



November 8, 2007

Leslie A. Kirwan, Secretary
Executive Office for Administration and Finance
State House, Room 373
Boston, MA 02133

Dear Secretary Kirwan:

On behalf of the Massachusetts Water Resources Authority (MWRA) Advisory Board, we want to extend a sincere thank you for your willingness to meet with us to discuss the Commonwealth Sewer Rate Relief Program. I am writing in response to an inquiry from your staff regarding Debt Service Assistance:

- What is the difference in the impact to ratepayers between a \$15 million and a \$23 million appropriation for state-wide debt service?¹
- Why is the Debt Service Assistance program the most effective way to provide rate relief, and what would be an alternative to the current program?²

We appreciate your interest in this important matter and would like to that this opportunity to answer the questions in the proper historical context.

MWRA HISTORY

Decades of underfunding had left the Metropolitan District Commission (MDC) understaffed and the facilities under its control badly in need of repair and upgrade. In 1984, legislation was enacted to create the Massachusetts Water Resources Authority to assume responsibility for the water and sewer infrastructure serving greater Boston, and to end the pollution of Boston Harbor from obsolete wastewater treatment facilities. The primary mission was to modernize the area's water and sewer systems and clean up Boston Harbor. Other key elements included a huge capital program to repair and upgrade the systems, increase of staff to improve operations and maintenance, promotion of water conservation, and planning for the future to meet growing demand.

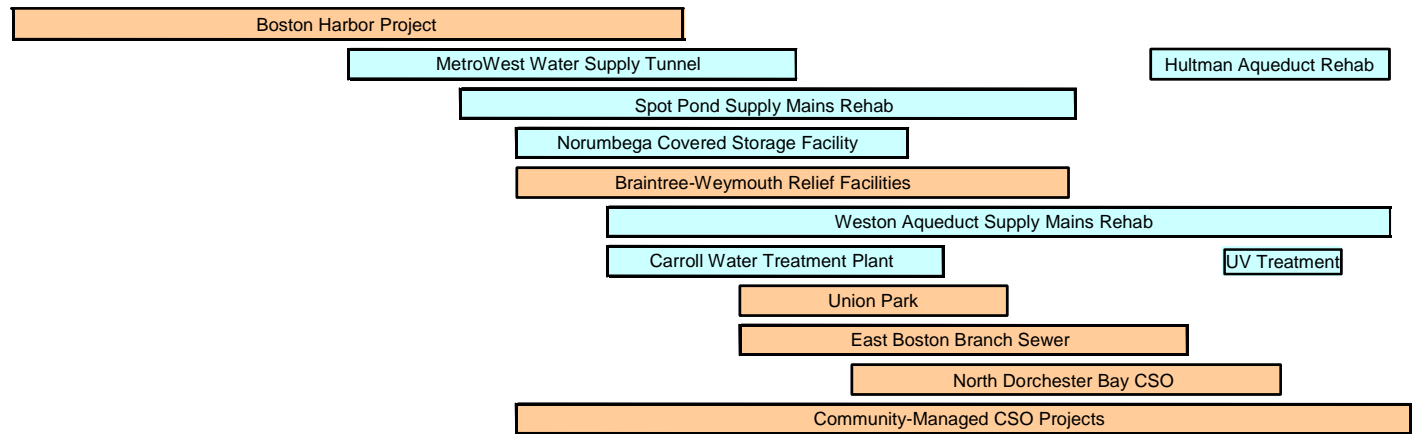
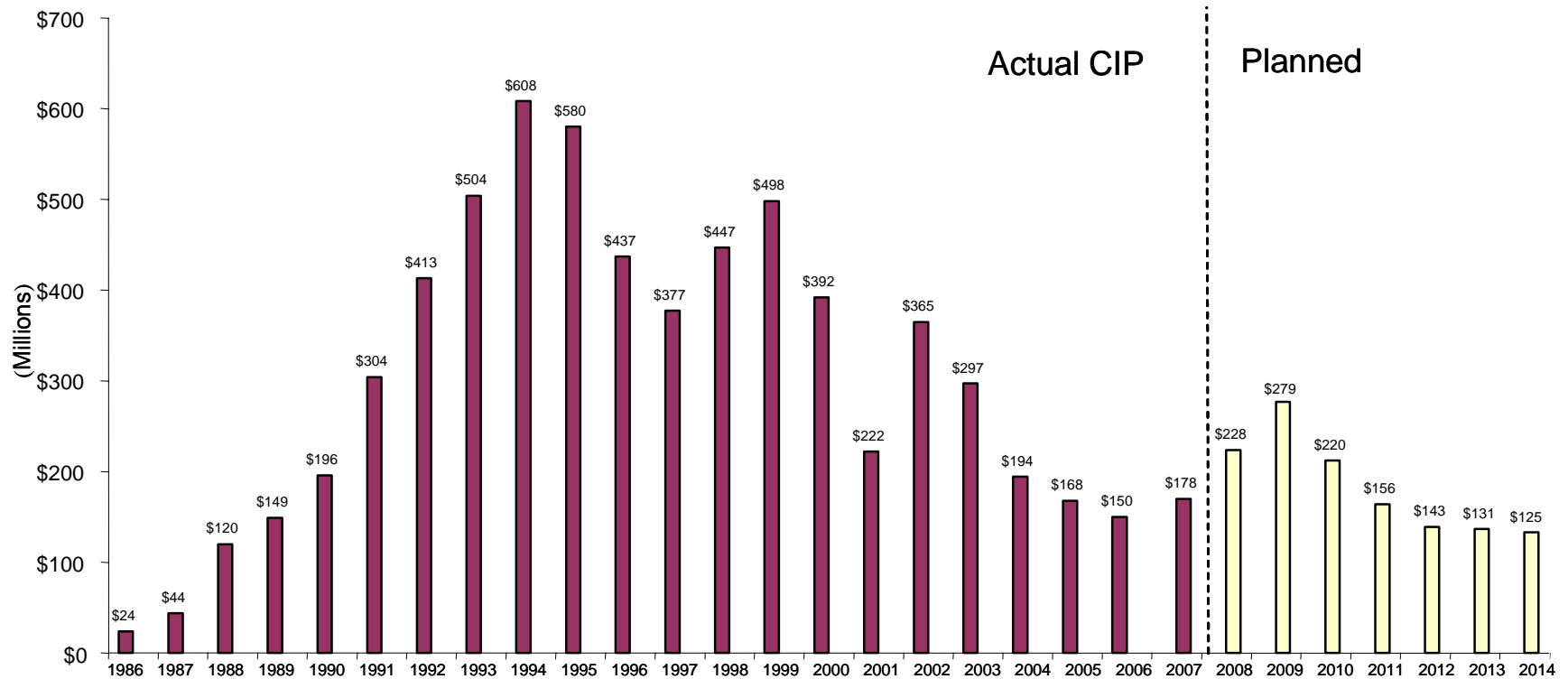
The MWRA recently celebrated its 20th anniversary and in that time, they have completed over \$6 billion worth of upgrades to the water and sewer systems that have all but reversed the effects of neglect and underfunding of the preceding decades. With the new treatment facilities on Deer Island complete, the clean-up of Boston Harbor has gained national acclaim as one of the greatest environmental success stories of our time. On the drinking water side, massive upgrades to water infrastructure, including a state-of-the-art ozone disinfection plant and covered storage tanks throughout the district, will help guarantee some of the best drinking water in the country for generations to come.

Over 80% of MWRA's capital projects have been mandated by state or federal regulations or by the federal court and have come at great expense to the ratepayers in the MWRA's customer communities. MWRA continues to find ways to keep costs down and to ensure that every dollar spent provides tangible public health or environmental benefits.

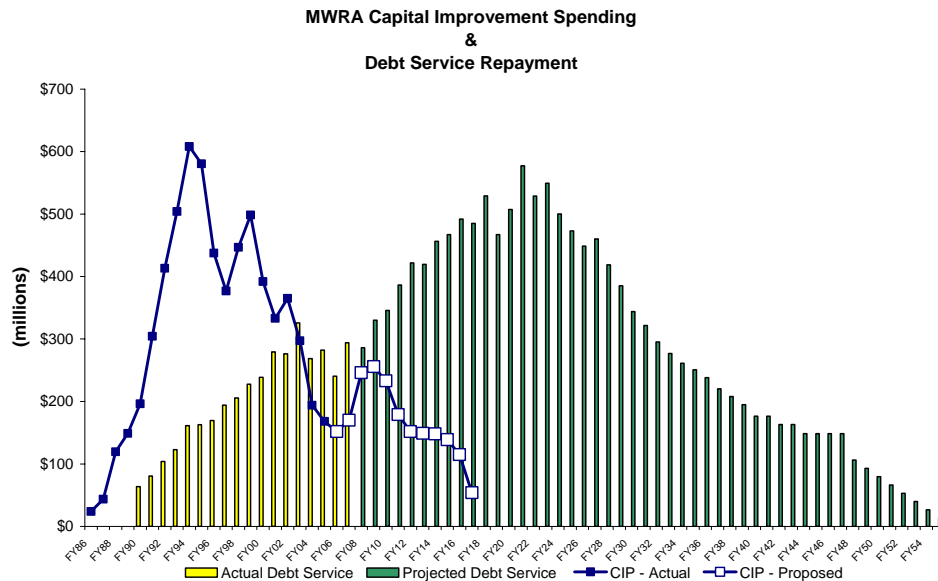
¹ See Page 4.

² See Page 6.

MWRA's Major Capital Projects



The single, largest driver of MWRA's budget is debt service on the bonds that finance major capital improvement projects. These projects have all but reversed the effects of neglect and underfunding of the previous decades. But these improvements have come at a price: MWRA's debt service burden now accounts for almost 60% of the agency's budget and is the single, largest driver of MWRA rate increases.



THE CASE FOR DEBT SERVICE ASSISTANCE

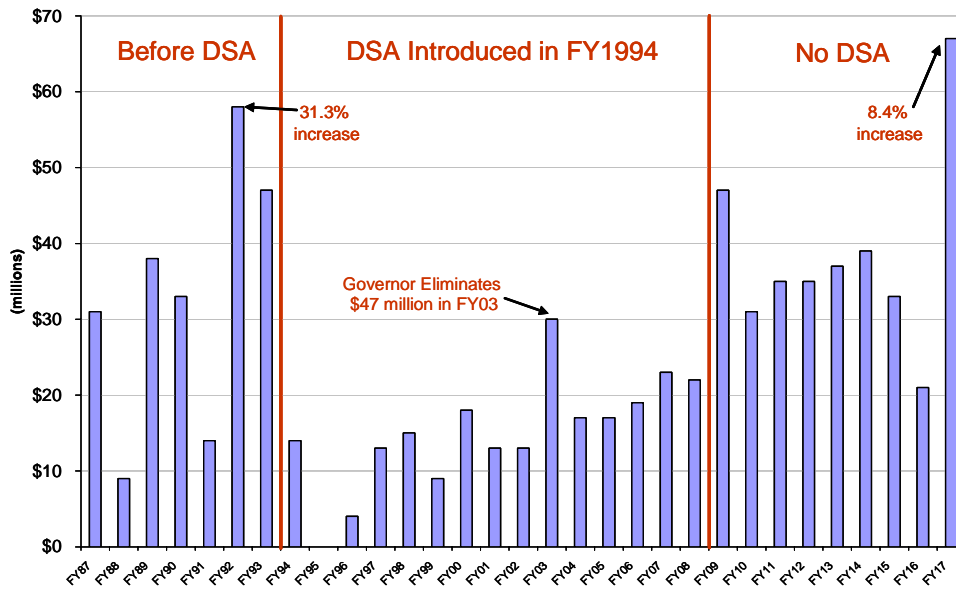
Debt Service Assistance has been successful in past years and continues to be an important piece of the state budget. It is crucial to stabilizing water and sewer charges that are passed on to ratepayers. MWRA and other districts draw debt service assistance from the Sewer Rate Relief Fund to stabilize wholesale rate increases. Debt Service Assistance is akin to local aid for municipalities. In order to understand what we hope to achieve in the future, it is important to be aware of the history of the program.

In 1992, with the Boston Harbor Project starting to ramp up and following several years of double-digit rate increases, the ability of many service area residents to pay their water and sewer bills was seriously questioned. A “rate revolt” ensued, with ceremoniously people burning their bills on the steps of the State House or dumping them into Boston Harbor.

In response, the MWRA Advisory Board (comprised the CEO’s of every city and town in the MWRA service area) and the MWRA Legislative Caucus (108 MWRA Legislative Caucus members representing communities in MWRA’s service area and watersheds), working with the Weld Administration, established the Commonwealth Sewer Rate Relief Fund in the FY1994 budget act to make state debt service assistance available to issuers of indebtedness, like the MWRA, for qualified wastewater projects mandated by the federal Clean Water Act.

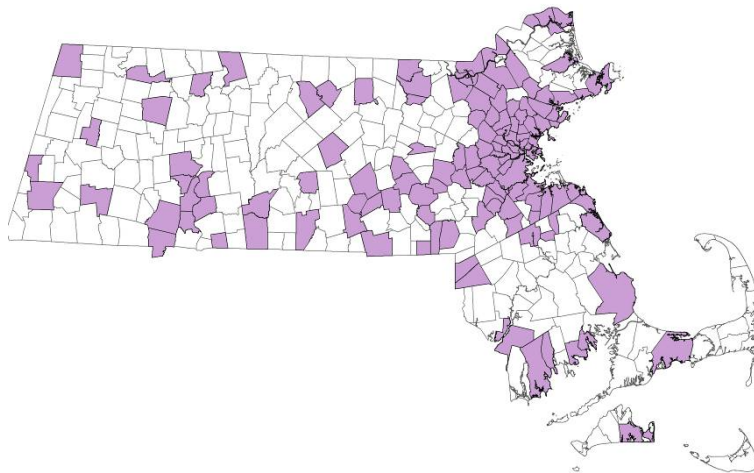
When the program was established, MWRA’s share was \$20 million - enough funding to offset 20% of MWRA’s debt service for wastewater projects. By FY2002 the statewide appropriation had grown to \$60 million. The fund is administered by the Department of Revenue and has proven to be successful in mitigating extraordinary increases in household sewer bills. In fiscal 2003, however, the program was eliminated in response to the state's fiscal crisis. Funding has been gradually restored, but not enough to keep pace with MWRA's increasing debt service.

MWRA Actual and Projected Rate Revenue Increases FY1987-2017



The projected rate revenue increase over the next five years, FY09 through FY13, is \$185 million.

Over 100 communities across the state benefit from this program. It is a critical tool in managing water and sewer rates. MWRA’s share of the \$23 million appropriation for this fiscal year is \$17.25 million. Without this funding, our ratepayers would have faced an 8% increase this year instead of 4.5%. As a general rule of thumb, each \$5 million in debt service assistance reduces the rate increase by one percent.



What is the difference in the impact to ratepayers between a \$15 million and a \$23 million appropriation for state-wide debt service?

Typically, the MWRA’s share of the state-wide debt service appropriation is 75%. Therefore, for \$15 million MWRA’s share would be \$11.25 million, for \$23 million it would be \$17.25 million. Every dollar of debt service assistance is used to directly offset MWRA’s assessments to its communities.

The following table illustrates what the reduction to the wholesale assessments between those two funding levels would be for the 20 MWRA communities with the highest rates³:

	MWRA DSA @ \$11.25 Million	MWRA DSA @ \$17.25 Million	Increase in DSA
Boston	\$3,228,832	\$4,950,876	\$1,722,044
Cambridge	512,808	786,305	273,498
Quincy	505,309	774,807	269,498
Newton	488,405	748,887	260,482
Somerville	398,885	611,623	212,738
Waltham	344,147	527,691	183,545
Framingham	329,740	505,601	175,861
Brookline	316,593	485,442	168,850
Malden	308,039	472,326	164,287
Medford	302,668	464,090	161,423
Weymouth	254,733	390,591	135,858
Revere	244,089	374,270	130,181
Woburn	229,757	352,294	122,537
Arlington	221,945	340,316	118,371
Everett	208,950	320,390	111,440
Lexington	184,900	283,514	98,613
Braintree	175,166	268,587	93,422
Chelsea	168,851	258,905	90,054
Norwood	166,900	255,913	89,013
Watertown	166,662	255,549	88,887

Debt Service Assistance also has an impact on communities outside of MWRA’s service area. In FY07, 80 non-MWRA communities and sewer districts received funds. A sampling of those communities and districts receiving Debt Service Assistance is illustrated here:

South Essex Sewer District: \$674,569
Lynn Water & Sewer District: \$133,914
City of New Bedford: \$365,091
Town of Tewksbury: \$166,334
Town of Sturbridge: \$42,277

Ongoing MWRA Cost-Saving Measures

As a critical component of its multi-year rates management strategy, MWRA has used a range of tools to lower its borrowing costs and manage its debt structure to take advantage of favorable interest rates. These tools include maximizing use of SRF debt, issuance of variable rate debt, the use of surplus revenues to defease debt, swap agreements, and using tax-exempt commercial paper to minimize the financing cost of construction in progress.

In FY2007, the MWRA, working with the Advisory Board, restructured approximately \$675 million in long-term borrowings to level out debt service through 2017 and create rate relief for member communities. Using proceeds from the refunding, the Authority also defeased approximately \$41 million in bonds in May to lower the FY2008 through FY2012 debt service requirement; the greatest savings will occur in FY2012.

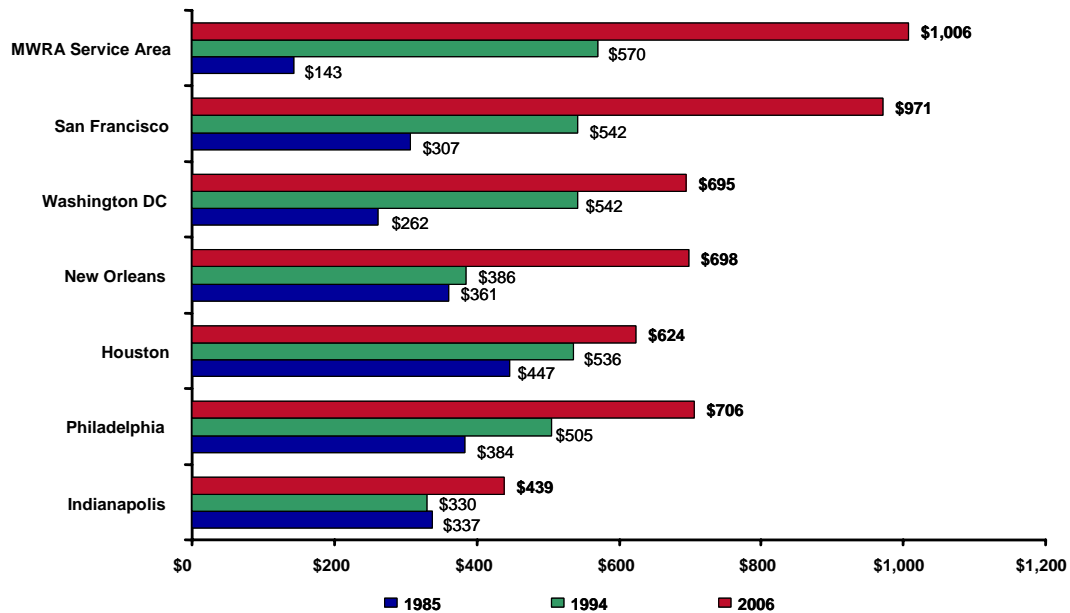
MWRA has continued to focus on aggressively managing its expenses. When adjusted for inflation, MWRA’s direct operating costs for FY2007 were lower than actual expenses were in FY2000. Since 1997, staffing has been reduced by more than 500 positions. We are committed to keeping operating

³ See Attachment #1 for a list of the Impact of Debt Service Assistance on all communities.

expenses down as much as possible, but cannot eliminate programs that would compromise water and sewer services that are critical for public health and environmental protection.

The Ratepayers' Burden

Since the MWRA's inception, water and sewer rates have gone from being among the lowest in the country to the highest.



The 900,000 households facing ever-increasing water and sewer bills are also contending with the rising cost of heat, fuel, electric and property taxes. Over 90% of MWRA's total revenue is derived from users' rates and charges. Since debt service is by far the major component of MWRA's budget and will continue to grow even if MWRA cuts all present and future spending, MWRA rates will continue to increase. How much rates will rise is in direct proportion to the extent to which debt service assistance is funded.

Why is Debt Service Assistance the most effective way to provide rate relief and what would be an alternative to the current program?

CONSIDERING ALTERNATIVES

Before considering alternatives to the Debt Service Assistance program, it is important to note that the program is the product of the collaboration between the Legislature, the Executive Branch, the MWRA, the Advisory Board, and most importantly the cities and towns. Debt Service Assistance is the end product of years of evaluation and review of many concepts that have been up for consideration. From the early concept of a dedicated lottery ticket proceed ("The Royal Flush Ticket") to various state tax deduction scenarios, the question of how to fill the void from the abandonment of the Federal government and meet the intent of the Enabling Legislation (providing 90% funding from the Federal and State Governments) has been discussed. Today, the Debt Service Assistance program is a success story; it is crucial in mitigating water and sewer rate increases.

MWRA and other districts draw debt service assistance from the Sewer Rate Relief Fund to stabilize rate increases. Debt Service Assistance is akin to local aid for municipalities. Over 100 communities across the Commonwealth have been able to take advantage of this program, underscoring the point that Debt Service Assistance is a state-wide issue and not limited to the MWRA service area. Dollar for dollar, Debt Service Assistance goes to pay off debt incurred for the capital projects; it directly offsets water and

sewer rates. Approximately every \$5 million in Debt Service Assistance is equivalent to a one percent reduction in assessments.

As requested, Advisory Board staff has compiled information on potential alternatives to the Debt Service Assistance program that would provide direct relief to low income and/or elderly taxpayers. It is difficult to develop a program which maximizes benefits directly or indirectly to as many ratepayers as possible as well minimizing layers of state and local bureaucracies. Another difficulty is the fact that many low income residents are renters, rather than home-owners, and therefore they never receive a water or sewer bill.

Per your request, please see the following alternative concepts:

1. LOW INCOME WATER & SEWER RATE ASSISTANCE PROGRAM

This alternative program would provide a direct target of rate relief to low income and elderly homeowners.⁴

History:

A previous attempt at a program designed specifically for low income and/or elderly was included in the budget as section 127 of Chapter 51 of the Acts of 1996. The Low Income Sewer & Water Rate Assistance Program (LISAWAP), championed by Senator Warren Tolman, was established in FY97 and provided \$2 million in assistance to qualified homeowners earning less than 150 percent of the federal poverty level. The program offered to pay up to 25% of eligible homeowners 1997 water and sewer costs, up to a maximum of \$200. The program was administered in conjunction with the Department of Housing and Community Development and it partnered with several private organizations, including Action for Boston Community Development, which assisted with the application process.

Pros:

The program funneled assistance to low income homeowners.

Cons:

Of the 371 municipalities and districts surveyed, only 92 were eligible for the LISAWAP program.⁵ Only 8,000 households in the entire Commonwealth received any benefit. The process was cumbersome and it was difficult to get the money to those in need. The actual spending was approximately \$1.5 million. There has been no further appropriation since FY97.

2. INCOME TAX DEDUCTION

This alternative would allow water and sewer charges to be eligible for a state income tax deduction. This provision could include income guidelines to target low income and/or elderly homeowners.

History:

Over the years, legislation has been filed that would allow water and sewer bills to be eligible for a state income tax deduction for single family homeowners.

Pros:

The program would provide relief to individual households and would be easily administered.

Cons:

The overall cost of this alternative could be prohibitive to the state. Depending on the established guidelines, the overall households that would benefit could be significantly limited.

⁴ See Attachment #2: M.G.L. Chapter 23b, Section 24b. Low-Income Sewer & Water Assistance Program.

⁵ Eligibility was determined by median retail water and sewer rates.

3. INCOME TAX CREDIT

This alternative would provide state tax credits for water and sewer charges similar to Title V Septic Tax Credits.⁶ This provision could include income guidelines to target low income and/or elderly homeowners.

History:

Currently, the Commonwealth provides over \$20 million annually for a state income tax credit up to \$800 for individuals who replace their septic systems.

Pros:

The program could provide significant annual benefits to homeowners.

Cons:

The overall cost of this alternative could be prohibitive to the state. A significant bureaucratic layer of administration would be necessary to administer this program. Depending on guidelines, the overall households that would benefit could be significantly limited.

4. DEBT SERVICE EXCLUSION

This alternative would adopt a statewide policy allowing communities to use debt exclusion for a federal tax deduction as permitted under General Law 59, Section 21C (n).⁷

History:

Currently, under General Law 59 Section 21C (n), communities can transfer water and sewer capital costs (MWRA and local) from the water and sewer bill onto the property tax. Currently, two MWRA communities (Arlington and Winchester) have utilized this approach.

Pros:

This would create a mechanism to allow individual homeowners a backdoor federal income tax deduction. It would keep water and sewer bills significantly lower than average rates.

Cons:

The approach would significantly increase property tax bills. Additionally, there is not a clear relationship between property values and water and sewer charges.

5. EXPAND & ENCOURAGE PROVISIONS ON THE LOCAL LEVEL

This program would provide incentives to municipalities to provide discounts to elderly and/or low income ratepayers.

History:

Many cities and towns already have low-income residential discount programs in place. According to the Advisory Board's Annual Water and Sewer Retail Rate Survey, 38 communities in the MWRA service area provide a retail discount option to eligible homeowners.⁸

Pros:

This approach would directly impact and benefit low income and/or elderly retail ratepayers.

Cons:

Experience indicates that these programs have limited participation and penetration levels are miniscule. Rates are a zero sum game; reducing costs to one sector of the population increases the costs for others.

⁶ See Attachment #3: Fiscal Year 2007 Tax Expenditure Budget: 1.606 Septic System Repair Credit. Page 35 of <http://www.mass.gov/Ador/docs/dor/Stats/TEB/TEB2007.pdf>

⁷ See Attachment #4: M.G.L. Chapter 59, Section 21C (n).

⁸ See Attachment #5: Communities within the MWRA water and sewer service area offering elderly and low income discounts to their ratepayers.

In conclusion, over the years we have looked at many alternatives to the Debt Service Assistance program. The Advisory Board and the Legislative Caucus contend that this program is the most effective, efficient, and direct method of providing rate relief. The Commonwealth's residents are facing "the perfect storm" of infrastructure needs – including schools, transportation, and water and sewer. It is critical that water and sewer needs do not become the forgotten infrastructure. MWRA took on its current level of debt to fix the infrastructure problems it inherited from the MDC. The Authority moved forward in addressing these problems on the assumption that the Commonwealth would remain its funding partner, consistent with the shift from the federal funding strategy to increased reliance on state and local resources.

The amount of Debt Service Assistance provided in the state budget directly reduces the rate increases in the MWRA service area. It is critical that the state continue to be an active partner in keeping water and sewer rates affordable. We look forward to working with the Patrick Administration on this important matter. Please do not hesitate to contact me if we can offer assistance to you or your staff. Thank you.

Sincerely,

A handwritten signature in black ink, appearing to read "Joseph E. Favaloro". The signature is written in a cursive, flowing style.

Joseph E. Favaloro
Executive Director

Cc: MWRA Advisory Board
MWRA Board of Directors
Fred Laskey, Executive Director, MWRA