# *Capital Budget*

ENSE PETIT PLACIDAM SVB LIBERTATE QVIETEM

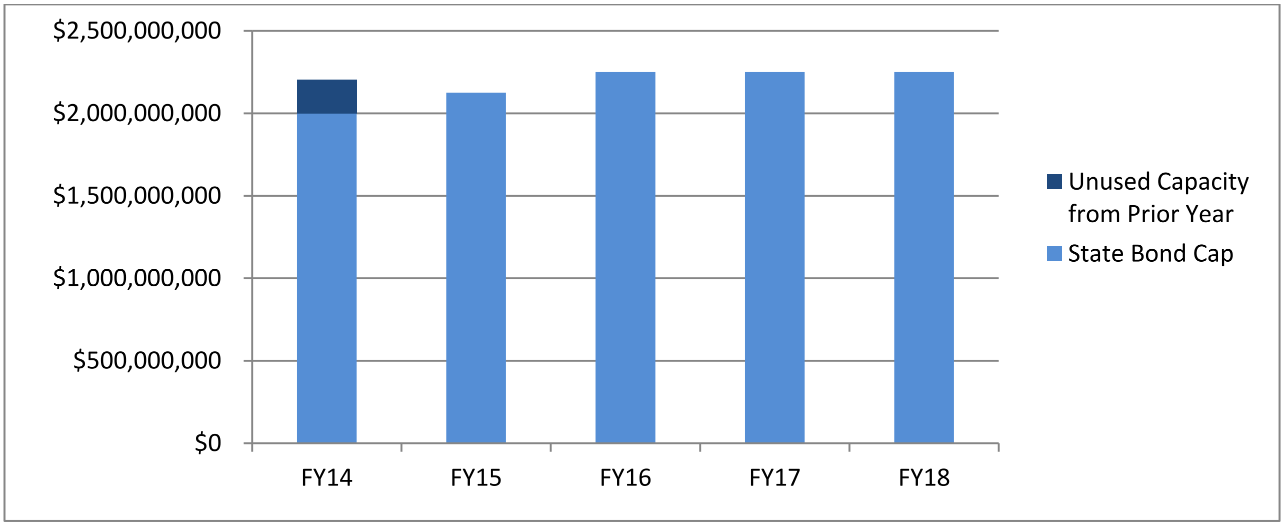
The Commonwealth's five-year capital investment plan is updated annually after the operating budget has been released. Under Governor Patrick's leadership, the Executive Office for Administration and Finance (A&F) now develops a five-year capital investment plan in conjunction with an annual debt affordability analysis to help ensure Massachusetts continues to borrow responsibly.

The current FY 2014-2018 plan implements the vision and priorities established in each of the Patrick Administration's first six plans. In large part, the investments included in the FY 2014-2018 plan continue ongoing projects launched in prior years. Over 80% of the bond-funded FY 2014 capital investment plan is needed to fund previously-made commitments, including ongoing construction contracts, investments needed to leverage federal funds, legal commitments and personnel needed to carry out capital programs.

As with the prior capital plans, the Administration engaged in a diligent, fiscally responsible, and comprehensive process for developing this five-year capital investment proposal. The Commonwealth is responsible for maintaining a large inventory of capital assets, including transportation infrastructure, courts, correctional facilities, state hospitals, office buildings, parks and more. In addition, the Commonwealth makes targeted capital investments to support economic growth, strengthen communities and improve the quality of life in the Commonwealth. These investments include funding for public infrastructure to support private development and job growth, local infrastructure improvements and protection of our natural resources. One common challenge each year is that demand for capital improvements far exceeds affordable funding capacity. The inevitable consequence is that many worthy projects will not receive funding.

The primary factor constraining the amount of the Commonwealth's capital budget is affordability. The Commonwealth must pay principal and interest costs each year on the bonds it issues to fund its capital investment program. These annual debt service expenses on outstanding Commonwealth bonds are funded each year in the Commonwealth's annual operating budget. The Patrick Administration is the first to develop and publish an analysis of the amount of debt the Commonwealth can afford in terms of its impact on debt service and the operating budget, and it is the first to develop a policy for determining the annual borrowing amount to fund the capital budget. In part due to the Patrick Administration's diligence in following the debt affordability analysis, the state presently has ratings of Aa1 from Moody's and AA+ from Fitch and Standard & Poor's. Taken together, these ratings give Massachusetts its highest credit standing in history.

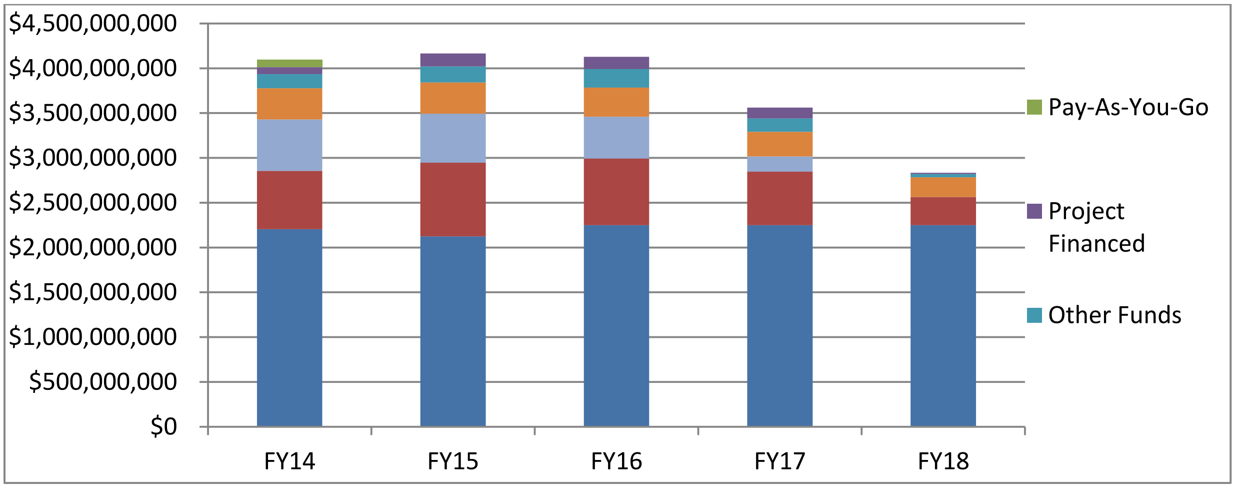
**FY 2014-2018 Capital Investment Plan**
Total Bond Cap




**FY2014-2018 Capital Investment Plan**
Total Bond Cap (In thousands)

| | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 | Five Year Total | % of 5-Year Total |
|---|---|---|---|---|---|---|---|
| **Community Investments** | $346,485 | $324,053 | $290,509 | $295,305 | $275,974 | $1,532,326 | 14% |
| **Corrections** | $76,412 | $21,225 | $30,115 | $30,500 | $30,100 | $188,352 | 2% |
| **Courts** | $27,681 | $66,472 | $120,559 | $82,600 | $48,200 | $345,512 | 3% |
| **Economic Development** | $126,780 | $143,500 | $123,500 | $123,500 | $117,003 | $634,283 | 6% |
| **Energy And Environment** | $191,362 | $126,691 | $127,061 | $107,152 | $124,463 | $676,729 | 6% |
| **Health And Human Services** | $92,338 | $63,287 | $40,081 | $38,114 | $48,000 | $281,820 | 3% |
| **Higher Education** | $226,813 | $251,716 | $330,573 | $409,100 | $324,103 | $1,542,305 | 14% |
| **Housing** | $179,500 | $168,850 | $169,500 | $169,500 | $170,000 | $857,350 | 8% |
| **Public Safety** | $73,351 | $44,546 | $44,630 | $36,086 | $27,080 | $225,692 | 2% |
| **State Government Infrastructure** | $220,401 | $195,486 | $158,197 | $140,943 | $142,078 | $857,104 | 8% |
| **Transportation** | $644,550 | $719,175 | $815,275 | $817,200 | $943,000 | $3,939,200 | 36% |
| **Total Bond Cap** | **$2,205,673** | **$2,125,000** | **$2,250,000** | **$2,250,000** | **$2,250,000** | **$11,080,673** | |

**FY 2014-2018 Capital Investment Plan**
Total All Sources




**FY 2014-2018 Capital Investment Plan**
Total All Sources (In thousands)

| | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 | Five Year Total | % of 5-Year Total |
|---|---|---|---|---|---|---|---|
| Community Investments | $381,427 | $354,953 | $321,009 | $326,205 | $279,474 | $1,663,068 | 9% |
| Corrections | $76,412 | $21,225 | $30,115 | $30,500 | $30,100 | $188,352 | 1% |
| Courts | $27,681 | $71,472 | $135,559 | $87,600 | $48,200 | $370,512 | 2% |
| Economic Development | $151,780 | $168,500 | $148,500 | $148,500 | $117,003 | $734,283 | 4% |
| Energy And Environment | $243,038 | $241,262 | $237,531 | $236,952 | $182,392 | $1,141,175 | 6% |
| Health And Human Services | $165,490 | $125,706 | $87,645 | $63,066 | $64,440 | $506,347 | 3% |
| Higher Education | $266,611 | $298,466 | $386,773 | $430,700 | $325,603 | $1,708,153 | 9% |
| Housing | $179,500 | $168,850 | $169,500 | $169,500 | $170,000 | $857,350 | 5% |
| Public Safety | $83,001 | $54,216 | $47,830 | $36,786 | $27,080 | $248,912 | 1% |
| State Government Infrastructure | $309,266 | $290,223 | $235,545 | $193,862 | $189,562 | $1,218,458 | 6% |
| Transportation | $2,209,051 | $2,372,916 | $2,308,708 | $1,848,490 | $1,490,006 | $10,229,171 | 54% |
| Total All Sources | $4,093,257 | $4,167,789 | $4,108,714 | $3,572,161 | $2,923,859 | $18,865,781 | |

**Highlights of the FY 2014 Capital Investment Plan**

- In FY 2014, the Patrick Administration will triple the funding to $15 M in the Cultural Facilities Fund to support non-profit cultural facilities throughout the Commonwealth.

- An investment of $10 M will be made in critical coastal infrastructure projects immediately ready for construction. This funding will also provide for a sweeping risk assessment of the entire Massachusetts coastline and stimulate the development of sustainable infrastructure projects to mitigate coastal risk.

- The Boston Public Market project will convert a vacant state building adjacent to the Rose Kennedy Greenway into a public market to offer a variety of local and culturally significant food products. This project will create 100 construction jobs and 200 permanent jobs.

- Funding of $62.6 M will be invested in Governor Patrick's Life Sciences Initiative in FY 2014, an $8.7 M increase over FY13. These capital investments provide funding for over 15 projects including the University of Massachusetts Amherst's new life sciences laboratories, Boston Children's Hospital, LabCentral, Northern Essex Community College, the University of the Massachusetts Dartmouth's Biomanufacturing Facility, the Joslin Diabetes Center, and the Dana Farber Cancer Institute.

- The FY 2014 Capital Plan includes the announcement of an unprecedented number of new community college projects, which affirms the Administration's commitment to investing in community colleges that provide students with strong educational foundations and relevant workforce training opportunities that will prepare them for success in the local job market or further academic study.

- A one-time, $10 M additional investment in Affordable Housing for Priority Populations projects will be funded in FY 2014. This additional capital funding capacity will allow DHCD to create additional housing options for priority populations, including the chronically homeless, veterans and others in need of supportive housing.

- With over $450 M committed to the Green Line Extension project to date, the FY 2014-18 Capital Investment Plan anticipates Union Square service by mid-2017 and completing construction tasks necessary to ensure rest of the proposed service begins by the of this decade.

The full five-year Capital Investment Plan can be found at www.mass.gov/capital. The charts below show the plan's investments by major investment categories for each of the five fiscal years covered by the plan funded only from state bond proceeds or "bond cap" and funded from all anticipated sources of capital funding. Note that FY 14 includes $205 million in unused capacity from the prior fiscal year. The Administration established the FY 2015 bond cap at $2.125 B, and the FY16-2018 bond caps at $2.25 B. Future debt affordability analysis may show sufficient revenue growth to allow increased bond cap in future plans.

**Impact of Capital Budget on the Operating Budget**

Each year, as part of the annual development of the capital investment plan, the Executive Office for Administration and Finance evaluates the operating budget impacts for all requested projects. Every capital spending request must show the incremental and ongoing annual operating costs/savings that are expected to be incurred upon completion of the project. The decision on whether to fund a capital project depends on A&F's assessment of not only the programmatic need for the project, but also the affordability of the related operating costs. The following capital budget construction projects are expected to result in an FY 2014 operating budget impact that exceeds $500,000 per year:

- Bridgewater State University's Conant Science Building Modernization and Expansion

- New Middlesex Justice Complex
- The Hampden Sheriff's Department's Western Massachusetts Women's Correctional Facility
- The Massachusetts College of Liberal Arts' Center for Science and Innovation
- Springfield Data Center
- UMass Amherst's New Laboratory Science Building
- UMass Lowell's South Campus Academic Facilities

In addition, for construction projects that are starting study in FY 2014, those studies will project the operating cost impact and will be reported to A&F during the year. When agencies are preparing their annual budget requests during A&F's spending plan process they are asked that the additional operational costs associated with capital projects are reflected in their projected funding requirements.

With additional funding appropriated in the FY 14 General Appropriations Act, MassDOT was able to transfer $40 M in expenses from the capital budget to its operating budget. The FY 2014-2018 Capital Investment Plan was developed in accordance with the goal of ending the historical practice of using borrowed money to pay for salaries, rents and other operating expenses within the next two years.

Several overarching initiatives currently being undertaken by the Commonwealth have both capital and operating budget components. These initiatives include the following:

*Integrated Facilities Management & the Clean Energy Investment Program*

The Patrick Administration has also increased its focus on sustainable funding for capital projects once they are completed, to ensure they are properly maintained into the future. Through the capital investment plan, the Patrick Administration has taken steps to reverse the pattern of underinvestment and reduce the deferred maintenance backlog that was facing the Commonwealth's infrastructure. The Administration has also taken steps to improve care for current and new capital assets as they are completed. The Governor's FY 2015 budget includes a $3.3 M investment in Integrated Facilities Management (IFM) which will allow the Division of Capital Asset Management and Maintenance (DCAMM) to implement a sustainable funding structure for their capital portfolio. IFM establishes service standards as well as a detailed rent methodology to ensure state agencies are caring for their capital assets properly so they Commonwealth can use them for generations.

DCAMM has also established the Clean Energy Investment Program (CEIP) to investment in technology that increases energy efficiency and reduces costs in the long term. Each CEIP project is required to submit a detailed return on investment (ROI) analysis to DCAMM prior to receiving CEIP capital funds. This ROI analysis requires each project to show at least a 10% savings figure; agencies are then required to use this savings to fund the debt service on the CEIP project once it is completed. Requiring agencies to use their savings on debt service for the CEIP project ensures that agencies have the operating funding necessary to sustain debt service payments over the life of the bonds as it matches with corresponding decreases in energy spending need.

*Project Financed IT Investments*

Investments in IT have substantial impacts across all corners of state government. State agencies are able to provide increasingly higher levels of service in even the most challenging fiscal climates; municipalities are able to invest more local aid in programmatic needs instead of support systems; and health care cost containment is in part made possible by the investments made in the Commonwealth's IT infrastructure. In addition to improving service, IT investments can produce a return on investment to the Commonwealth through new revenue or cost savings due to operational efficiencies.

To ensure that the Commonwealth realizes this return on investment, the Administration engaged a renowned private IT investment consultant to produce a methodology for creating, maintaining and monitoring the long term benefits and costs of IT capital projects. This methodology will be used to verify new and existing projects' long term impact and drive investment decisions. The consultant is also now partnering with the Commonwealth to design and implement a user-friendly but powerful web-based application to help identify the key financial and non-financial benefits of IT investments.

One of the key features of the new return on investment-based process is to help identify projects which can generate increased revenues and/or operational savings that can also help pay some or all of the costs of the project. In cases where all or part of the project cost will be paid back through operational savings or new revenue, the Commonwealth will use those funding streams to pay back the associated debt service.

Finally, the Administration will deploy a new Strategic IT Procurement Team to provide assistance to agencies procuring large, complex IT projects and to help ensure that projects get off to a good start. This team will take recommendations from the IT procurement study due to the Legislature in 2014 and other industry best practices to assist agencies with planning, writing and completing large procurements. The goal of this team is to reduce onerous requirements which lead to extended timelines for project completion and implementation of dated technology, as well as to improve competition for the Commonwealth's IT business.

### *Introduction*

The Patrick Administration's capital investment program continues to be guided by three key principles: (1) affordability, (2) strategic prioritization of capital investments and (3) transparency. The Commonwealth faces a backlog of needed capital projects; at the same time, it faces the constraints of a challenging, albeit improving, economic climate and a high debt burden. In light of these challenges, it is as critical as ever that the Commonwealth take a disciplined approach to capital budgeting that is guided by the three principles stated above. Over the past seven years, the implementation of these principles has contributed to bond ratings of Aa1, AA+ and AA+ from Moody's, Standard & Poor's and Fitch, respectively – the highest ratings in Commonwealth history.

The Commonwealth's capital program is funded primarily through bond proceeds. As such, the total size of the capital program is determined primarily by the amount of debt the Commonwealth can afford to issue and pay in debt service. The FY 2015 budgeted debt service figure, $2.508 B, displays the capital program impact on the operating budget. It should be noted that a large majority of the $2.508 B funds decades of previous capital infrastructure investment, while only a small portion funds debt service requirements based on new debt issuances. In order to achieve affordable debt service costs, while prudently addressing the Commonwealth's infrastructure needs, the Patrick Administration has conducted an annual debt affordability analysis.

For the seventh consecutive year, this rigorous analysis of the Commonwealth's outstanding debt determined the affordable level of bond issuance and addressed the affordability principles listed above. An administrative "bond cap" is established as a guideline for annual bond issuance in support of the capital program. Based on the analysis conducted during the development of the FY 2014-2018 Capital Investment Plan, the Administration established the FY 2014 bond cap at $2 B, the FY 2015 bond cap at $2.125 B, and the FY16-2018 bond caps at $2.25 B. FY 2014 will also utilize $205 M in unspent FY13 bond cap capacity.

### *Debt Affordability Analysis*

The goal of the Administration's debt affordability analysis is to determine an annual borrowing amount that addresses the Commonwealth's critical infrastructure needs while remaining affordable in terms of its impact on debt service and the operating budget. To achieve this, two core principles are adhered to: limiting annual growth to $125 M and holding total debt service under 8% of budgeted revenues. The intent of the analysis is to fully encompass all debt service obligations including general obligation bonds, certain special obligations, contract assistance obligations and certain capital lease payments. The analysis also takes a conservative approach to projecting future budgeted revenues, basing its growth estimate on the lesser of 3% or the actual compound annual growth rate of the Commonwealth's revenues over the last ten years – which included both economic booms and downturns. The analysis models future debt issuance using fiscally conservative assumptions about interest rates, maturities, dates of issuance and market conditions.

While the analysis limits virtually all future bond-funded capital projects to the bond cap, there are certain, limited circumstances in which the Administration plans to undertake borrowing outside the bond cap when there is a sound policy justification for doing so. For example, there are certain projects for which dedicated streams of new, project-related revenues or savings can be identified to support debt service costs related to those projects.

Based on this analytical approach, it is projected that the Commonwealth will have the capacity to accommodate steady increases in the bond cap over the next two years while maintaining the percentage of the Commonwealth's budgeted revenues needed to pay debt service during that period.

The debt affordability analysis methodology is based on the Commonwealth's current available financing resources and mechanisms; changes in financing structures and resources in the future may impact how the administrative bond cap and the Commonwealth's capacity for additional borrowing are viewed. The Administration plans to revisit the debt capacity and affordability analysis every year, revising its estimates for future years by taking into account fluctuations in interest rates, budgeted revenues and other changes impacting the Commonwealth's debt capacity. In addition, the Administration will annually assess the appropriateness of the methodology and constraints for establishing the bond cap described above.

### *Self-Supporting Project Financings*

Unlike past practice in Commonwealth capital budgeting, the Patrick Administration has taken all debt service and debt-like payment obligations into account in determining the appropriate level of annual borrowing. The Administration recognizes, however, that exceptions to this policy may be justified in limited circumstances where a project financed with debt payable by the Commonwealth directly or indirectly generates new state revenue or budgetary savings that is targeted to the payment of such debt. In these limited circumstances, the Administration will exclude the debt from the annual bond cap and will exclude such debt service payment obligations from the debt affordability analysis. In the instances where such debt service is supported by a new or budgeted stream of state revenue, the related new revenue used to pay such obligations will also be excluded from the analysis set forth herein for purposes of determining the annual bond cap.

**Self-Supporting Project Financings**

**Fiscal Years 2013-2018**

($000s)

| Fiscal Year | Infrastructure Development Projects Debt Service | DFS Insurance Assessments | Energy Efficiency Projects Debt Service | IT ROI Projects | Total Self-Supporting Debt Service |
|---|---|---|---|---|---|
| *2013* | *1,977* | *2,986* | *3,579* | *0* | *8,542* |
| 2014 | 2,615 | 3,130 | 1,102 | 1,832 | 8,680 |
| 2015 | 7,211 | 3,302 | 6,027 | 8,194 | 24,734 |
| 2016 | 8,935 | 3,715 | 12,629 | 14,046 | 39,326 |
| 2017 | 8,934 | 3,847 | 20,079 | 17,555 | 50,415 |
| 2018 | 8,932 | 3,847 | 23,517 | 20,234 | 56,530 |

There are three examples of debt the Administration will exclude from the annual bond cap and debt affordability analysis. The first is debt that the Massachusetts Development Finance Agency issues for public infrastructure improvements necessary to support significant new private development, pursuant to the Infrastructure Investment Incentive Program, more commonly known as "I-Cubed". This debt will be excluded because the Commonwealth will ultimately be responsible for funding *only* the portion of the related debt service that is supported by new state tax revenue generated from the related private development. The second example of debt that will be excluded from the debt affordability analysis is debt the Administration issues to fund fire training facility projects, as legislation authorizes the Commonwealth to raise the amounts needed to fund the related debt service costs for such projects through assessments on property insurance policies. The third example is debt associated with projects deemed to be self-funded based on a rigorous return on investment (ROI) analysis. These projects result in cost avoidances, increased revenue or other savings that are in excess of the project's cost. There are two categories of self-funded projects based on their return on investment. The first is the Clean Energy Investment Program (CEIP) initiated by the Governor in January 2010, in which the Commonwealth issues general obligation bonds to fund energy efficiency and renewable energy projects at state facilities. These projects result in energy cost savings from less energy use and a portion of the related budgetary savings will be used to cover the debt service associated with the general obligation bonds issued to finance the projects. This idea may be expanded to include energy efficiency and renewable energy projects in the state's outdoor and recreational areas. The second category consists of IT projects that go through a rigorous analysis proving that costs will be decreased or eliminated or additional revenue will be created. In FY 2014 two projects, MassNET, a multi-use network that connects Commonwealth agencies, and COMMBUYS, the Commonwealth's electronic procurement system, will be subject to the ROI analysis and are candidates for self-funded status. The table above shows the amounts of incremental tax revenue, assessments and captured energy savings projected to be applied to pay debt service on bonds issued to fund the construction of the infrastructure development projects, fire training facilities and energy efficiency projects, respectively.