves and revenue to cover increased debt service responsibilities.

KEY INDICATORS

-Commonwealth GO rating: Aa1 with a stable outlook

-Fall 2013 full-time equivalent (FTE) students: 41,227 FTE

-Pro-forma Direct Debt: $1.3 billion

-Pro-Forma Maximum Annual Debt Service (including Series 2014B,C, and D bonds): $103.2 million

-Unrestricted Cash and Investments of MSCBA: $29.2 million at FYE 2014

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. The additional methodology used in this rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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