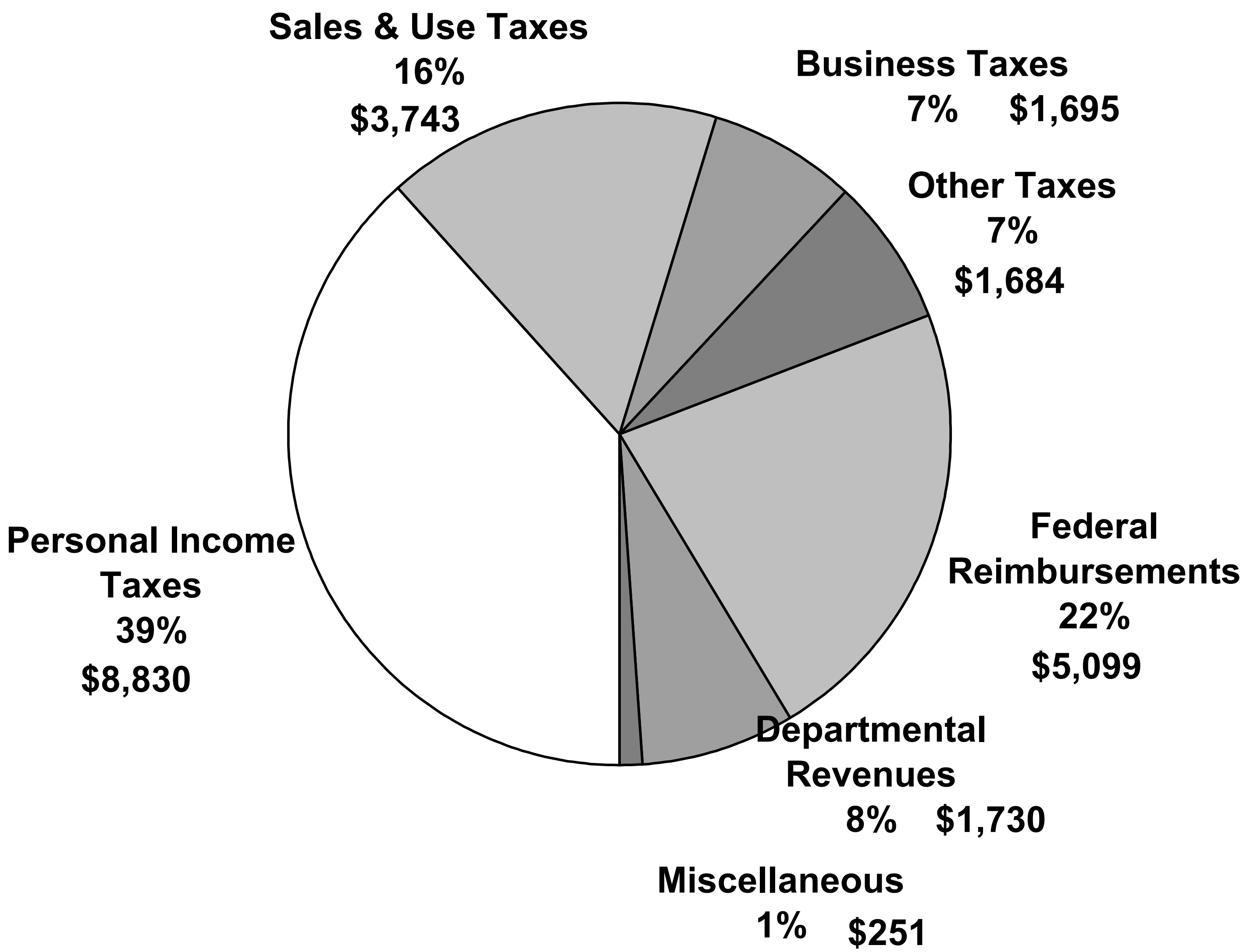
Academy for New State Legislators

Overview of State Finances

December 9, 2004

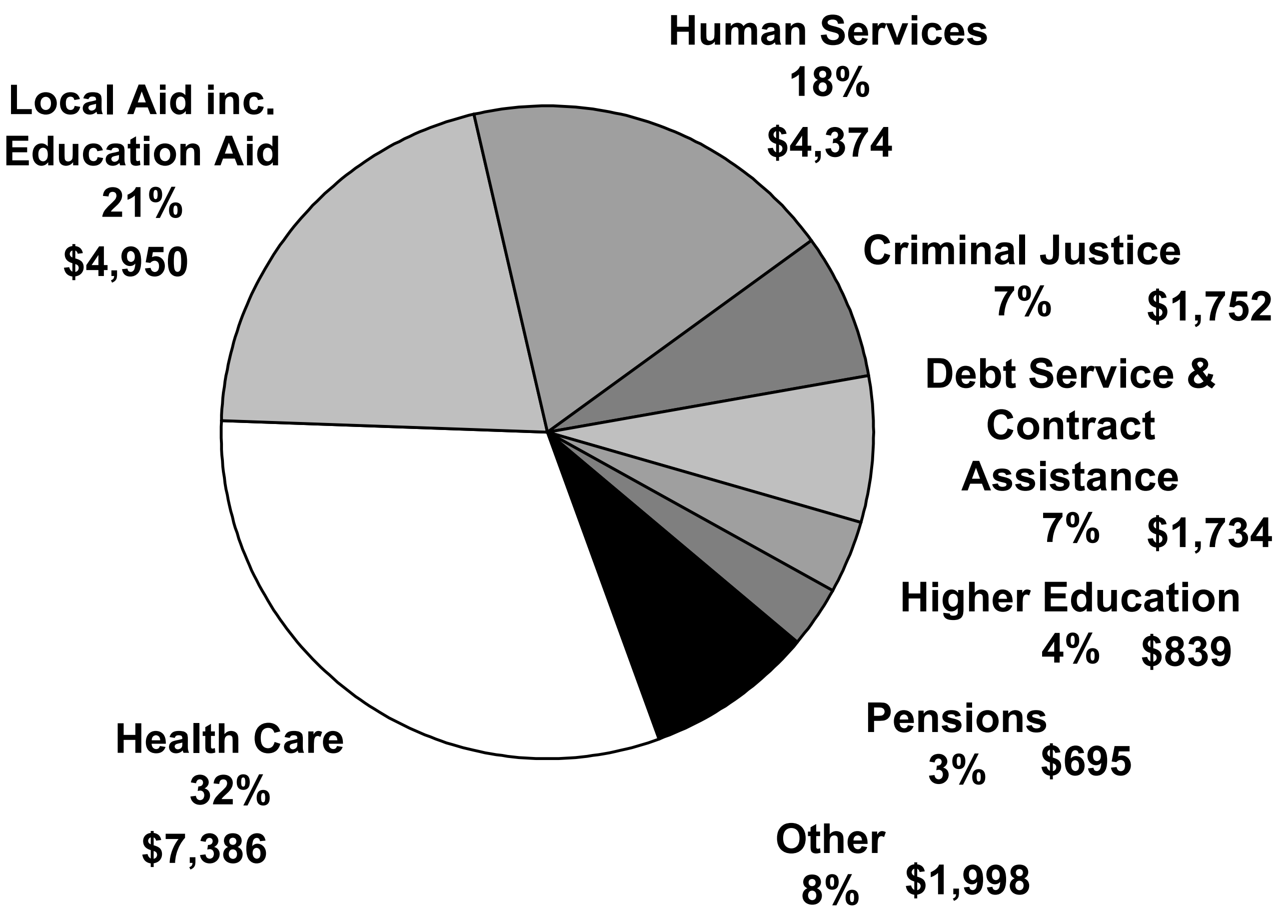
State Budget Revenue Sources, Fiscal 2004

($, Millions)



State Spending Categories, Fiscal 2004

($, Millions)



Changes in Spending During Fiscal Crisis

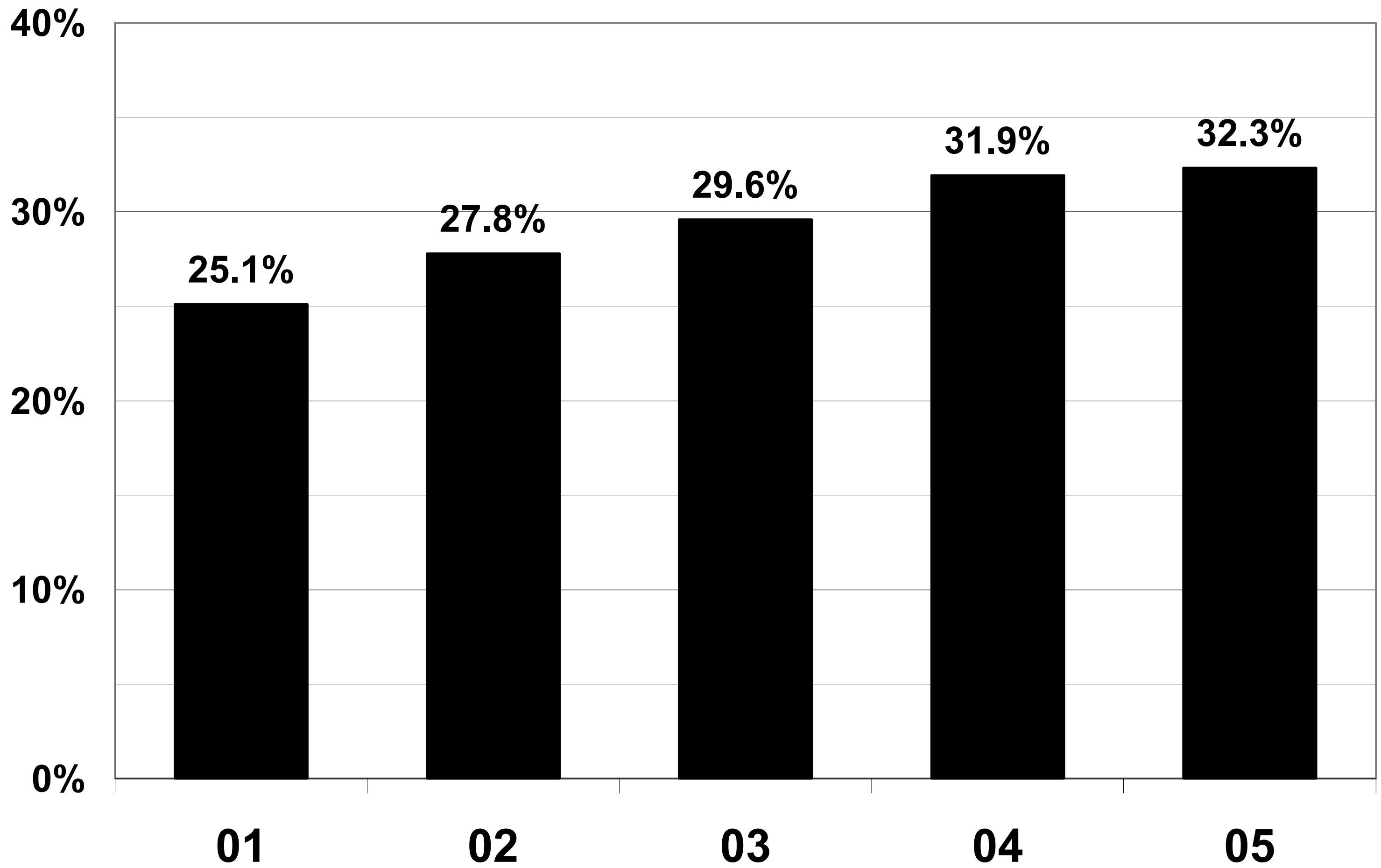
2001 vs. 2005

($, Millions)

	2001	2005	Change		
	Spending	Budget	$	%	Annual %
Health Care	$5,562	$8,185	$2,623	47.2%	10.1%
Debt Service & Pensions	2,712	3,202	490	18.1%	4.2%
Criminal Justice	1,731	1,861	130	7.5%	1.8%
Human Services	4,380	4,575	195	4.5%	1.1%
Education & Local Aid	5,260	5,161	(99)	(1.9%)	(0.5%)
Higher Education	1,109	916	(193)	(17.4%)	(4.7%)
Other	1,399	1,416	16	1.2%	0.3%
Total	$22,153	$25,315	$3,162	14.3%	3.4%

Health Care As Share of State Budget 2001 – 2005

Includes Medicaid, uncompensated care, senior pharmacy program, and employee health benefits



Major Reserves

($, Millions)

	Stabilization	Tobacco	Federal	Total
Ending Balance:				
2003	$641	$478	$492	$1,611
2004	1,137	420	270	1,827
2005 (est.)	797	420	0	1,217

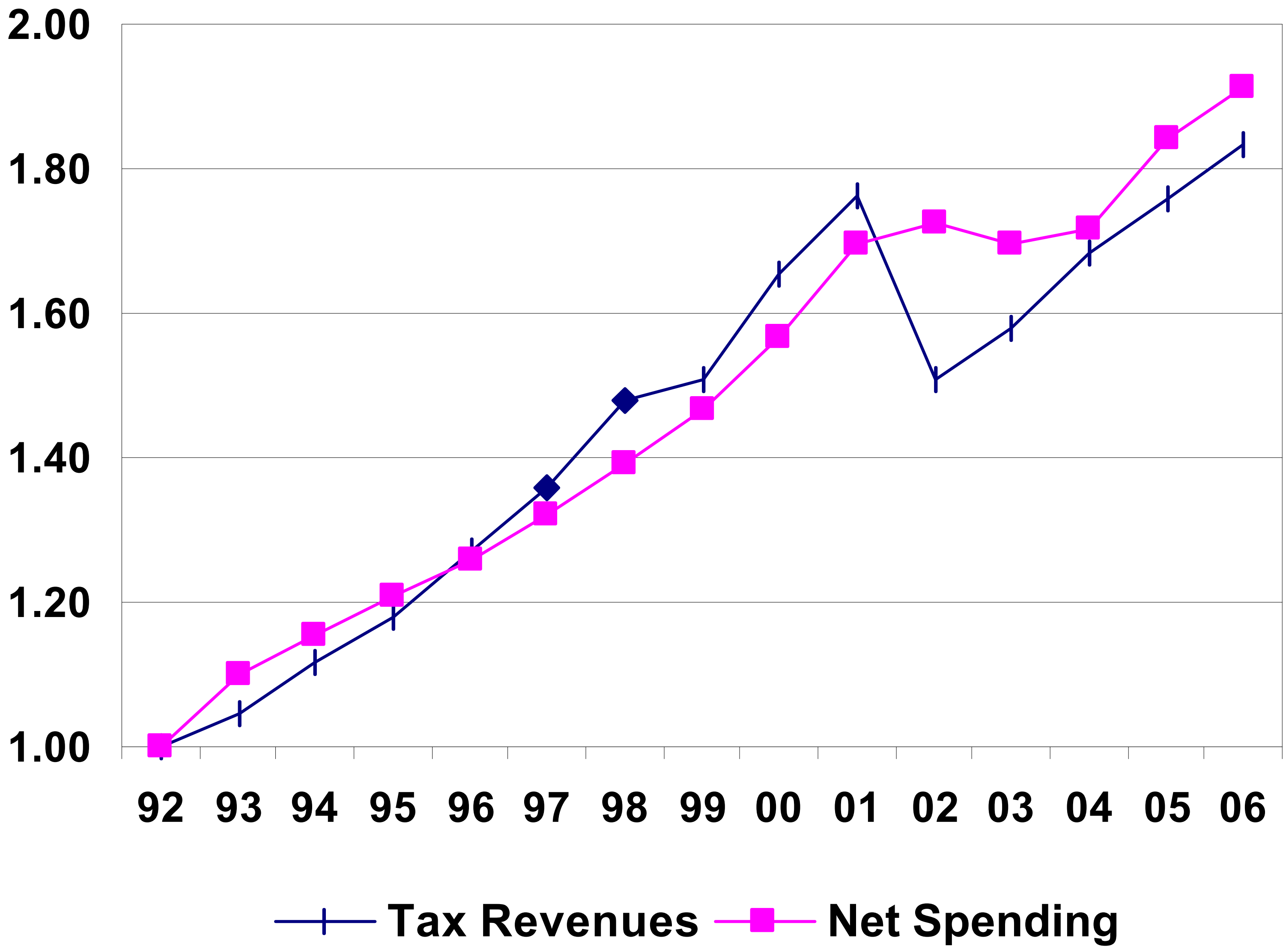
Despite Revenue Growth and Budget Cuts, Commonwealth Faces Structural Deficits

- Structural Deficit: The gap between spending in ongoing programs and revenues from recurring sources
- With economic recovery, tax revenues have been growing since fiscal 2002, but not enough to keep up with spending growth
- Resulting budget gaps in 2004 and 2005 filled with one-time resources that need to be replaced in following year, perpetuating structural deficit
- Revenue performance in 2004 and 2005 has been above budget forecasts, but not by enough to cover spending growth and eliminate need for one-timers
- Healthy revenue growth projected to continue in fiscal 2006 but still insufficient to close structural deficit

State Tax Revenues and Spending

(Net of Federal Medicaid Reimbursements)

FY92 = 1.00



2005 Tax Forecast Is Up, But Not Enough to Offset One-Time Resources

- Almost $1 Billion Of 2005 One-Timers:
  - $340 million of withdrawals from stabilization fund
  - $277 million of FY05 spending authorized in the final 2004 supplemental and charged to the stabilization fund
  - Remaining $270 million of federal fiscal relief (FMAP)
  - $104 million of other one-time sources
- MTF projects 2005 tax revenues will exceed budget forecast by approximately $700 million, still not enough to outweigh the non-recurring financing sources

Fiscal 2005 Structural Balance

($, Millions)

Deficit carried forward from 2004	($145)
Tax revenues above budget forecast (MTF December projection)	697
Less: 2005 one-time resources	991
Structural deficit	($439)

Fiscal 2006 Initial View

($, Millions)

Deficit carried forward from 2005	($439)
Tax revenue growth in MTF December Forecast	703
Spending growth	
Medicaid & other health care at 10 percent	465
Debt service	139
Chapter 70 school aid	95
School building assistance	93
Pensions	58
Sales tax dedicated to MBTA	34
Subtotal	884
Structural imbalance	($620)

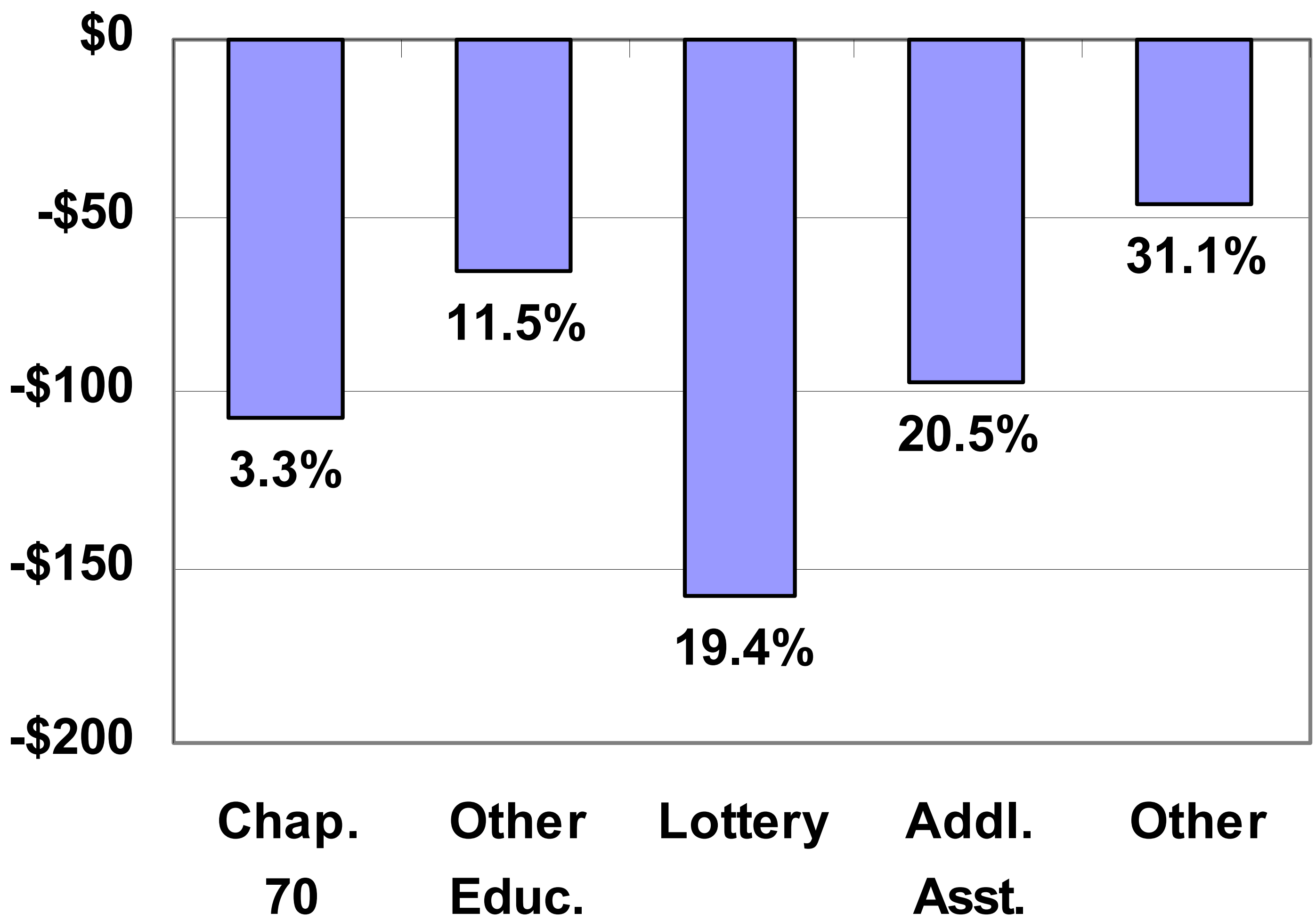
Longer-Term Funding Obligations

Hancock school funding suit	$1.0 b. +
Early childhood education initiative	1.0 b.
Health care provider reimbursements (partially offset by federal reimbursements)	850 m.
Incremental tax cuts per 2002 law (over ten years)	750 m.
School building assistance (over six years)	450 m.
Capital gains suit (one-time)	250-300 m.
Lottery cap phase-out (over five years)	225 m.
Debt service (annual average)	$150 m.
Restoration of spending cuts—human services, local aid, higher education	?
Universal health care ballot question	?

Municipal Finances

FY01-04 State Aid Cuts By Major Program

($, Millions, and Percent)



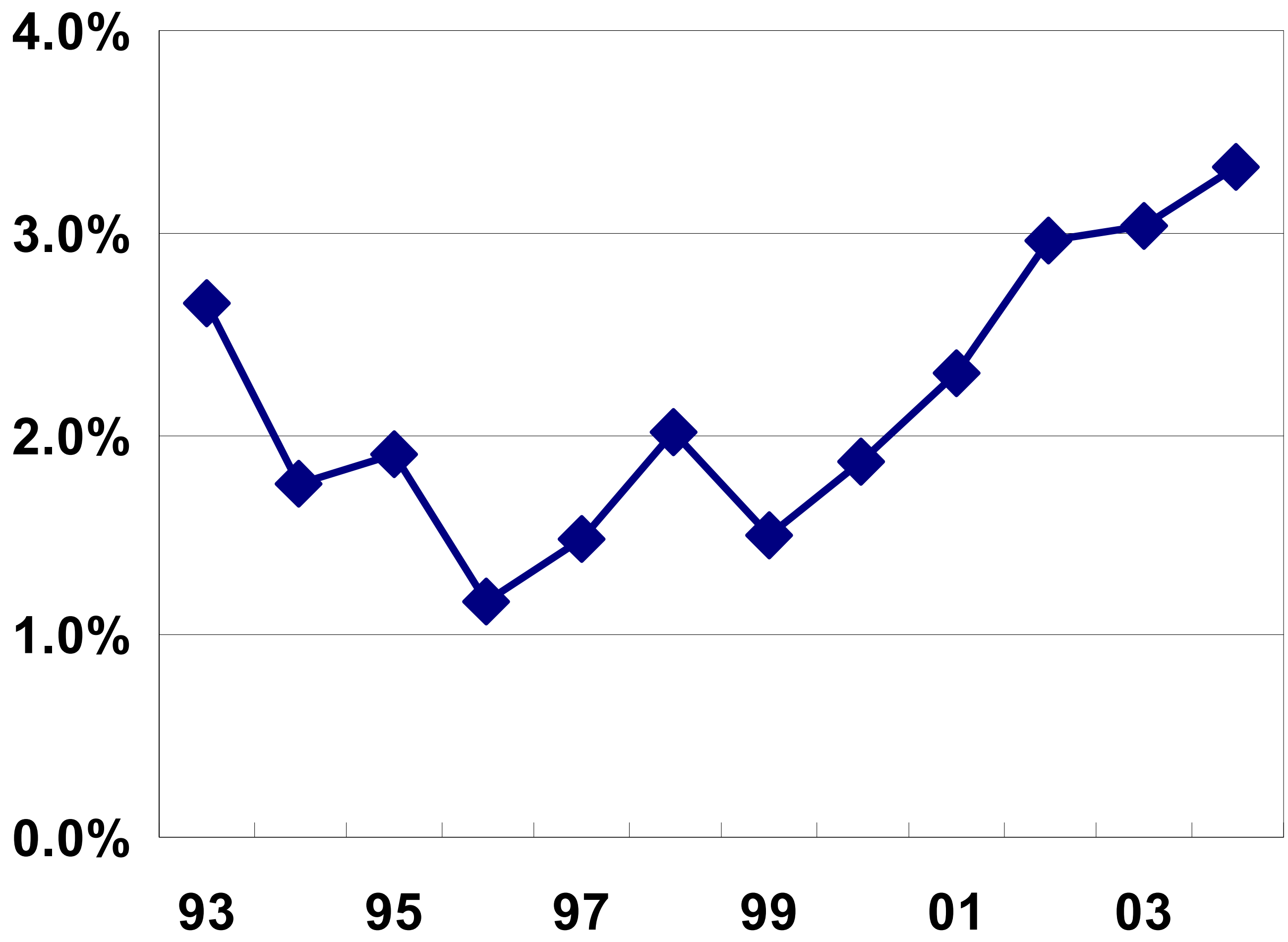
Fiscal 2005 Budget

- Total aid increase of almost $200 million
- Overall assistance still $230 million, or 4.5 percent, below pre-crisis levels—$750 million, or 13.1 percent, lower after adjusting for inflation
- In 273 communities, 2005 aid is $312 million, or almost 9 percent, below peak

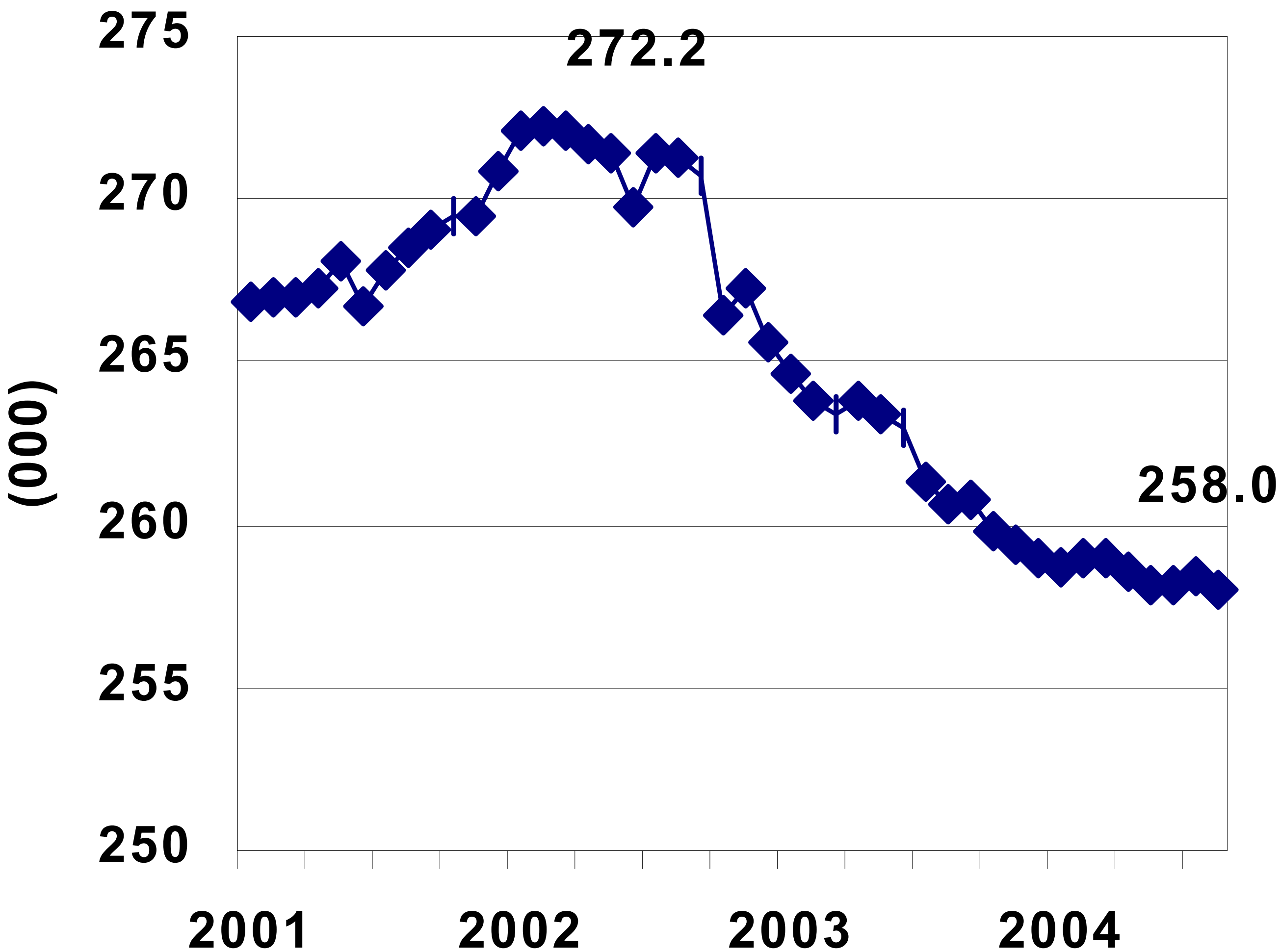
Impact of Aid Cuts

- Higher property tax burden
  - Taxes on the existing property tax base (excluding new construction) have grown at roughly double the rate that prevailed for much of the 1990s
  - Higher rate of growth has added $330 million to local tax bills over the last three years
- Largest percentage decline in local government employment in the nation in 2003 (3.3 percent); total decline of 5.2 percent from Feb. 2002 peak to Aug. 2004
- Rapid depletion of reserves in the majority of communities

Property Tax Growth Per Capita Excluding New Construction



Local Government Employment Down By 14,200 or 5.2 Percent



Capital Finances

Capital Budget

- Large, one-time infrastructure projects: highways, transit lines, seaports, drinking water and wastewater treatment, open space acquisition, school buildings, higher education facilities, courthouses, prisons, public housing, information systems
- Primary funding sources: Commonwealth bonds (borrowing), state contract assistance to authorities and local governments, and federal highway aid
- Two-part process for bonds: 1) Legislature authorizes projects and bonds, 2) Administration prioritizes projects into capital plan, issues bonds to pay for construction
- Bonds repaid over 20 to 30 years with debt service in operating budget

Bond Cap

- Double-digit cost growth made debt service one of the budget busters contributing to fiscal crisis of late 80s and early 90s
- Weld administration imposed $825 million annual cap on bond issues in order to control growth in debt service costs
- Cap has been increased several times, now stands at $1.25 billion
- Cap has been successful at slowing growth in debt service – 3.6% average annual growth from 1993 to 2005 – but has also led to long backlog of unfunded projects
- Cap does not cover all borrowing for capital projects – expensive capital needs have been financed outside of the cap, including MBTA, Central Artery cost overruns, Rt. 3 North reconstruction, Boston Convention Center and School Building Assistance

10% of Operating Budget Pays For Capital

Fiscal 2005 Spending

($, Millions)

On-Budget	
Debt Service on Commonwealth Capital Bonds	$1,740.5
Water Pollution Abatement Trust	72.2
Route 3 North Lease Payments	26.8
Mass. Turnpike Authority Subsidy	25.0
Convention Center Authority Debt Asst.	16.3
Mass. Development Finance Debt Asst.	13.3
MWRA Sewer Rate Relief	10.0
Foxborough Industrial Dev. Fin. Auth. Debt Asst.	5.3
Subtotal	$1,909.3
Off-Budget	
Dedicated Sales Tax: School Building Assistance	$395.7
Dedicated Sales Tax: MBTA debt service	approx. 300
Registry Fees: Transportation Infrastucture Fund	approx. 75
Total	**$2,680.0**

Commonwealth's Capital Problem

Backlog of capital investment priorities far exceeds Commonwealth's financial capacity:

- Cost of projects authorized for bond funding is nearly eight times annual spending under bond cap; additional projects not yet authorized
- $1.5 billion of federal funding for transportation projects will be diverted to repaying Central Artery debt over next decade
- Artery and Turnpike finances threatened by uncertainties regarding toll revenues
- MBTA is under fiscal stress and cannot afford expansion projects

Capital Demands Far Exceed Cap

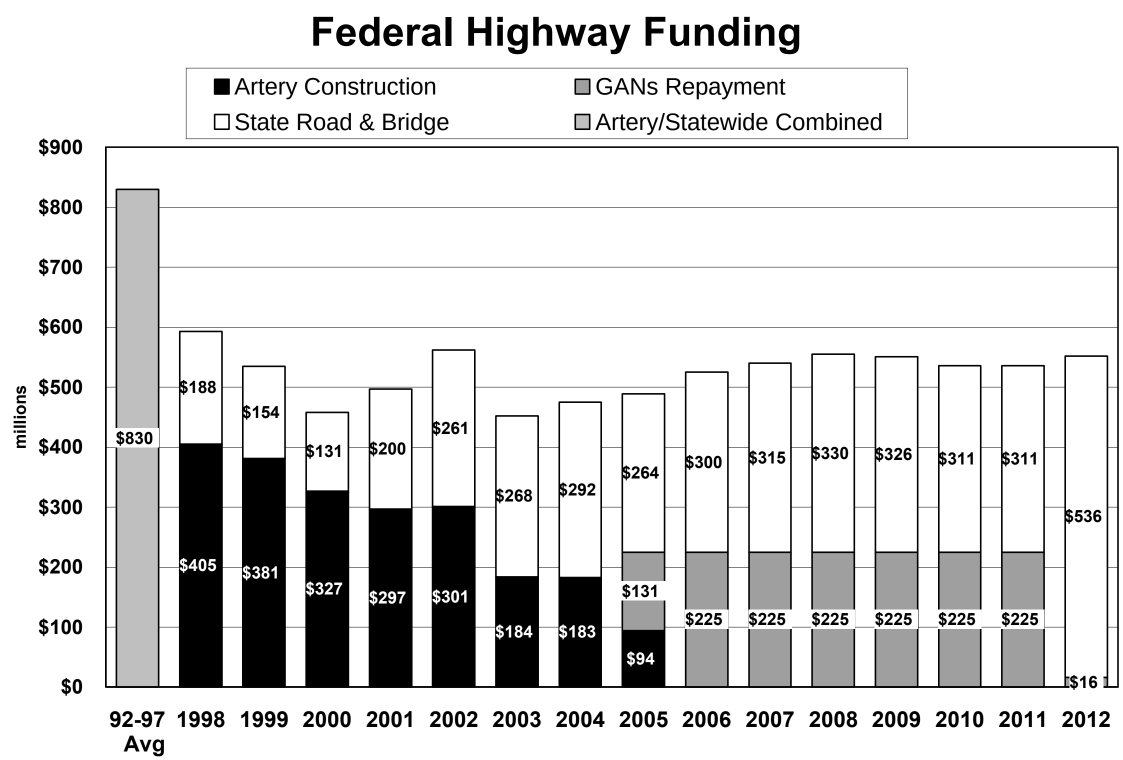
($, Millions)

Category	Previously Authorized / Unissued Bonds 2003/4	Prior Years	Total	FY05 Capital Allotment
Transportation	$2,763	$2,878	$5,641	$573
Environment	0	888	888	132
Housing	470	527	997	123
Courts	0	485	485	106
Higher Education	0	233	233	72
Information Technology	0	257	257	82
Public Safety	0	164	164	61
Other	0	1,159	1,159	131
Total	$3,233	$6,591	$9,824	$1,280

Does not include $1 billion authorized for School Building Assistance

Federal Highway Aid & Central Artery

- Repaying $1.5 billion borrowed in late 1990s to help cover Artery funding gap (GANs) will require up to half of state's federal highway aid between 2005 and 2015



- Federal transportation funding for highways and transit is up for reauthorization; Massachusetts could face a further reduction in aid

Unresolved Toll Issues Threaten Mass. Turnpike/Central Artery Finances

- Toll revenues are key part of Artery finances – expected to cover about $1.3 billion or 9% of construction costs, and all of ongoing operations and maintenance costs (estimated $40M per year)
- Discounts created to offset 2002 toll increase costing Turnpike Authority $14M per year in lost revenue; Turnpike covering discounts with one-time revenues from land sale – no long-term funding sources in place
- Artery finance plan requires additional toll increases in 2008 – $0.25 at Rt. 128 and Cambridge/Allston and $0.50 for tunnels – and every six years thereafter
- Proposal to merge MassPike and Highway Department raises concerns about Commonwealth's long-term ability to maintain adequate funding for the Artery and Turnpike

MBTA Capital Funding Pressures

- T under pressure to continue to expand system, including projects totaling $2B+ required as environmental mitigation for Central Artery
- MTF analysis: T cannot afford expansion projects without sacrificing critical improvements to existing system or undermining its finances:
  - Focus on expansion in 90s left T with $2.7B backlog of deferred maintenance and modernization needs; needs to spend $450M per year just to stay even
  - With $4B debt outstanding from financing decade of expansion, need to reduce debt service costs – currently 30% of budget – by limiting additional borrowing
  - Under forward funding, state support no longer increases to cover debt service and operating costs of new lines

Strategy for Financing Transit Expansions

- Transit is essential element of infrastructure underpinning Massachusetts economy, but expectation that T can finance expansion projects is clearly unrealistic
- Commonwealth needs strategy for financing critical expansions:
  - Commonwealth capital funds – transit should compete with highways for state and federal funds, but capacity is limited
  - User fees – highway tolls and other charges widely used to finance projects around the world
  - Alternative financing mechanisms – private developers funding new stations, tax increment financing, benefit assessments, transit-oriented development of T real estate