THE COMMONWEALTH'S CAPITAL BUDGET: A PRIMER:

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I. OVERVIEW

The Massachusetts Taxpayers Foundation is pleased to issue this report entitled: "The Commonwealth's Capital Budget: A Primer" the purpose of which is to provide policymakers and their staff, taxpayers and citizens interested in the state's capital spending with a guide on the process, how it differs from the operating budget and how capital revenues are spent.

This primer is the first in a series of MTF reports dedicated to the Commonwealth's capital spending.

II. INTRODUCTION TO THE CAPITAL BUDGET[1]

Elected officials are the stewards of the state's financial resources and their job entails both developing a balanced budget each year to fund ongoing operations of state government and determining where money will be invested to address the Commonwealth's future needs. To fund these programs, services, and infrastructure projects, the state produces two distinct budgets: one for operating expenses and one for capital investments.

Although equally vital to the long-term health of the state's economy, the capital budget receives far less attention – and scrutiny – than the operating budget. This is understandable. At $43 billion in FY 2017, the operating budget is more than ten times larger than the $4 billion annual capital budget and has an immediate impact on the lives of most residents of the commonwealth. In contrast, capital expenditures can take years to complete and often benefit individuals less directly.

The operating budget and capital budget do share some commonalities. Both budgets are originally developed by the Executive Office of Administration and Finance (ANF) working with state agencies to determine funding requirements for the upcoming fiscal year. Both documents specify the amount of funds available for each line-item account (operating) or plan- item account (capital). Both spending plans are expected to be finalized before July 1, the start of the fiscal year.

However, this is where the similarities end. Unlike the annual operating budget, the annual capital budget is not considered legislation and so is not subject to direct involvement by the state legislature nor is it subject to public hearings. Notably, there is no notification requirement if amounts expended on a capital project differ substantially from initial estimates.

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[1] The state's capital investment plan does not include capital spending by independent authorities such as the MBTA, the Massachusetts School Building Authority, the Massachusetts Water Resources Authority, the Massachusetts Housing Finance Authority, the University of Massachusetts Building Authority, the Massachusetts State College Building Authority, and the Boston Convention and Exhibition Center, among others.

Perhaps because of the difference in size and scope, the capital budget often gets lost in the shuffle when public finances and spending priorities are discussed, yet its role in determining how the state invests in its infrastructure is vitally important to the fiscal health of the Commonwealth and is deserving of closer attention. This report explains the capital budget process in order to provide a better understanding and greater scrutiny of the Commonwealth's capital investment program. Other reports dedicated to discreet spending areas, such as transportation and information technology, will follow and build from the fundamentals outlined in this primer.

III. THE OPERATING BUDGET V. THE CAPITAL BUDGET

A. Developing the Operating Budget

The Massachusetts constitution requires the Governor to recommend annually to the Legislature a general appropriation bill with all proposed expenditures for the fiscal year along with all taxes, revenues, and loans used to pay for these expenditures.[2]

Further, Massachusetts law stipulates that the general appropriation bill must be in balance, meaning that the state can only spend as much as the revenue it collects.[3] Thus, the operating budget is constrained by the amount of total revenues received from state taxes, departmental fees, and federal reimbursements.

In order to ensure that there are sufficient revenues to support its spending plan, lawmakers rely on a rigorous review of revenue projections. This process is known as the establishment of a consensus tax revenue estimate and provides the Governor, House, and Senate with the same dollar amount upon which to build their respective budget proposals.

The Secretary of Administration and Finance, together with the chairs of the House and Senate Committees on Ways and Means, develop this consensus revenue estimate. It is based on revenue forecasts presented by the Department of Revenue and fiscal and economic analysts at an annual public hearing.[4] The consensus tax revenue estimate is then included in a joint resolution, and, if passed by both branches, establishes the maximum amount of tax revenues that can be included in the general appropriation bill for the upcoming fiscal year.[5] Although lawmakers may differ on projections of federal funds and departmental fees, the size of the operating budget is largely shaped by the consensus tax revenue estimate.

With an agreement on tax revenues in place, the governor's budget recommendation initiates a well-established sequential process that eventually results in the final budget (Figure 1).

[2] Constitution of the Commonwealth of Massachusetts, Article LXIII, Section 2.
[3] M.G.L. Chapter 29, Section 6E.
[4] Massachusetts Taxpayers Foundation prepares tax revenue estimates annually for the consensus revenue hearings.
[5] M.G.L. Chapter 29, Section 5B.

After the Governor submits his spending proposal to the General Court, it moves to the House Ways and Means Committee which reviews the governor's spending plan and develops its own recommendations for the fiscal year. During this process, the Joint Committee on Ways and Means hosts a series of open hearings around the state for the public's participation and comment on particular spending categories.

Figure 1 – State Operating Budget Process

The House Ways and Means budget recommendation is then introduced to the full House for deliberation. Representatives have the opportunity to file amendments to the budget and those amendments are considered when the full House has a floor debate, which may last several days. House members vote to accept or reject the proposed amendments and then on the passage of the budget in its entirety.

When passed, the budget process shifts to the Senate Ways and Means Committee for its review. After the Committee releases its fiscal year recommendations to the full Senate, it follows the same process as the House with the Senate amending, debating and voting on passage of its own version of the budget.

Once approved by the Senate, the House and Senate each appoint three members to serve on a conference committee to reconcile House and Senate budget differences. The resulting conference committee budget is presented to each branch for its approval without further amendment, often referred to as an "an up or down vote" and, if passed, is sent to the Governor.

The Governor has ten days to review during which time he can amend or veto line-item accounts in the Legislature's budget. The Legislature may then override the Governor's changes with a two-thirds vote. Following legislative overrides, the process to develop the General Appropriations Act is complete.

B. <u>Developing the Capital Budget and Investment Plan (CIP)</u>

In contrast to the operating budget, the development of the capital budget and investment plan or CIP has far less public input and minimal transparency. The spending commitments differ as well.

The capital budget supports investments intended to be used over a long period of time. Some projects, such as the construction or maintenance of infrastructure, can take several years to complete and may require significant investment and rigorous planning.

Given the long-term nature of these capital investments – assets often have life spans of 20 years or more – the state usually uses its borrowing authority to cover them. Having the authority to borrow is important because, as a practical matter, Massachusetts rarely has the reserves, or "pay as you go" capital as it is sometimes called, to pay for capital projects with excess cash on hand. More typically, the capital investment plan is financed through the proceeds of state-issued bonds and federal grants.

This financing mechanism of borrowing money to pay for capital spending further limits the legislature's role in the capital budget process. Unlike the operating budget, the capital budget is not subject to the legislative appropriation process.

The legislature's role is also limited when it comes to spending bond proceeds. The constitution simply states that for loans other than the defense of the Commonwealth and short-term borrowing in anticipation of tax receipts, "the commonwealth may borrow money only by a vote, taken by the yeas and nays, of two-thirds of each house of the general court present and voting thereon".[6] In other words, the Legislature must pass bond bills that give the executive branch the authority to borrow and spend on state assets, but it has limited influence over where capital investments are actually spent.

Enactment of a bond bill is effectively the first step in the process, not the last. The legislature does approve a comprehensive list of projects that may potentially receive capital funding, but deciding which of the many authorized projects will actually be funded falls to the Executive Branch. It is the Governor who releases the CIP describing the sources of funds available, the uses of funds by investment category and beneficiary agency, and the detailed list of projects for the first fiscal year of the five year plan. Legislators can and often do request that the administration include specific projects in that year's capital budget, but the executive branch has ultimate approval.

There is a common misunderstanding that a project's inclusion in a bond authorization bill signals that the project has received funding when, in fact, it merely indicates that the project has been authorized for funding for the next five fiscal years should the executive branch choose to include it in the capital spending plan.[7] After five years, unused bond authorizations expire, although the Legislature frequently extends project authorizations in the hope that funding will become available eventually for them. This practice of extending projects beyond the five years inflates the amount of authorized debt and results in a substantial discrepancy between the amounts of

[6] Constitution of the Commonwealth of Massachusetts, Article LXII, Section 3.
[7] M.G.L. Chapter 29, Section 14.

authorized debt and actual appropriations in the annual capital plan. As of FY 2015, authorized but unissued debt surpasses $29 billion (Table 1).

Table 1 – Authorized and Unissued Debt

FY	Authorized and Unissued Debt
2010	$18,516,310
2011	$15,870,432
2012	$13,893,469
2013	$13,762,257
2014	$26,255,768
2015	$29,071,339

Source: Office of the Comptroller; * 2015 amount is unaudited

Since the capital spending plan is almost entirely the product of internal workings within the executive branch, there is relatively little transparency. Other than projects included in the statewide transportation improvement program (STIP) which, under federal statute requires public review and comment, most executive agencies do not review their capital spending plans in public forums.

IV. FUNDING SOURCES FOR THE CAPITAL BUDGET

Capital budget funds derive from three principle sources: general obligation bonds backed by the Commonwealth, federal funds predominantly for transportation investments in transit infrastructure, roads, bridges, and rail assets, and special obligation bonds supported by dedicated sources of revenues.

Given these different sources of capital funding, it is important to understand how the state has managed to increase the amount of annual capital spending over the past decade and the constraints the state faces going forward.

In FY 2008, the state's CIP called for approximately $2.28 billion in total capital spending. By FY 2017, the CIP had grown to $3.62 billion, an increase of $1.34 billion or nearly 60 percent. Of this increase, approximately one-half comes from the issuance of general obligation bonds while 35 percent is attributable to two special obligation bond programs. Two major policy changes that were adopted in the intervening years between FY 2008 and FY 2017 contributed greatly to the increased size of the state's CIP during this period. Both were intended to increase the state's investment in infrastructure.

Table 2 – Sources of Capital Funds FY 2008 and FY 2017[8]

	FY 2008	FY 2017	Change $	Change %
General Obligation Bonds (bond cap)	1,556	2,190	634	47%
Federal Funds	600	878	278	21%
Accelerated Bridge Program		230	230	17%
Rail Enhancement Program		242	242	18%
Project Funded	120	78	-42	-3%
Total	**2,276**	**3,617**	**1,341**	**100%**

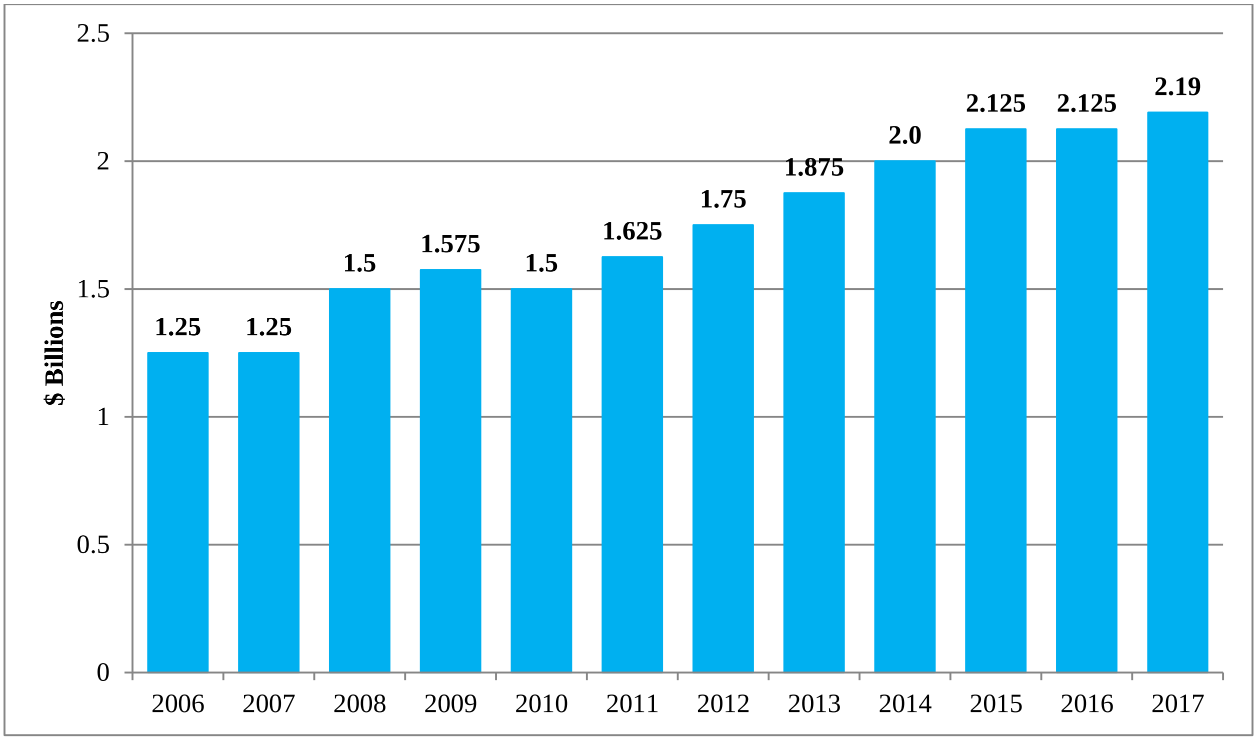
One policy change was to increase the state bond cap, that is, the amount of general obligation debt the state borrows each year. The bond cap has grown from $1.25 billion in FY 2007 to $2.19 billion in FY 2017 (Figure 2), an increase of $940 million in annual capital spending.

While increasing the bond cap allows the Commonwealth to invest more in necessary capital projects, it also adversely affects the state's operating budget. As noted, an additional $940 million in annual capital spending is offset by higher debt service costs paid each year in the operating budget. In FY 2008, debt service costs were $2 billion. Debt service costs in the 2017 budget are expected to reach $2.64 billion, a $640 million or 30 percent increase. It is important to note that the extra debt service costs impact the operating budget for years as the state repays the principal and interest costs of borrowing over the life of the bonds.

[8] FY 2017 sources do not include $198 million of toll revenues and $330 million of revenues from municipalities, campuses, and authorities.

Figure 2 – State Bond Cap – FY 2006 – FY 2017

($ billions)



The second major policy change was the creation of two special obligation bond programs for transportation that are financed by dedicated revenues.[9] The Accelerated Bridge Program (ABP) was created in 2008 to fix structurally deficient bridges. It is backed by $3 billion of state gas tax bonds and borrowing against future federal funds through the sale of Grant Anticipation Notes. ABP debt is not included in the statutory debt limit.

The Rail Enhancement Program (REP), established in 2014, is backed by a variety of transportation-related revenues including the incremental revenue increase from the three cent hike in the gas tax and the re-purposing of motor vehicle sales taxes to the Commonwealth Transportation Fund. Over the life of this program, the state expects to sell approximately $2.1 billion in bonds. The first issuance took place in 2015 and subsequent issuances will occur as necessary. REP debt is not part of the bond cap but is included in the statutory debt limit.[10] While these bonds have enabled the state to expand its capital program in recent years, both

[9] Special obligation bonds are backed by a dedicated sources of revenues and are not sold as general obligation bonds, hence they are not part of the state's bond cap.

[10] Governor Baker's FY 2016 Chapter 90 proposal includes a section to exclude the Rail Enhancement Program from the state's outstanding direct debt.

programs have hard limits on available funding meaning that once the money is spent it will no longer be an available resource for future capital spending.[11]

V. SIZE OF THE CAPITAL BUDGET – CONTROLLING STATE DEBT

While the size of the operating budget is subject to the availability of anticipated revenues, it is only recently that policymakers have imposed more meaningful restrictions on capital spending. Prior to these changes, the biggest determinant of capital spending had been the amount of debt the state was willing to tolerate. Controls on the amount of state borrowing were largely a measure of the impact of debt service costs on the state's operating budget. Simply put, the more the state borrows, the more the state must spend on debt service to repay principle and interest obligations, and the less money there is to spend on other needs.

Beginning in the early 1990s, policymakers attempted to place controls on the state's debt burden. These capital budget controls were necessary for three reasons: (1) to reduce the amount of debt-related costs the state incurs; (2) to alleviate the strain it puts on the operating budget and (3) to demonstrate to credit agencies that Massachusetts could show fiscal restraint. Efforts to manage the capital budget have varied in form – from changes in statute to the institution of administrative controls –and effectiveness.

The following sections provide a chronology of the legislative action taken with respect to debt limits and debt affordability. While the two categories are closely intertwined, we will separate them for ease of presentation.

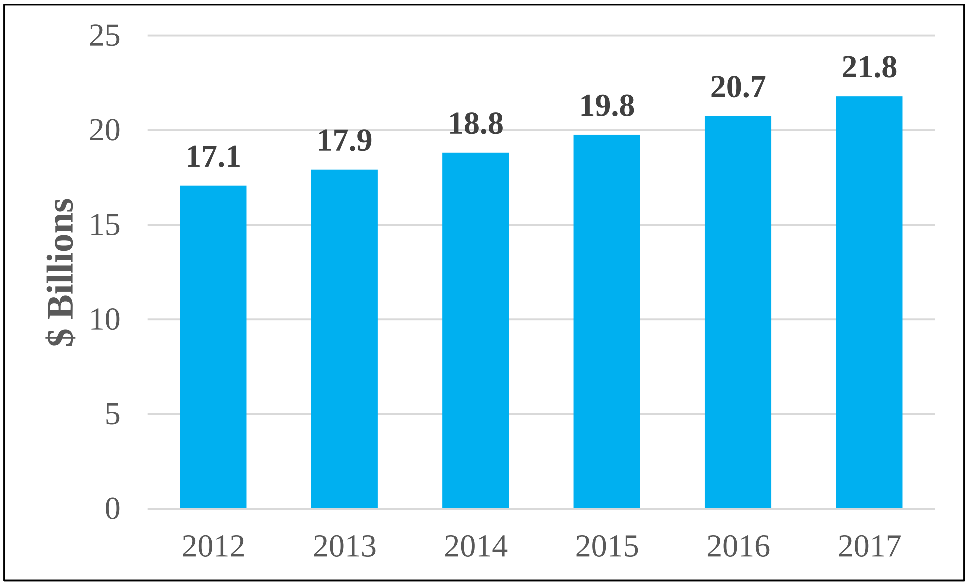
A. Statutory Debt Limit

In 1991, legislators imposed statutory limits on the amount of outstanding direct debt the state could carry on its books and restrictions on the growth of debt from one year to the next.[12] At that time, the outstanding direct debt limit was set at $6.8 billion and restricted to five percent growth over the previous fiscal year.

In 2011 legislators enacted additional debt restrictions. The statutory debt limit was reduced by almost a billion dollars – to $17.07 billion from $18.04 billion, but the annual allowable growth rate of 5 percent remained in place. In FY 2016, the statutory debt limit is $20.75 billion and rises another five percent to $21.79 billion in FY 2017 (Figure 4).

[11] All funds for the Accelerated Bridge Program are expected to be committed by September 2016. The state projects issuing approximately $2.1 billion in Rail Enhancement Bonds supported by transportation revenues in the 2013 Transportation finance Bill.
[12] M.G.L. Chapter 29, Section 60A.

Figure 4 – Statutory Debt Limit – FY 2012 – FY 2017



It is important to note that not all state debt is included in the calculation of the statutory debt limit. In fact, several types of borrowing are explicitly exempt from the statutory debt limit including:

- bonds payable from the Central Artery and Statewide Road and Bridge Infrastructure fund;
- the Accelerated Bridge Program;
- federal Grant Anticipation Notes (GANs);
- convention center bonds;
- Massachusetts School Building Authority SMART bonds; and
- some special obligation gas bonds.

These borrowing categories are exempt because they rely on dedicated revenue sources to pay debt service obligations rather than the General Fund. In total, these exclusions comprise $4.9 billion in additional debt obligations above the $18.9 billion of outstanding direct debt limit for FY 2015 (Table 3 and Figure 4).

Table 3 – Outstanding Direct Debt Calculation as of June 30, 2015[13]
($ thousands)

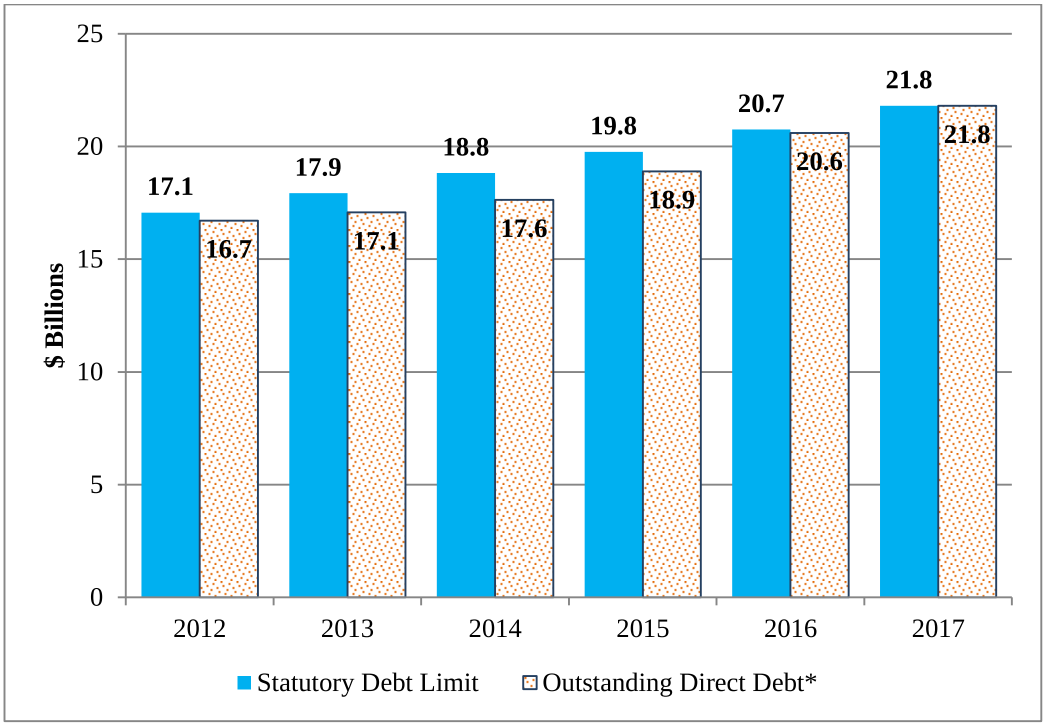
	Principal Outstanding
Statutory debt June 30, 2015	**23,826,301**
Less amounts excluded	**(4,911,124)**
Central artery project bonds	(1,197,127)
Accelerated bridge program	(2,195,004)
MBTA forward funding	(207)
SMART bonds	(689,446)
Convention center bonds	(618,705)
Special obligation gas bonds	(210,635)
Outstanding direct debt	**18,915,177**

As shown in Figure 5, in fiscal years 2012 through 2015, the statutory debt limit exceeded total outstanding direct debt by approximately $600 million on average and did not impede state borrowing. Beginning in FY 2017, however, state debt is likely to come up against the statutory cap, constraining future borrowing. This change is partially the result of the issuance of rail enhancement bonds which are included in the calculation of outstanding direct debt.

As described earlier the Rail Enhancement Program is a new capital source to support additional borrowing for transportation investments. REP bonds were issued to fund the acquisition of Red and Orange Line vehicles and certain Green Line Extension costs among other things. While few would dispute the necessity of new MBTA trains, the creation of new programs such as REP illustrates the difficulty of staying within the statutory debt limit while also leveraging revenues and enhancing the state's borrowing capacity.[14]

[13] The Commonwealth of Massachusetts, *Comprehensive Annual Financial Report (draft - unaudited)*, fiscal year ending June 30, 2015, p. 102.
[14] Governor Baker's FY 2016 Chapter 90 proposal includes a section to exclude the Rail Enhancement Program from the state's outstanding direct debt.

Figure 5 – Statutory Debt Limit vs. Outstanding Direct Debt, FY 2012 – FY 2017



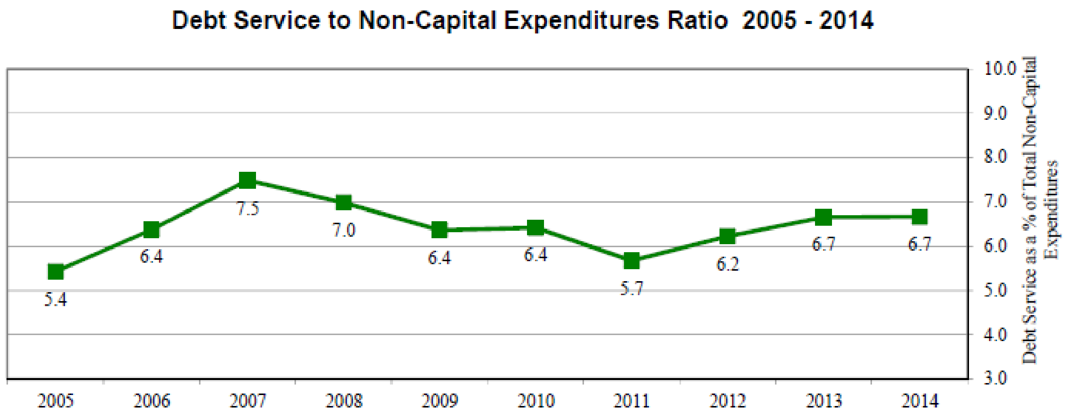
*FY 2016 and FY 2017 outstanding direct debt figures are estimates from the debt affordability committee's December 2015 recommendations based on current issuance plans

B. Debt Affordability Policy

In order to limit the amount of aggregate debt carried on the books of the state, in 1990, the Legislature placed a ten percent ceiling on the amount of annual budgeted appropriations that could be spent for the Commonwealth's debt service costs. Unfortunately, this policy was marginally effective in controlling debt limits and debt service costs because the ten percent ceiling did not apply to several bond categories. These include fiscal recovery bonds, special obligation bonds, Commonwealth refunding bonds and MBTA capital spending that was supported by the state at that time.[15] Thus, these controls were inadequate in addressing overall state borrowing because they did not cover total debt service costs.

[15] Massachusetts Taxpayers Foundation, *Massachusetts Capital Spending: Collision Course?*, September 1995, p. 7.

Figure 6



In 2008, in response to the ever increasing demand for capital investments and the need for a standardized process, the Patrick administration adopted a more restrictive debt affordability policy than the 1990 legislation. The new policy imposed further restrictions on debt service costs, including some non-general obligation debt, by limiting them to eight percent of budgeted revenues.[16,17] The purpose of the policy was to better align growth in the state bond cap with growth in state revenues as measured by the ratio of debt service costs to budgeted revenues. (As shown in Figure 6, debt service costs have remained below the eight percent limit.)

Additionally, this policy imposed a stricter cap on growth by limiting the amount the bond cap could increase to $125 million annually.[18] This policy is not a statutory requirement to which the administration must strictly adhere; rather it is an administrative procedure designed to maintain flexibility for changing economic conditions.

C. Debt Affordability Committee

The most recent effort to instill greater rigor and transparency into the annual capital spending process occurred in 2012 when lawmakers established the capital debt affordability committee.[19]

[16] Budgeted revenues includes Massachusetts tax collections, departmental fees, and federal reimbursements used to pay the operating budget including debt service and pensions but not off budget dedicated revenues to the MBTA and the Massachusetts School Building Authority. In 2015 the Debt Affordability Committee recommends a target of 7.0 percent to 7.5 percent of debt service costs to budgeted revenues, below the 8.0 percent cap adopted administratively.

[17] Includes all principal and interest payments on general obligation debt, special obligation gas tax debt, rail enhancement bond debt, and accelerated bridge program debt.

[18] The 5% growth affects the allowable year-over-year increase in the statutory debt limit and has no impact on the bond.

[19] M.G.L. Chapter 29, Section 60B. Voting members of the committee include the Secretary of Administration and Finance; the Treasurer; the Comptroller; the Secretary of Transportation; one individual appointed by the Governor; and two individuals appointed by the Treasurer (any voting member may appoint a designee). Non-voting members include "the house and senate chairs and the ranking minority members of the committees on bonding, capital expenditures and state assets and the committees on ways and means.

This committee is charged with providing the Governor and legislative leaders with an annual recommendation for the amount of new Commonwealth debt to be authorized in the coming fiscal year. The recommendation is advisory and does not bind the governor or legislature. The enabling statute holds:

> "On or before September 10 of each year, the committee shall submit to the governor and the general court the committee's estimate of the total amount of new commonwealth debt that prudently may be authorized for the next fiscal year."

The statute instructs the committee to consider several variables in developing its annual recommendation. These variables include:

- the amount of state bonds outstanding and the amount of state bonds authorized but unissued (see Table 1);
- a ten-year projection of debt service requirements and the state's ability to pay debt service costs for the next five years;
- criteria used by bond rating agencies that include various debt-ratio measures; and
- a comparison of Massachusetts debt-ratios with the five other New England states, New York, and five additional states selected by the committee (see Appendix A for complete enabling language).

As part of its recommendation, the debt affordability committee's most recent analysis shows the high debt burden of the Commonwealth (Table 4). According to the committee's analysis, Massachusetts ranks second only to Connecticut among its peer states in every measure of debt obligation including: debt and debt service as a percentage of personal income; debt per capita; debt as a percentage of gross state product; and debt as a percentage of state expenditures and state revenues.

Table 4 – Debt Affordability Committee's FY 2017 Comparative Debt Analysis[20]

	Debt to personal income	Debt service to personal income	Debt per capita	Debt as % of GDP	Debt service as % of GDP	Debt service as % expenditures	Debt service as % of revenues
Connecticut	8.68%	0.95%	$5,630	8.70%	0.95%	8.41%	8.90%
Maine*	0.30%	0.30%	$120	3.10%	0.31%	2.19%	2.27%
Maryland	3.46%	0.36%	$1,875	3.49%	0.37%	3.52%	3.82%
Massachusetts	**5.66%**	**0.70%**	**$3,324**	**5.28%**	**0.65%**	**5.54%**	**5.80%**
Minnesota	3.23%	0.40%	$1,581	2.99%	0.37%	3.26%	3.16%
New Hampshire	3.78%	0.20%	$1,994	3.99%	0.21%	2.70%	2.91%
New York	3.81%	0.48%	$2,119	3.27%	0.41%	3.91%	3.91%
North Carolina	1.99%	0.23%	$778	1.76%	0.20%	2.12%	2.12%
Ohio**	3.21%	0.25%	$1,356	2.96%	0.23%	2.99%	2.89%
Rhode Island	4.83%	0.59%	$2,334	4.87%	0.59%	4.46%	4.77%
Vermont**	2.04%	0.25%	$948	2.19%	0.26%	2.28%	1.99%
Virginia	1.40%	0.20%	$705	1.37%	0.19%	2.54%	2.58%

This high debt burden relative to other states has been confirmed by other independent sources such as the Pew Charitable Trust and is carefully monitored by credit rating agencies. In its most recent annual review, the debt affordability committee acknowledges the concerns expressed by both Moody's and Standard & Poor's (S&P) regarding the high level of state debt and its impact on future borrowing. In a recent alert in which S&P revised its outlook on the Commonwealth's long-term rating from stable to negative, it concluded "On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a score of '3.3' to Massachusetts's debt and liability profile".[21]

Moody's concurs that Massachusetts debt ratios are among the highest in the nation and cause for concern when the state's large unfunded pension and retirees' health insurance obligations are also considered. While Moody's acknowledges that Massachusetts debt burden is well-managed and that the debt burden is high in part due to the state paying for capital investments that are often covered at the local level in other states, "the increased leveraging of the Commonwealth's resources to pay debt service or further erosion in pension funding ratios"[22] could result in a lowering the state's credit rating which would increase borrowing costs and further limit the size of the capital budget.

D. The debt affordability committee has raised other concerns. Among them are the growth in annual payments to pay for the state's unfunded pension liabilities and the nearly $16 billion in unfunded OPEB (other retiree employment benefits) liabilities, the largest

[20] *Debt Affordability Committee Attachment to Recommendation December 15, 2015*, p. 7.
[21] Ratings Direct, *Massachusetts; General Obligation; General Obligation Equivalent Security, etc*., November 23, 2015, p. 10.
[22] Moody's Investor Services, Moody's assigns Aa1 to $550M of Massachusetts GO bonds; outlook stable, November 19, 2015, p. 2.

component of which is retiree health care benefits. The growing costs for these obligations will put additional strain on the state's operating budget and leave fewer funds available to pay for debt service costs or other public spending priorities. Potential Reforms to the CIP.

The majority of the capital budget reforms that have been adopted in recent years have focused on tracking total capital spending and the affordability of debt service. A complementary reform that lawmakers have not adopted to date but one they should consider is increasing the transparency of the process for choosing capital investments. Prior to allocating money to a specific project in the capital plan, a rigorous and transparent process for selecting projects, for scoring the cost of projects and for evaluating which ones provide the greatest value should be employed and made public. After the money is allocated, regular reporting requirements for how the money was spent should be required. By creating an annual review process to reestablish the timelines, costs, benefits, and value to the state of each project, the state could minimize the misuse or inefficient use of capital funds. This is critical since nearly 90 percent of the state's capital budget is directed to existing projects. Every agency receiving capital funds should report on the status of each project at least annually. Requisite information would include the original budget amount, capital and operating dollars spent since the project was funded, dollars spent during the most recent fiscal year, the number of personnel paid from capital funds, funds needed to complete the project, and the scheduled completion date.

These reporting requirements would also address the dearth of data that further hinders the state's ability to determine whether projects are on budget and on time. Without accurate information, it is virtually impossible to meaningfully monitor the progress of capital projects. For example, with greater transparency and accountability, the state could have avoided spending $75 million *over 19 years* for a software project (awarded in 1996) to link 100 court houses across the state *that is still not complete*.[23]

In addition, a commitment to redirect all available cash, especially from one-time funds currently used to balance the state's operating budget, to capital investments in state assets is also a sensible reform that lawmakers should consider. This practice could add more than $500 million to the state's five-year CIP and significantly reduce the overall cost of completing projects by eliminating interest payments.

By adopting the measures listed above, the Commonwealth could improve the capital spending plan, enhance the use of limited capital dollars and put the state on a more sound fiscal path.

[23] "Call it Big Data's Big Dig — $75m, 19 years, still not done", Todd Wallack, The Boston Globe, April12, 2015.

CONCLUSION

The capital budget is an important but often overlooked analog to the state's operating budget yet the consequences of capital investments are equally vital to the economy.

Massachusetts currently borrows to make most of its capital investments. Due to this fact, Massachusetts is a high debt state by almost every measure – among the highest in the nation. This high debt burden impedes the state's ability to make additional capital investments. While lawmakers have taken steps to manage the size of our debt and the costs associated therewith, more must be done because the state has limited flexibility to increase borrowing from current levels without exceeding its statutory debt limit.

Despite Massachusetts's high debt burden, the state has enormous unmet capital needs. Recent reports suggest that the state faces a potential funding gap of as much as $40 billion in transportation and water and sewer infrastructure over the next 20 years and that is only a portion of the state's overall infrastructure needs.

While not the subject of this report, further complicating matters is the size of the state's unfunded state pension and OPEB liabilities. Totaling nearly $50 billion, this obligation erodes the state's capacity to direct additional funds towards long-term investments in assets.

What should be abundantly clear is that the state can ill afford to waste or mismanage capital spending. There are numerous examples in recent years of capital projects that have squandered hundreds of millions of dollars of precious capital dollars with little or no return.[24] Such inefficiencies must not persist.

The process could be improved greatly with the adoption of some common sense reforms that increase accountability and improve transparency.

[24] Recent examples include Department of Revenue's MassTax II, the Connector's health insurance exchange, and the Registry of Motor Vehicle's ten-year development to update its antiquated online system.

Appendix A

Chapter 165 of the Acts of 2012, Section 60B:

Section 60B. (a) In this section, the following words shall, unless the context clearly requires otherwise, have the following meanings.

"Committee", the capital debt affordability committee established under this section.

"Tax supported debt", direct debt, as further described and limited in the first sentence of the second paragraph of section 60A; and other forms of debt, including state agency capital leases supported in whole or part by state tax revenues and debt of the department of transportation, and other units of commonwealth government which, in the opinion of the committee, are supported directly or indirectly by state tax revenues; provided that "tax supported debt", shall include debt issued by the department of transportation under chapter 6C that is secured by a pledge of future federal aid from any source.

(b) This section applies only to tax supported debt. This section shall not be construed to affect the authority of the governor to submit any bills under the procedures established in Article XLII or XLIII of the Amendments to the Constitution, or the authority of the general court to continue its independent analysis of commonwealth debt affordability or to consider bills that authorize commonwealth debt or appropriations bills under said Article XLII or XLIII of the Amendments to the Constitution.

(c) There shall be within the executive office for administration and finance, but not subject to its supervision or control, a capital debt affordability committee consisting of the following voting members: the secretary of administration and finance who shall chair the committee; the treasurer; the comptroller; the secretary of transportation; 1 individual appointed by the governor who shall be an expert in public finance and who shall be a resident of the commonwealth and employed by a public or private institution of higher education; and 2 individuals appointed by the treasurer who shall be experts in state public finance, and who shall be residents of the commonwealth and not employed by state government, either as a state employee or as an independent contractor. The house and senate chairs and the ranking minority members of the committees on bonding, capital expenditures and state assets and the committees on ways and means shall be nonvoting members of the committee. Any voting member may delegate that member's appointment. Each individual appointed by the secretary or treasurer shall serve terms established by the appointing authority, but not longer than 4 years. Each appointed individual may serve second or subsequent terms, and each appointed individual may continue to serve after the individual's term expires if desired by the appointing authority.

(d) The chairman shall call meetings of the committee as needed to perform its duties.

(e) The committee shall review on a continuing basis the size and condition of the commonwealth tax supported debt as well as other debt of any authority of the commonwealth that is determined to be a component unit of the commonwealth by the comptroller under subsection (c) of section

12 of chapter 7A. The estimate shall be made available electronically and prominently displayed on the official website of the commonwealth.
(f) On or before September 10 of each year, the committee shall submit to the governor and the general court the committee's estimate of the total amount of new commonwealth debt that prudently may be authorized for the next fiscal year. In making its estimate, the committee shall consider:

(1) the amount of state bonds that, during the next fiscal year:

(i) will be outstanding; and
(ii) will be authorized but unissued;

(2) the capital program prepared by the secretary of administration and finance;

(3) capital improvement and school construction needs during the next 5 fiscal years, as projected by the Massachusetts School Building Assistance Authority;

(4) projections of debt service requirements during the next 10 fiscal years;

(5) the criteria that recognized bond rating agencies use to judge the quality of issues of state bonds;

(6) any other factor that is relevant to:

(i) the ability of the state to meet its projected debt service requirements for the next 5 fiscal years; or
(ii) the marketability of state bonds;

(7) the effect of authorizations of new state debt on each of the factors in this subsection;

(8) identification of pertinent debt ratios, such as debt service to General Fund revenues, debt to personal income, debt to estimated full-value of property, and debt per capita;

(9) A comparison of the debt ratios prepared for paragraph (8) with the comparable debt ratios for the 5 other states in New England, New York and 5 other states the committee determines to offer a fair comparison to the commonwealth;

(10) A description of the percentage of the state's outstanding general obligation bonds constituting fixed rate bonds, variable rate bonds, bonds that have an effective fixed interest rate through a hedging contract, and bonds that have an effective variable interest rate through a hedging contract. The report shall also include, for each outstanding hedging contract, a description of the hedging contract, the outstanding notional amount, the effective date, the expiration date, the name and ratings of the counterparty, the rate or floating index paid by the state and the rate or floating index paid by the counterparty, and a summary of the performance of the state's hedging contracts in comparison to the objectives for which the hedging contracts were executed; and

(11) the amount of issuances, debt outstanding, and debt service requirement of other classes of commonwealth tax supported debt as well as other debt of commonwealth units.

(g) The estimate of the committee shall be advisory, and shall not bind the governor or the general court.

(h) On or before October 15 of each year, after considering the current estimate of the committee, the governor shall determine:

(1) the total authorizations of new commonwealth debt that the governor considers advisable for the next fiscal year; and
(2) the preliminary allocation of new commonwealth debt for capital facility projects

Appendix B

2007 – 2015 Bond Bills ~ $37.9 billion

Immediate Needs - $1.8 billion

- March 2007 – $1.8 B immediate needs for the completion of ongoing capital projects, federal funding for transportation projects and funding for projects related to state buildings, energy and environment, public safety, health and human services and transportation.

Transportation - $20.6 billion

- April 2008 – $1.6 B bond bill for transportation improvements.
- August 2008 – $2.984 B in Commonwealth special obligation bonds and/or federal highway grant anticipation notes to finance the accelerated bridge program.
- August 2008 – $1.445 B for road and bridge projects and other transportation-related capital investments.
- April 2011 and June 2012 – $200 M bond bills for local Chapter 90 road and bridge construction.
- August 2012 – $885 M transportation bond authorization.
- May 2013 – $300 M bond bill for local Chapter 90 road and bridge construction.
- April 2014 – $12.8 B bond bill for road and bridge construction, rail construction, MBTA projects, RTA projects, and airport projects.
- April 2015 – $200 M bond bill for local Chapter 90 road and bridge construction.

Housing - $2.7 billion

- May 2008 – $1.275 B affordable housing bond bill.
- November 2013 – $1.4 B housing bill that funds 11 capital funding programs.

Life Sciences - $500 million

- June 2008 – $500 M over a 10-year period to fund capital investments and infrastructure improvements to support the life sciences industry.

Broadband - $40 million

- August 2008 – $40 M to capitalize the Broadband Incentive Fund, which is to be used to invest in long-lived, publicly owned broadband infrastructure to connect the Commonwealth's un-served and underserved communities to broadband services.

Higher Education - $2.2 billion

- August 2008 – $2.2 B higher education for new buildings, renovation projects and capital improvements at the Commonwealth's public higher education campuses.

General Government - $4.5 billion

- August 2008 – $3.3 B general government bond bill to investment in public safety, city and town facilities, state buildings and information technology systems including funding to replace and upgrade the outdated systems at the Department of Revenue and the Registry of Motor Vehicles.
- August 2014 – $1.241 B to support a wide range of capital projects including state facility improvements, public safety equipment and municipal grant programs.

Energy & Environment - $3.9 billion

- August 2008 – $1.64 B land, parks and clean energy that includes funding to enhance state parks and rebuild related infrastructure.
- August 2014 – $2.228 B to fund energy efficiency programs, coastal repairs, dam repair projects, environmental grant programs and other park land and recreation facilities projects.

Capital Supplemental - $375 million

- June 2013 – $375 M capital supplemental for the continued funding of information technology projects, deferred maintenance projects at state facilities and energy projects.

Military - $177 million

- March 2014 – $177 M to make investments in the Commonwealth's military bases.

Information Technology – 1.1 billion

- August 2014 – $1.104 B to modernize and enhance government operations through information systems and network improvements.