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Massachusetts 2004 And 2005 Bonds Outlook To Negative From Stable On Potential Decline In Hotel And Car Rental Activity

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NEW YORK (S&P Global Ratings) April 3, 2020--S&P Global Ratings revised its outlook to negative from stable on the Commonwealth of Massachusetts' $528 million outstanding special obligation dedicated tax revenue bonds series 2004, and revenue refunding bonds series 2005. At the same time, S&P Global Ratings affirmed its 'A' rating on the bonds.

Pledged revenues securing the bonds include certain room occupancy taxes, vehicle rental surcharges, and sales tax and sightseeing surcharges that Massachusetts collects within the cities of Boston, Cambridge, Springfield, Worcester, and Chicopee, as well as the town of West Springfield. The different pledged revenues are accumulated and held in the debt service fund on a monthly or quarterly basis until sufficient to pay debt service due within the fiscal year.

"The negative outlook reflects at least a one-in-three chance we will take a negative rating action on the bonds over the next two years," said S&P Global Ratings credit analyst David Hitchcock. "If hotel and car rental activity remains significantly depressed over the outlook horizon, we could lower the rating. However, if pledged revenue returns to near historical levels, we could revise the outlook to stable," Mr. Hitchcock added.

The trustee currently holds enough money in the bonds' debt service fund to pay an upcoming July 1, interest payment, as well as the following January interest and principal payment, and in addition has a capital reserve available to pay debt service remains fully funded.

However, we believe the long-term outlook for hotel and car rental activity in the Boston area is now uncertain, despite strong 3.01x historical coverage of annual debt service in fiscal 2019 for these special obligation bonds. As the COVID-19 pandemic persists, the implications on the leisure and hospitality sector have been acute and dramatic. Restrictions on travel and consumer activity--driven by physical distancing and stay-at-home orders intended to flatten the curve and slow the viral infection rate--have led to hotel booking cancellations and deferrals, convention and conference cancellations, and the widespread closure of bars and restaurants.

Although the closure decisions are prudent, in our opinion, the health and safety aspect of this action in the near term will materially affect coverage, financial results, and liquidity, which we believe might deteriorate further as a result of the onset of a global recession, and is reflective of our analysis of environmental, social, and governance risks. While the precise impact on the special obligation bonds is unknown at this point, we believe that the decline in pledged hotel tax and vehicle rental surcharge revenues will be precipitous and likely sustained well into the second quarter. With almost 200 million Americans either under shelter-in-place orders or being urged to stay at home in a concerted effort to contain the spread of the coronavirus, we believe that the longest economic expansion in U.S. history has come to an abrupt end (see "It's Game Over For The Record U.S. Run; The Timing Of A Restart Remains Uncertain," published March 27, 2020, on RatingsDirect). S&P Global Economics are now forecasting a global slowdown in GDP growth, with a base-case assumption of 1.3% decline in U.S. GDP in 2020, with annualized declines of 2.1% in the first quarter and 12.7% in the second quarter.

While we acknowledge that there is a high degree of uncertainty regarding the rate of spread and peak of the coronavirus in the U.S., some government authorities estimate that the peak will likely occur about midyear. Though our baseline economic forecast includes an assumption that the current recession will likely be on par with the Great Recession, we believe that the sudden stop to economic activity disproportionately affects the hospitality sector and will likely result in losses occurring over a much shorter time horizon. We estimate a permanent loss of $145 billion (inflation adjusted) from just the consumer channel by 2023. We also believe that there is a high risk to credit if the coronavirus outbreak widens substantially in the U.S., with the impact being a protracted period of COVID-19-containment measures that further amplify the current U.S. economic recession.

While our priority-lien criteria assumes a baseline level of revenue volatility, which we believe is moderate for most hotel taxes, we believe that the sudden economic stop will have an extremely negative impact on pledged revenue. During the Great Recession, revenue per available room (RevPAR) at hotels nationwide declined for 19 consecutive months and there was a 17% annual decline in RevPAR in 2009. We currently assume that RevPAR in the U.S. declines 20%-30% in 2020, but more severely in the second and third quarters. We also expect restaurant sales to decline substantially, particularly for casual diners, as more people eat in and commute less or not at all, and the economic slowdown reduces a propensity to spend on food away from home. However, to the extent that these taxes are pledged in combination with other more stable revenue streams, we have not included those bonds in this rating action because we believe the impact will be attenuated by the other revenue streams, such as personal income taxes and broad-based sales taxes.

Given the assumptions that we have outlined above, we believe that any potential rating action will likely be caused by the magnitude of declines in pledged revenues from the abrupt and sharp decline in economic activity driven by the COVID-19 pandemic and related physical distancing efforts.