

MWRA ADVISORY BOARD

COMMENTS AND RECOMMENDATIONS

on the MWRA's Proposed
Fiscal Year 2007
Current Expense Budget



May 2006

The Community Advisory Board to the
Massachusetts Water Resources Authority

The MWRA Advisory Board...

was established by the state Legislature to represent the 60 communities in the MWRA service area. Through annual comments and recommendations on the Authority's proposed capital and current expense budgets and rates, the Advisory Board provides a ratepayer perspective on the MWRA's plans and policies to improve the region's water and sewer systems.

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Joseph E. Favaloro
Executive Director

PREFACE

Pursuant to its responsibility under Sections 8 and 23 of Chapter 372 of the Acts of 1984, the MWRA Advisory Board has undertaken a comprehensive review of the Authority's proposed Current Expense Budget for the fiscal year beginning July 1, 2006 (FY07). The Advisory Board's review has produced these *COMMENTS AND RECOMMENDATIONS*, which state the Advisory Board's opinions on a number of issues and policies, plus recommendations on proposed spending in each MWRA department. These Comments and Recommendations were approved at the May 18, 2006 meeting of the full Advisory Board.

These Comments and Recommendations were prepared by Joseph Favaloro, Ryan Ferrara and Cornelia Potter of the Advisory Board staff. Overall direction was provided by Vice Chairman for Finance, Bernard Cooper, with the participation of Advisory Board members.

The Advisory Board would like to express our thanks to MWRA staff for their assistance in reviewing the FY07 Proposed Current Expense Budget.

MWRA ADVISORY BOARD

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OVERVIEW

THE BUDGET IN BRIEF

The Massachusetts Water Resources Authority has proposed a Current Expense Budget of \$600.7 million for Fiscal Year 2007 (beginning July 1, 2006). *Non-Rate Revenue* and *Investment Income* totaling \$46.6 million plus use of \$35.7 million from reserves leave \$518.5 million to be raised from rate revenue, an increase of \$46.3 million or 9.8% from the amount budgeted in FY06. More daunting, without the use of \$35.7 million in rate stabilization reserves, the rate increase would have been 17.4%.

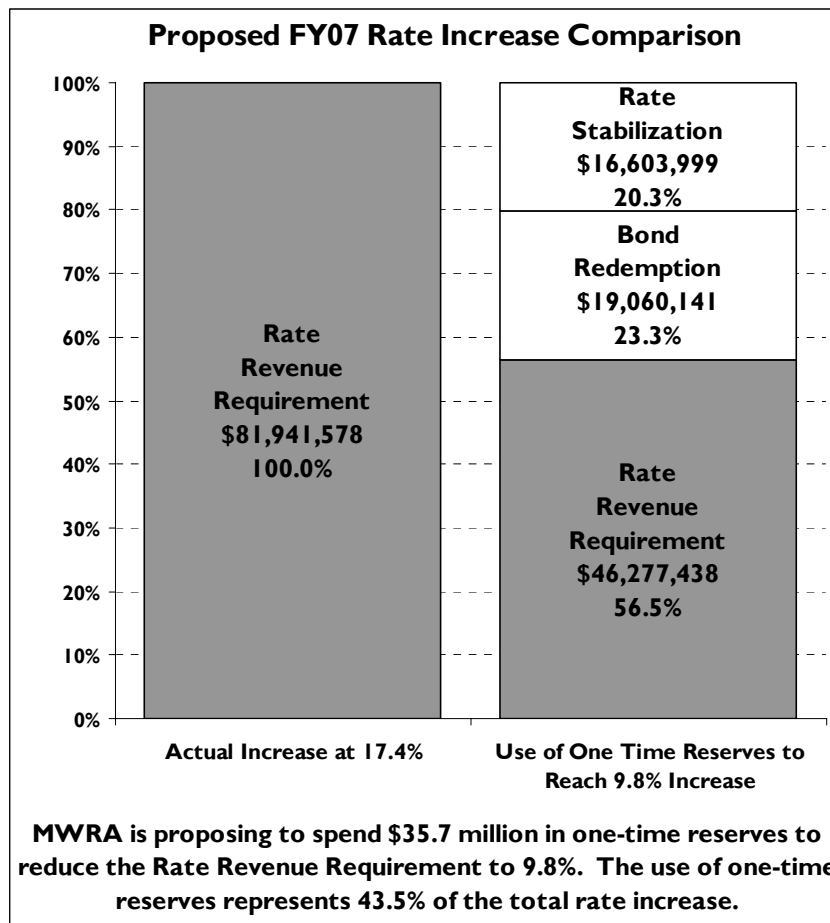
Table 1

MWRA Current Expense Budgets (\$000)				
	FY04 Actual	FY05 Actual	FY06 Budget	FY07 Proposed
<i>Expenses</i>				
Direct Expenses	\$171,509	\$176,821	\$185,742	\$202,842
Indirect Expenses	31,810	33,217	37,024	40,584
Capital Financing	297,264	296,666	326,579	357,310
Subtotal: Expenses	\$500,583	\$506,704	\$549,345	\$600,736
<i>Revenues</i>				
Other User Charges/Other Revenue	\$14,679	\$11,809	\$11,445	\$11,890
Investment Income	23,604	29,502	28,719	32,521
Non-Recurring Revenue	0	0	10,740	16,604
Debt Service Assistance	4,063	8,019	10,000	0
Swap Receipts	5,817	5,425	1,359	1,359
Entrance Fees	432	517	432	805
Other Debt Service Offsets	21,675	12,496	14,430	19,060
Subtotal: Non-Rate Revenue	70,270	67,768	77,125	82,239
Rate Revenue	\$431,765	\$444,269	\$472,220	\$518,497
	\$ Increase	12,504	19,220	46,277
	% Increase	2.9%	4.2%	9.8%
<p>(1) The Rate Revenue Increase in FY06 is 4.2% higher than the Final FY05 Rate Revenue Requirement of \$453.0 million, which did not include Debt Service Assistance of \$8.02 million.</p>				

Due to the uncertainty of debt service assistance receipts, the Authority has not assumed potential revenue from the Commonwealth Sewer Rate Relief Fund. No funding was included in the Governor's budget in January. (See page 7.)

Table 2 and Figure 1

The Full Rate Revenue Requirement for the Proposed Fiscal Year 2007 CEB	
FY06 Rate Revenue Requirement is:	\$472,219,800
The <u>ACTUAL</u> FY07 Rate Revenue Requirement is: \$554,161,378	
An Increase of:	\$81,941,578
or:	17.4%
MWRA is Proposing to Utilize One-Time Reserves in FY07 to Reduce the Rate Revenue Requirement to Under 10%	
Actual FY07 Rate Revenue Requirement	\$554,161,378
Bond Redemption	(19,060,141)
Rate Stabilization	(16,603,999)
Revised FY07 Rate Revenue Requirement	\$518,497,238
An Increase of:	\$46,277,438
or:	9.8%



The proposed budget is stated net of debt service offsets of \$19.06 million from the bond redemption fund. Thus, Table I-1 in the proposed FY07 CEB budget states *Total Expenses* of \$581.7 million, an increase of \$56.8 million or nearly 11% from the \$524.9 million budgeted in FY06.

Direct Expense spending is budgeted at \$202.8 million, a \$17.1 million increase (9.2%) over the \$185.7 million budgeted in FY06. While *Direct Expense* spending had been declining from FY00 through FY04, the budget has been increasing as the agency absorbs the full year costs of the new John Carroll Water Treatment Plant, the Braintree-Weymouth Intermediate Pump Station and, in FY07, the Union Park Pump Station/CSO Treatment Facility. Also putting pressure on the budget has been increased prices and use of *Electricity* and *Diesel Fuel* (and to a lesser extent, *Natural Gas*), as well as increased costs of *Health Insurance* and *Medicare*. *Maintenance* expense increases by \$3.7 million (23%), particularly as major facilities age and certain equipment becomes obsolete.

Indirect Expense spending is budgeted at \$40.6 million, an increase of \$3.56 million or 9.6% from the \$37.0 million approved in the FY06 budget. Contributing to the increase are a \$2.1 million increase to *Additions to Reserves*, a \$0.7 million increase to *Watershed/PILOT* expense and a \$0.5 million increase to *Pension* expense.

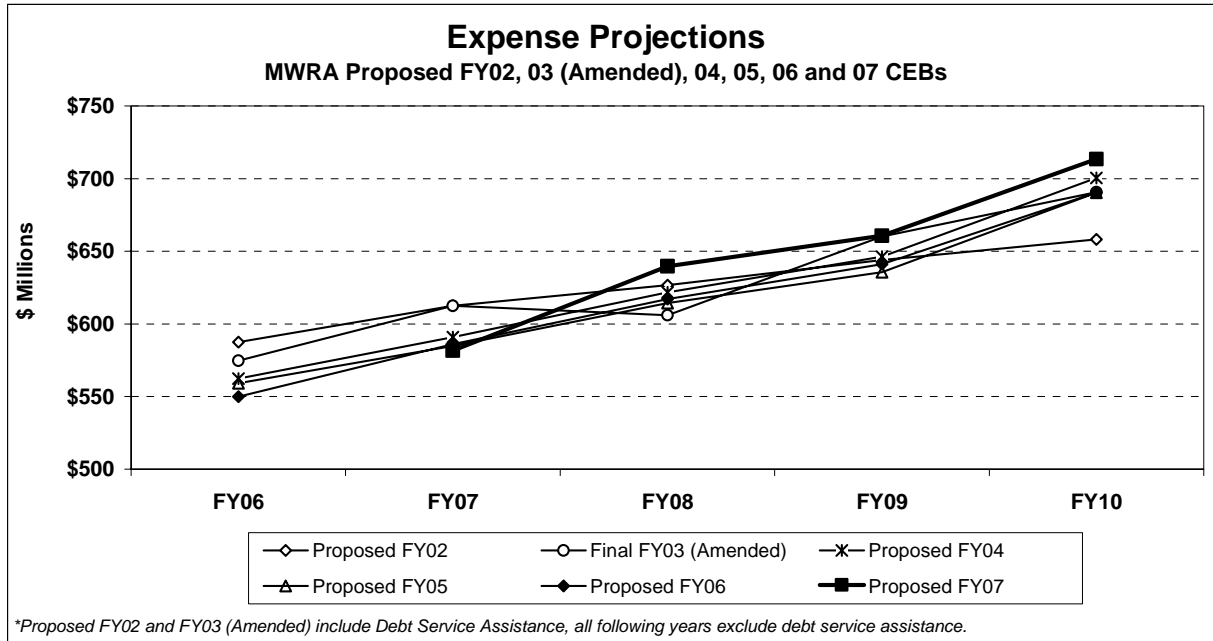
Capital Financing Expense is expected to rise to \$338.25 million, an increase of \$36.1 million or nearly 12%. The budget includes total *Capital Financing Expense* of \$357.3 million less use of \$19.06 million in Bond Redemption Funds, which is treated as an offset. No *Debt Service Assistance* is assumed at this time; action by the state legislature this spring may warrant inclusion of this funding in the budget, which is also treated as an offset to *Capital Financing*.

Non-Rate Revenue totals \$63,179,172 from *Other User Charges*, *Other Revenue*, use of *Rate Stabilization Funds* and *Investment Income*.

During FY06, facing sharply increased utilities prices, as well as increases to health insurance and other costs totaling an estimated \$5.4 million in increased total expenses, the Authority issued a proposed budget amendment using a combination of non-rate revenues and rate stabilization funds. The Advisory Board has commented that more recent forecasts of higher than budgeted investment income support the strategy of using those funds instead of rate stabilization reserves to close the budget gap. At its May meeting, the Board of Directors approved an amended budget with additional expenses of \$3.0 million and additional revenue of \$10.7 million, as compared to the original FY06 Current Expense Budget, approved last June.

Overview

Figure 2



THE ADVISORY BOARD'S REVIEW

As it does each year, the Advisory Board has conducted a detailed review of the Authority's proposed budget and supporting materials. The Advisory Board has addressed Authority goals, objectives and schedules and has examined strategies for managing future budget growth and options for containing future rate increases.

The Advisory Board's recommendations address appropriate and reasonable tightening of operating expenses; careful review and reasoned pursuit of non-rate revenues; and updated examination of capital financing, refinancing and restructuring opportunities, including the size and schedule for capital program spending; and the use of the Authority's rates management reserves in a multi-year context.

The Advisory Board's *Comments and Recommendations* are organized in two parts. First, is a section called Striving for Sustainable and Predictable Rates, outlining the need to revisit the Authority's rates management strategy utilizing tools such as restructuring a small portion of the MWRA's debt portfolio to achieve sustainable and predictable levels of rate increases for the service area communities. The second section, Comments on Line Items, summarizes the components of the proposed budget and includes a number of specific *Recommendations* to modify spending or increase non-rate revenue.

STRIVING FOR SUSTAINABLE AND PREDICTABLE RATES

Figure 3: Potential Risk

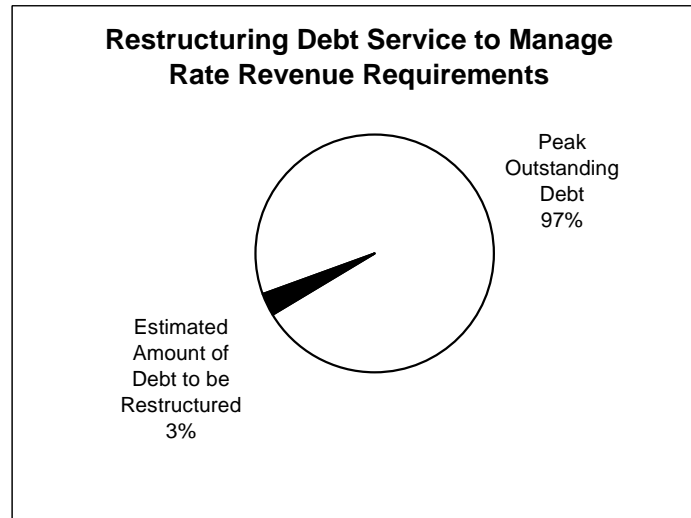
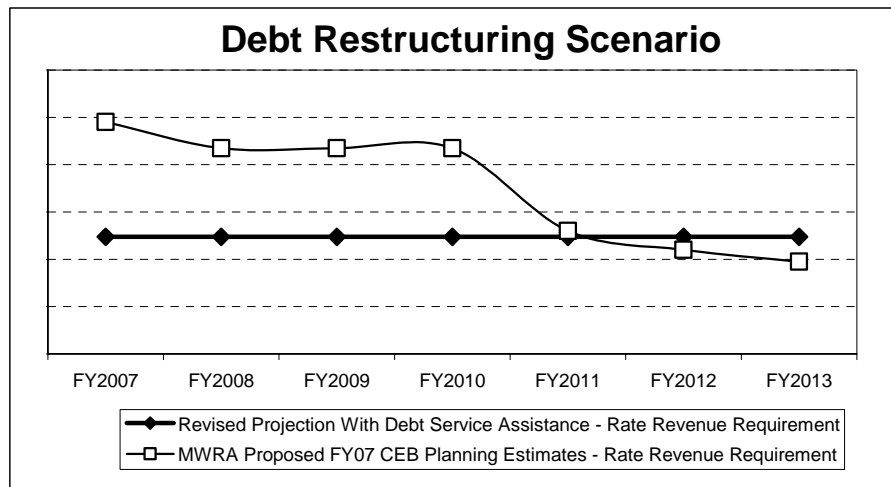


Figure 4: Versus Potential Reward



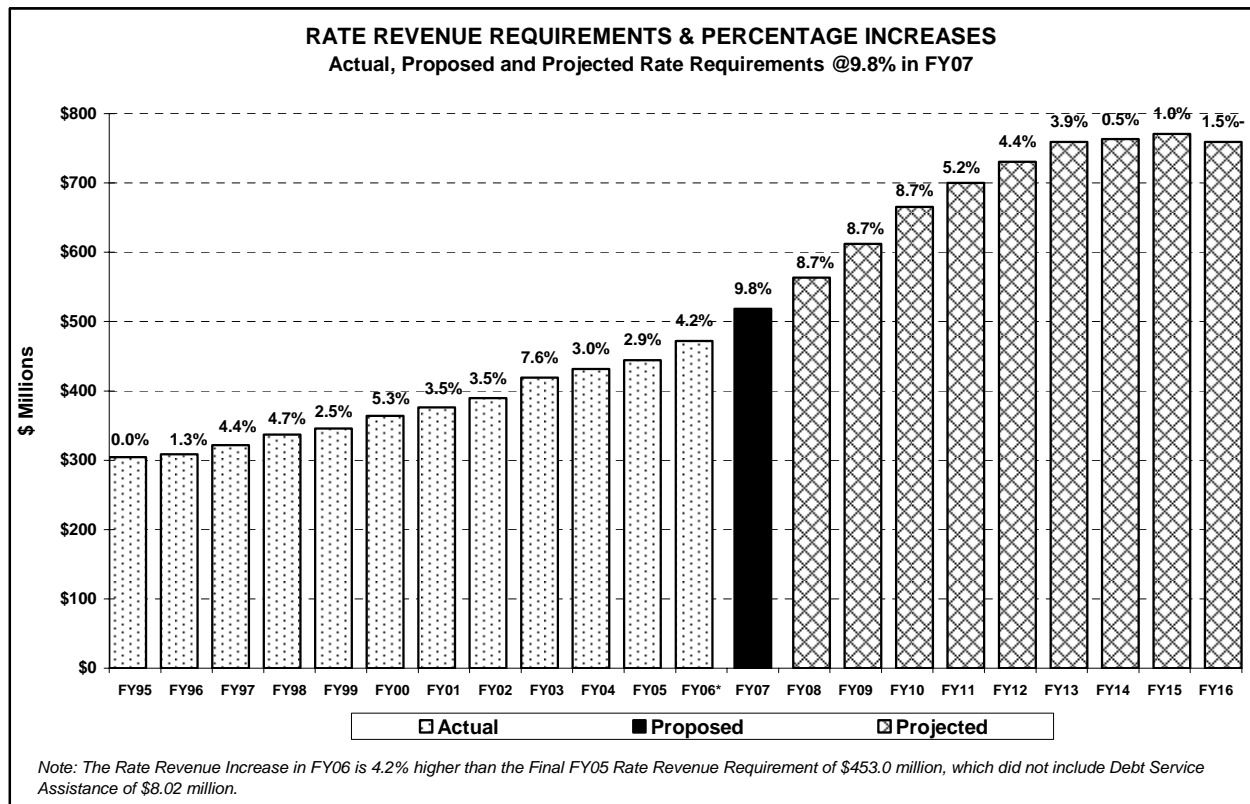
- The Advisory Board is recommending that the MWRA convene a working committee of Authority staff, the Advisory Board, and the Financial Advisor to revisit and revise the rates management strategy.
- A key element of this revised strategy is the development of a debt restructuring plan to provide sustainable and predictable rate revenue requirements through FY 2013.

STRIVING FOR SUSTAINABLE AND PREDICTABLE RATES

Rates are Projected to Rise Rapidly and Stay High in the Next Several Years

The Authority's planning projections indicate a particularly challenging period ahead. Between now and fiscal year 2011, rate revenue is projected to rise by nearly \$100 million every two years, crossing the \$500 million mark in FY07, the \$600 million mark in FY09 and the \$700 million mark in FY11. Rates are expected to continue to rise, although more slowly, and remain around \$760 million for at least the five years after that.

Figure 5

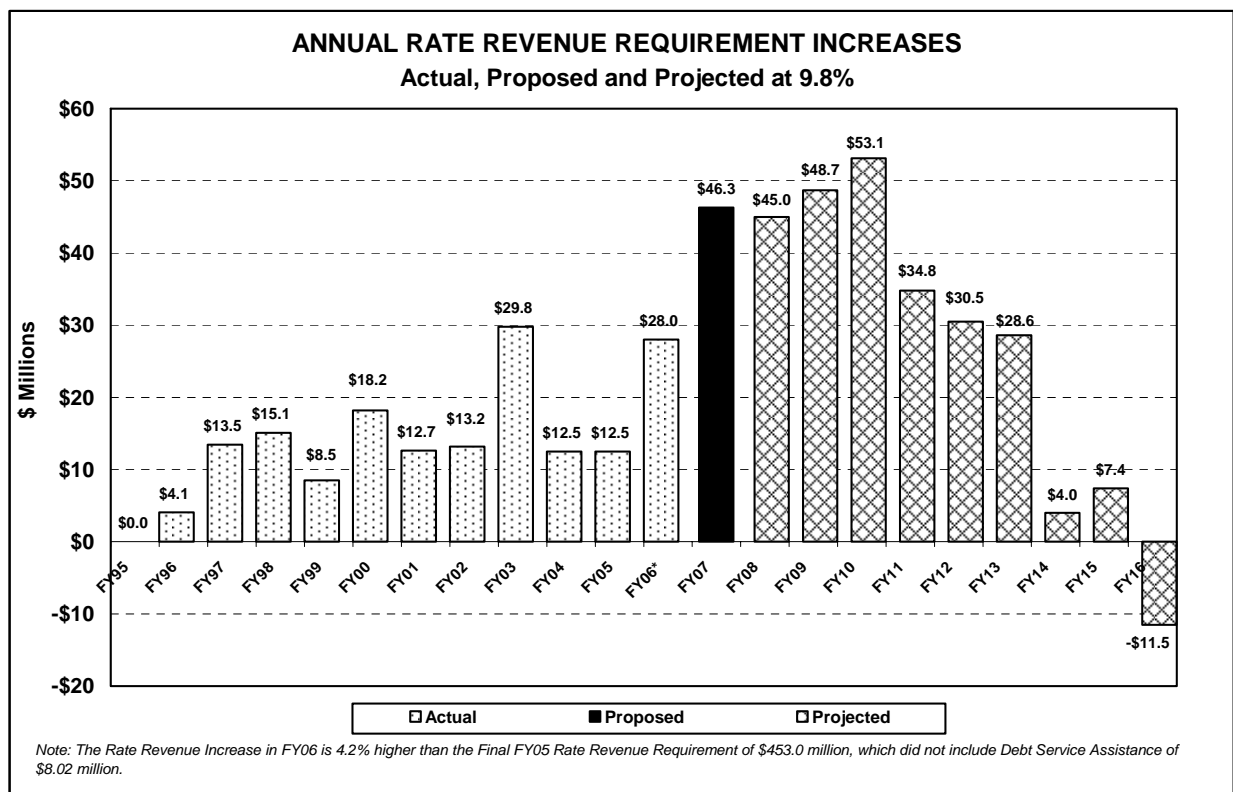


Put another way, rate increases for each of the next seven years (FY07 through FY13) are expected to be higher than rates in more than a dozen years (since 1993, with the exception of FY03 when the Debt Service Assistance Program was eliminated mid-year). For the twelve-year period from FY95 through this fiscal year, rates increased a total of \$159.3 million. Over the next seven years, from FY06 through FY13, rates are projected to increase \$286.9 million, an 80% increase, in just over half the time. (The projections do not assume receipt of state *Debt Service Assistance*.)

Table 3

Proposed FY07 Current Expense Budget Planning Estimates (\$000)								
	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Total Expenses	\$581,676	\$619,327	\$653,587	\$709,673	\$743,233	\$773,905	\$803,098	\$807,321
Debt Service Assistance	0	0	0	0	0	0	0	0
Interest Income/Other Charges	46,575	41,810	41,343	42,231	43,046	43,238	43,857	44,110
Non-Recurring Revenue (Rate Stabilization)	16,604	14,022	0	2,079	0	0	0	0
Rate Revenue	\$518,497	\$563,495	\$612,244	\$665,363	\$700,187	\$730,667	\$759,241	\$763,211
Rate Revenue Increase	9.8%	8.7%	8.7%	8.7%	5.2%	4.4%	3.9%	0.5%

Figure 6



Communities and the State Continue to Face Tight Economic Times

Communities in the MWRA service area continue to face difficult economic conditions as the area’s economy continues to lag behind the pace of recovery for other parts of the region and the nation. While recent receipts by the state have continued to rise and the proposed state budget for FY07 includes an almost 10% increase in total local aid, state and local budgets are still pressured by rapidly rising health care costs, as well as other areas. When accounting for inflation, local aid proposed for FY07 is \$742 million below the 2002 level.

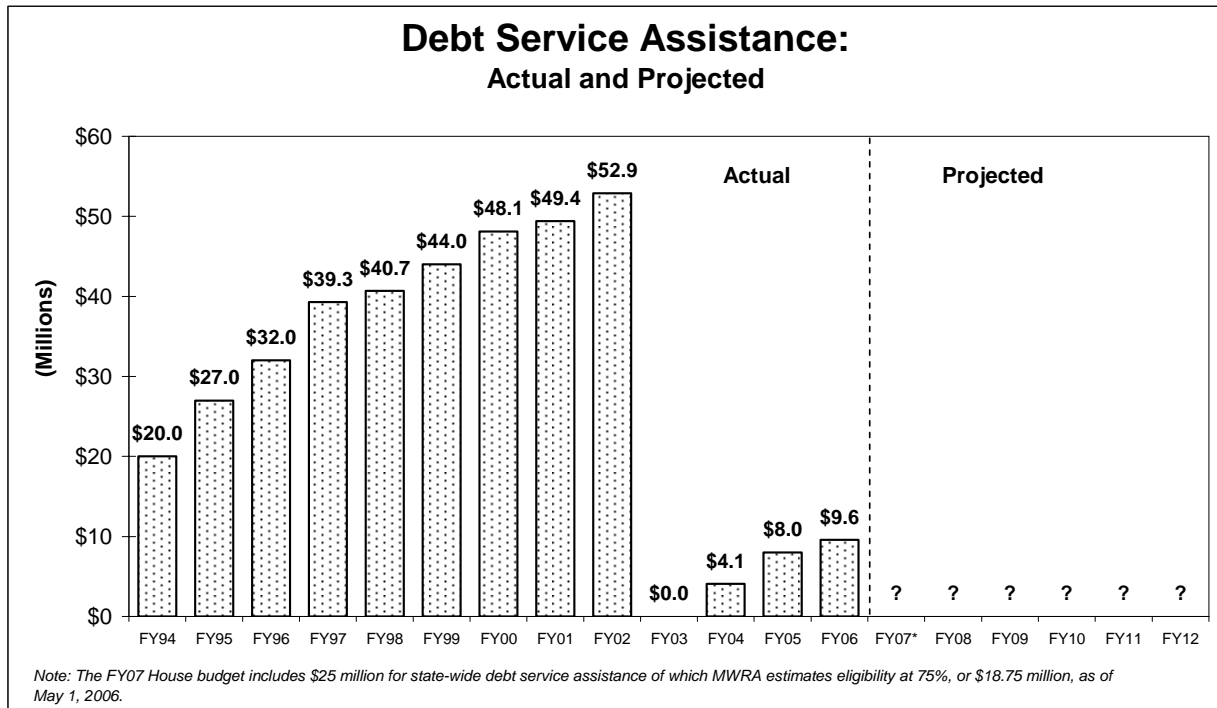
A number of communities have deferred improvements to their own water and sewer systems because of lower revenues and other demands on local budgets. This past fall, during visits by Advisory Board staff to 50 communities in 50 days, mayors, administrators, councils and managers all stated that water and sewer rates continue to be one of their biggest concerns.

Table 4

The Potential Impact of State Debt Service Assistance			
MWRA Portion at 75% of the State-Wide			
State DSA Level	Allotment	Rate Revenue Increase	% Increase
\$0	\$0	\$46,277,438	9.80%
\$15,000,000	\$11,250,000	\$35,027,412	7.42%
\$25,000,000	\$18,750,000	\$27,527,412	5.83%

During the state budget crisis in 2002, the Governor eliminated the debt service assistance program. The Legislature has gradually reintroduced the program over the last several years. Through the efforts of the member communities, the House budget has doubled funding for the Debt Service Assistance Program, in FY07, to \$25 million for which the MWRA would be eligible for approximately \$18.75 million. Funding at this level would reduce the projected rate increase from 9.8% to 5.83%. The Senate budget was introduced with \$15 million for the state-wide program, of which the Authority could be eligible for \$11.25 million.

Figure 7



MWRA Has Made Significant Strides in Controlling Expenses but Faces New External Pressures on its Budget and Budget Projections

Over the last several years, the Authority has taken a number of steps to control costs and achieve budget savings. Notable among them are reductions in staffing levels (staffing levels have decreased nearly 30% since FY97), award of new contracts at lower costs (such as the sludge processing contract), consolidated facilities and space needs, reduced the vehicle fleet by 10%, increased self generation of electricity and reduced sodium hypochlorite use at Deer Island, established a capital spending cap and refunded nearly \$3.5 billion of its outstanding debt for savings of \$188.7 million.

Looking forward, new and increased costs have been emerging that put pressure on the Authority's current and future budgets. Among these pressures are rising health care costs, increased energy costs and rising interest rates.

The planning projections may be low due to two important assumptions: the first is that Direct Expense spending grows at no more than 2.5% from FY09 forward, and the second is that capital spending drops from a current peak of \$305 million in FY08 to half that amount (\$149 million) just two years later. By FY12 capital spending is projected to be \$88 million and decline to \$29 million by FY15. After that point, the projections assume no new capital spending.

It can be expected that with the publication of the Master Plan, due in July 2006, the Authority will have the basis to revisit projections of future capital spending and to update the multi-year planning projections. Even as the current edition of the planning projections shows a leveling off of rate growth by FY 2013, rate revenue requirements are shown to be growing by \$30 million to \$35 million per year from FY 2010 to FY 2013 and then, as noted previously, to remain at the \$760 to \$770 million level from FY 2013 through FY 2016, the last year of the ten-year horizon for these projections.

Debt Service Is Rapidly Growing to Two-Thirds of the Authority's Budgets

The Authority projects that as it continues to repay debt and control new capital spending in the coming years, the proportion of the budget those repayments represent will be growing from the one-third it once was in FY 1990 and the 54% it was in FY 2000 to 65% in just another two years. The sheer size of capital financing expense makes a reassessment of debt service payments and schedules a focus for managing future rate increases.

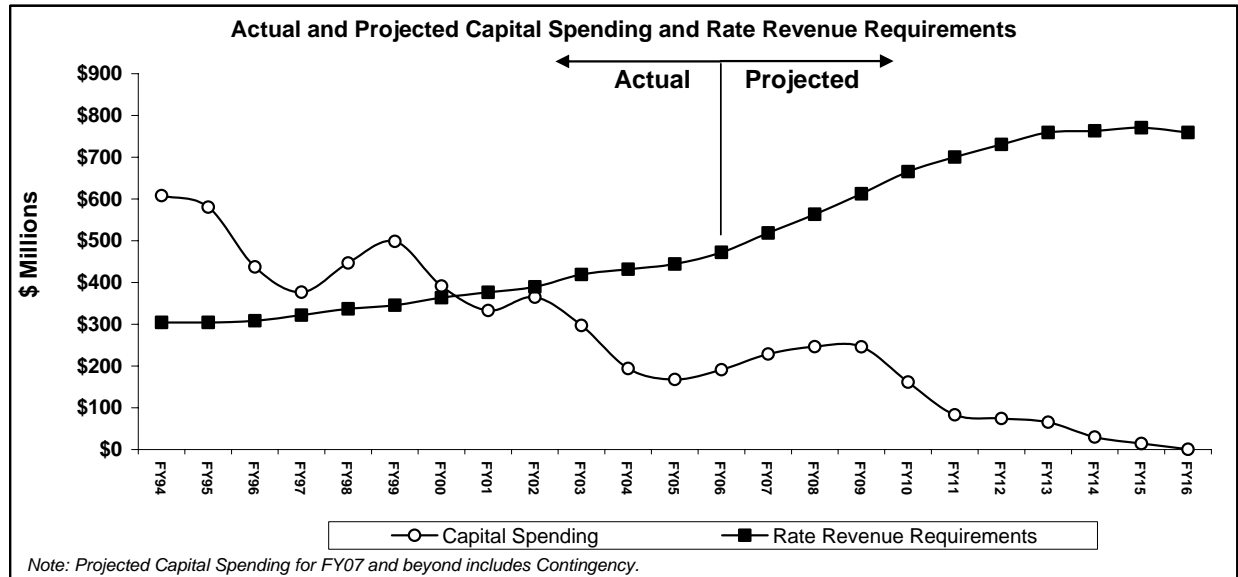
The Rates Management Strategy Needs Revisiting

The Advisory Board believes the MWRA should revise its strategy for managing its budgets and the required rate revenue for supporting them. **Convene a working committee which could include MWRA staff, the Advisory Board, representatives from the MWRA Board of Directors and the Financial Advisor to revisit the rates**

•1•

management strategy. The committee should meet this spring and identify steps to begin as soon as FY07. Regular reports should be made to the Board of Directors.

Figure 8



The key element of this strategy is the restructuring of portions of the Authority’s outstanding debt, which together with growth of debt service receipts from the FY07 levels should provide some predictability and stability to the outlook for rate revenue requirements for the near and mid-term future. The Advisory Board anticipates restructuring of less than an estimated \$200 million over the next seven or so years, or less than 5% of the peak of \$6.3 billion in outstanding principal predicted by FY 2011.

- 2• **The cost of this restructuring is estimated at less than \$5 million. Develop a debt restructuring plan to provide sustainable and predictable rate revenue requirements through FY 2013.**

The goal of the plan would be to provide sustainable and predictable rate revenue requirements over the next several years, thereby achieving rate stability for our communities.

Figure 9

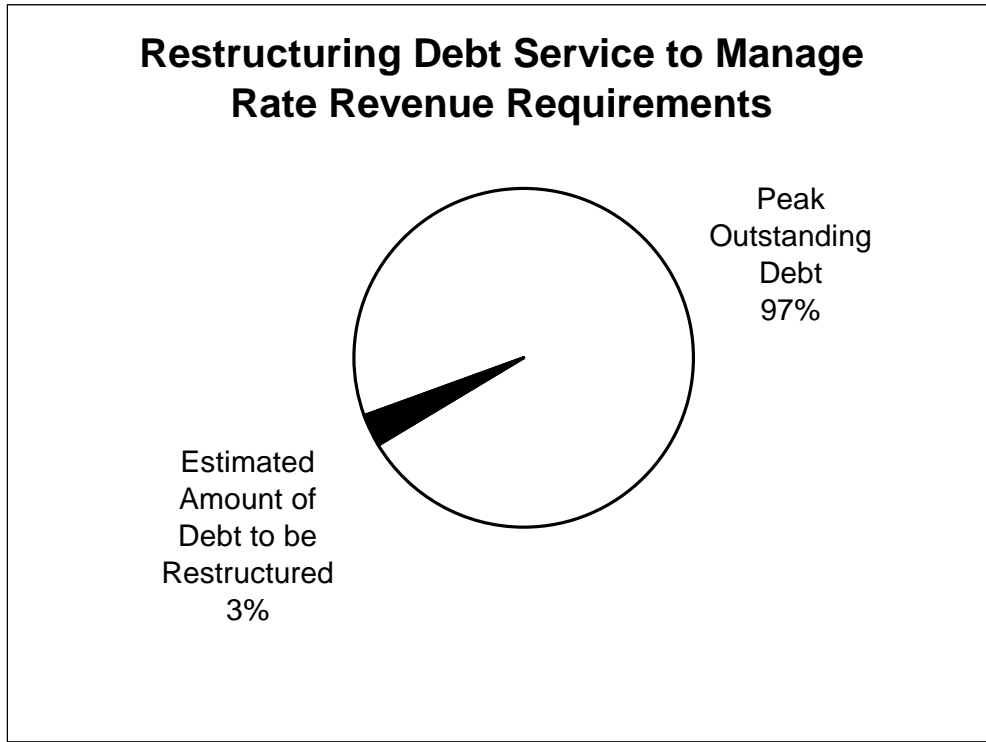


Figure 10

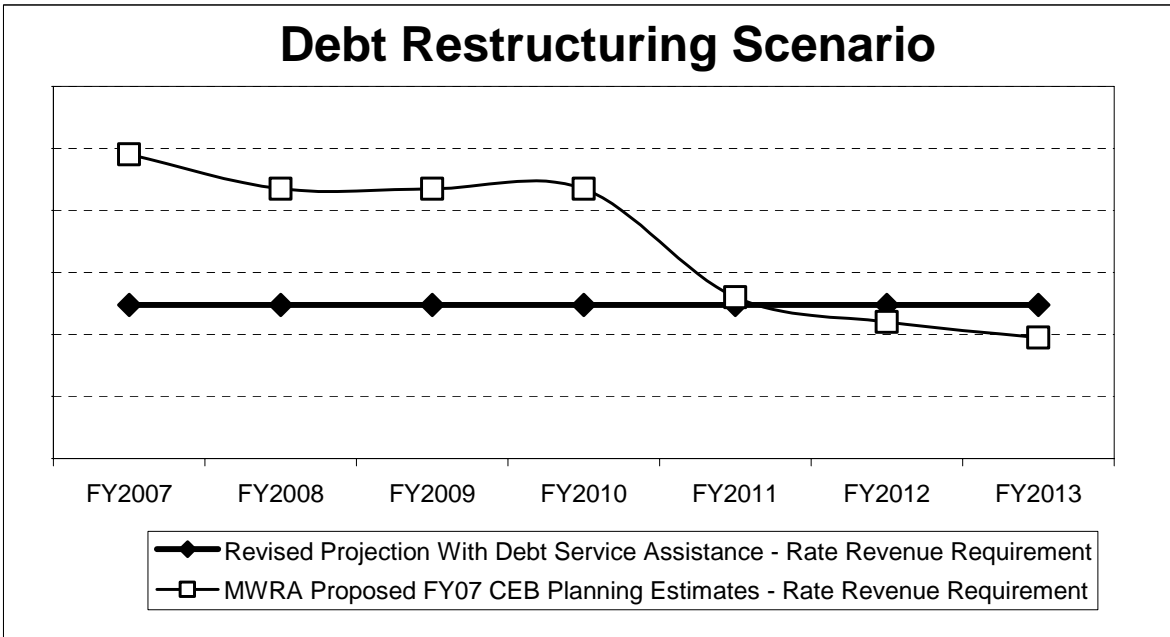


Table 5

**FISCAL YEAR 2007 CURRENT EXPENSE BUDGET
AS PROPOSED BY THE MWRA AND AS RECOMMENDED BY THE ADVISORY BOARD**

	MWRA Proposed FY07 Budget	Advisory Board Adjusted Budget	Advisory Board Recommendations
DIRECT EXPENSES			
Wages and Salaries	\$85,498,777	\$85,498,777	\$0
Overtime	3,934,643	3,934,643	0
Fringe Benefits	15,914,022	15,914,022	0
Workers' Compensation	940,000	900,000	(40,000)
Chemicals	8,617,677	8,102,677	(515,000)
Utilities and Energy	31,267,267	30,648,134	(619,133)
Maintenance	24,196,620	24,073,370	(123,250)
Training and Meetings	207,363	207,363	0
Professional Services	7,462,937	7,371,937	(91,000)
Other Materials	4,210,905	4,204,555	(6,350)
Other Services	20,591,858	20,311,266	(280,592)
Subtotal	<u>\$202,842,069</u>	<u>\$201,166,744</u>	<u>(\$1,675,325)</u>
INDIRECT EXPENSES			
Insurance	\$2,500,000	\$2,500,000	\$0
Watershed/PILOT	24,986,012	23,461,460	(1,524,552)
Mitigation	1,386,250	1,386,250	0
BECo Payment	4,681,380	4,681,380	0
Capital Financing	335,249,976	329,294,982	(5,954,994)
Additions to Reserves	2,977,490	2,698,269	(279,221)
Retirement Fund	4,053,207	4,053,207	0
Current Revenue/Capital	3,000,000	3,000,000	0
Subtotal	<u>\$378,834,315</u>	<u>\$371,075,548</u>	<u>(\$7,758,767)</u>
TOTAL EXPENSES	<u>\$581,676,384</u>	<u>\$572,242,292</u>	<u>(\$9,434,092)</u>
NON-RATE REVENUE AND INCOME			
Other User Charges	6,924,717	7,054,717	130,000
Hydropower	266,000	266,000	0
Permit Fees	1,950,000	1,950,000	0
Penalties	250,000	250,000	0
Commonwealth Reimbursements	867,000	867,000	0
Miscellaneous	347,000	347,000	0
Energy	1,285,000	1,285,000	0
Entrance Fees	805,252	805,252	0
Interest Income/Swap Receipts	33,880,204	36,378,574	2,498,370
Rate Stabilization	16,603,999	4,541,537	(12,062,462)
Subtotal	<u>\$63,179,172</u>	<u>\$53,745,080</u>	<u>(\$9,434,092)</u>
State Debt Service Assistance	\$0	\$0	\$0
TOTAL REVENUE	<u>\$581,676,384</u>	<u>\$572,242,292</u>	<u>\$0</u>
Total Advisory Board Reductions			<u>\$0</u>
RATE REVENUE REQUIREMENT	\$518,497,212	\$518,497,212	
RATE REVENUE INCREASE	\$46,277,412	\$46,277,412	\$0
Percent Increase from FY06 (1% = \$4,722,198)	9.80%	9.80%	
FY06 Rate Revenue = \$472,219,800			

COMMENTS ON LINE ITEMS

DIRECT EXPENSES

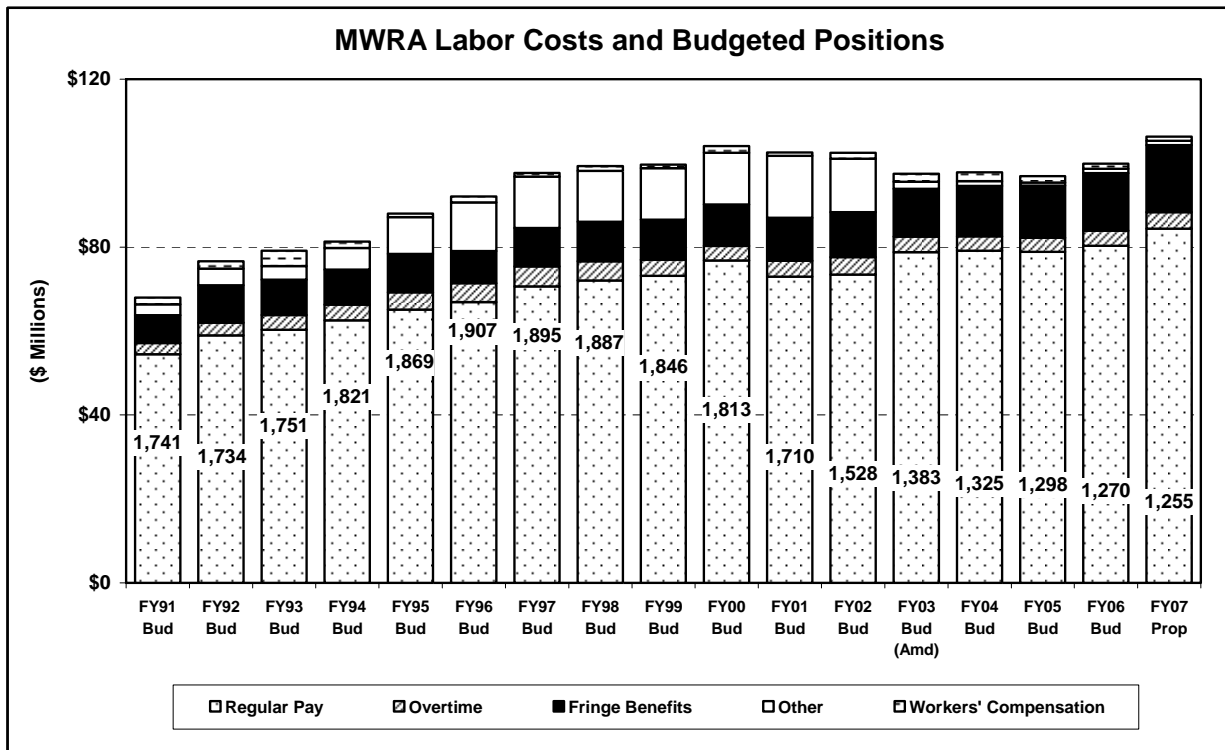
Labor and Benefits

The Authority is proposing a budget of \$106,287,442 for all *Personnel-Related Expenses* for FY07. The amount represents a 6.4% increase (\$6,408,262) from the \$99,879,181 budgeted for FY06. *Personnel-Related* costs include: *Wages and Salaries*, *Overtime*, *Fringe Benefits* and *Workers' Compensation* expense and represent 52% of all proposed *Direct Expense* spending.

Wages and Salaries

The Authority is proposing a budget of \$85,498,777 for *Wages and Salaries* in FY07, a 5.1% increase (\$4,124,772) from the \$81,374,006 budgeted in FY06. Most of the amount (\$84,391,614) is for *Regular Pay* (and leave balance accruals). Other components of the *Wages and Salaries* category of spending are: *Shift Differential* \$175,728; *Holiday Pay* \$225,833; *Temporary Employees* \$230,905; *Interns* \$70,540; and *Standby Pay* \$404,157.

Figure 11



Comments on Line Items

Regular Pay. The Authority is budgeting \$84,391,614 for *Regular Pay* for FY07, an increase of 5% from the amount budgeted in FY06. The proposed budget supports the equivalent of 1,255 filled positions and represents no net increase in the number of filled positions as of December 2005. The proposed budget includes funds for negotiated increases in salaries and for estimated leave balance accruals. Since FY97, the Authority has reduced staffing by more than 500 positions, a decrease of approximately 30%.

Temporary and Intern Employees. The Authority is proposing to spend \$230,905 on *Temporary Employees* in FY07, an 18% increase over the \$195,635 budgeted in FY06. Spending through March reached \$325,164 as compared to the \$126,758 budgeted for the period.

Intern spending declines by 13% (\$10,247) to \$70,540 from \$80,787. Spending on *Interns and Co-ops* has been sharply reduced in recent years and is budgeted in just a few departments.

Shift Differential, Holiday Pay and Standby Pay. The Authority is proposing a budget of \$175,728 for *Shift Differential* in FY07, a 2.6% increase from the amount budgeted in FY06. Spending through March is 10% greater than the amount budgeted for the period.

Holiday Pay increases by 7.7% to \$225,833 in FY07, or \$16,134 more than budgeted in FY06. Spending through March has been 20% greater than the amount budgeted for the period. *Standby Pay* increases by 1.5% to \$404,157 in FY07; spending through March has been within 1% of the year to date budget. Staff note that increased use of *Standby Pay* contributes to reductions in *Overtime* spending.

Overtime

The Authority is proposing a budget of \$3,934,643 for *Overtime* expense in FY07, an 8.6% (\$311,402) increase over the \$3,623,241 budgeted for FY06. The increase is due to wage increases, as well as some increased use. Just over 63% of all *Overtime* spending (\$2,493,775) is budgeted for the Field Operations Department, a 4.6% increase from the \$2,383,564 budgeted for FY06. Another 30% of the *Overtime* budget (\$1,190,687) is for the Deer Island Wastewater Treatment Plant. The Clinton Wastewater Treatment Plant's *Overtime* budget is \$57,025. *Overtime* for the Support Division is budgeted at \$45,354.

Through March, *Overtime* spending totaled \$2,384,275 or 15% below the \$2,818,041 budgeted for the period. *Overtime* use in the fall increased, the result of wet weather and a power outage at Deer Island. Mild winter weather contributed to reduced use of *Overtime* during the winter months.

Fringe Benefits

The Authority is proposing a budget of \$15,914,022 for *Fringe Benefits* in FY07, a 16.3% (\$2,232,088) increase over the \$13,681,934 budgeted for FY06. Included in this

category of expense are: \$13,661,533 for *Health Insurance*, \$826,450 for *Dental Insurance*, \$70,000 for *Unemployment Insurance*, \$1,244,410 for *Medicare* expense, \$31,000 for *Tuition Reimbursement* and \$80,629 for *Overtime Meals*.

Spending through March on all categories of *Fringe Benefits* totaled \$10,508,682 or \$272,671 (2.7%) more than the amount budgeted for the period. Contributing to this variance are greater than budgeted costs for *Health Insurance*, *Unemployment Insurance* and *Medicare* expense. The Authority projects that spending by year end will reach \$14,101,797 or \$102,863 (0.7%) greater than budget due to increased costs for *Health Insurance*, *Unemployment Insurance* and *Medicare* expense.

Health Insurance. The Authority staff have updated estimates for Health Insurance for FY07, based on updated rates. Budgeted amounts are expected to decline slightly.

Dental Insurance. Rates for *Dental Insurance* have also been revised based on projected insurance rates and are projected to increase by about \$1,000 from the \$826,450 proposed.

Medicare. *Medicare* expense is budgeted at \$1,244,410 for FY07, a 22% or \$221,710 increase from the \$1,022,700 budgeted for FY06. Spending through March came to \$795,983 or nearly \$29,000 (4%) greater than the amount budgeted for the period. Updated projections put the revised cost at \$1,311,904.

Unemployment Insurance. The Authority is proposing to budget \$70,000 for *Unemployment Insurance* in FY07, a \$10,000 increase (17%) from the \$60,000 budgeted for FY06. Actual spending through March was \$86,657.

Tuition Reimbursement. The Authority is proposing a budget of \$31,000 for *Tuition Reimbursement* in FY07, the same level as for FY06. Actual spending in FY05 was \$22,680. The Authority projects the full \$31,000 will be accrued in FY06.

Workers' Compensation

The Authority is proposing a budget of \$940,000 for *Workers' Compensation* expense in FY07, a decrease of \$260,000 or 22% below the \$1,200,000 budgeted in FY06. Proposed are \$435,000 for *Compensation Payments* (a 40% reduction from the FY06 budget), \$400,000 for *Medical Payments* (a \$40,000 or 11% increase), and \$105,000 for *Other* fees, examinations and reviews (a \$15,000 or 12.5% reduction from FY06).

Through March, accruals totaled \$466,886, just over half of the \$900,000 budgeted for the period. Reprojections for year-end spending for FY06 anticipate accruals at \$809,285. Given remaining reserves balances and the resolution of a number of outstanding cases, the Advisory Board believes that further reductions for FY07 are possible. **Reassess amounts budgeted for *Workers' Compensation* expense in FY07 and reduce the proposed budget by at least \$40,000.**

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OTHER DIRECT EXPENSES

Chemicals

The Authority is proposing a budget of \$8,617,677 for *Chemicals* expense in FY07, an increase of 16.2% or \$1,199,718 over the \$7,417,961 budgeted in FY06. Nearly every chemical expense has risen, with the exception of small decreases for *Polymer*, *Ferrous Chloride* and *Nytrazyme*.

The Final FY07 chemicals budget for the John Carroll Water Treatment Plant (CWTP) will be reconfigured to reflect lower dosage levels to meet revised Ph and alkalinity targets. MWRA is altering the pH and alkalinity targets to improve chlorine residual levels within the community distribution systems. Staff are; however, projecting a corresponding increase in chemical unit costs corresponding to forecasted increases in the oil market.

Soda Ash and *Sodium Hypochlorite* are the two largest components of the *Chemicals* budget.

Soda Ash. The Authority is proposing a budget of \$2,142,186 for *Soda Ash* in FY07, a 2% or \$40,953 increase over the \$2,101,233 budgeted in FY06. Spending through March reached \$1,475,203 or 7% (\$108,488) below the amount budgeted for the period.

Soda Ash is used primarily in the water treatment process. For FY07, MWRA is budgeting \$2,085,006 for *Soda Ash* for use at the CWTP, a 2% increase or \$48,577 from the amount budgeted in FY06, reflecting increased volume. The budget also includes \$57,180 for *Soda Ash* used at the Clinton Wastewater Treatment Plant to provide alkalinity to the secondary activated sludge system and nitrification. The amount represents a 12% reduction, as compared to the amount budgeted in FY06.

Sodium Hypochlorite. The Authority is proposing a budget of \$3,071,127 in FY07, a 24% increase (or \$598,616) from the \$2,472,512 budgeted in FY06. Deer Island accounts for 58% of the *Sodium Hypochlorite* budget, with \$1,783,635 proposed for FY07. The 30% increase reflects additional use of the chemical to meet enhanced regulatory requirements for enterococcus treatment, assuming that the new permit requirements will be in place by January 2007. The proposed budget reflects decreased use of sodium hypochlorite for odor control and increased use of activated carbon. The Authority is in the third year of a five-year contract for supply of the chemical. **Update assumptions for enterococcus treatment at Deer Island and reduce *Sodium Hypochlorite* expense by an estimated \$250,000.**

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Sodium Bisulfite. The Authority is proposing a budget of \$456,537 for *Sodium Bisulfite*, more than double the \$216,285 budgeted in FY06. Just over half the agency budget is for use at Deer Island and is related to the enterococcus treatment requirement. The Authority also proposes \$69,846 for the Field Operations Department. **Update**

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assumptions for enterococcus treatment at Deer Island and reduce Sodium Bisulfite expense by an estimated \$115,000.

Polymer. The Authority is proposing a budget of \$361,356 for *Polymer* in FY07, a 2% reduction from the \$367,855 budgeted in FY06. Deer Island accounts for nearly all the amount budgeted (\$352,046) where the chemical is used to thicken sludge. Use at the Clinton Wastewater Treatment Plant accounts for \$9,310. Through March, spending at Deer Island came to \$187,917 or nearly 30% below the \$263,122 budgeted for the period, due largely to lower dosing rates. **Update assumptions for *Polymer* use at Deer Island and reduce budgeted amounts by at least \$75,000.**

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Activated Carbon. The Authority is proposing a budget of \$285,600 for *Activated Carbon* in FY07, an increase of \$47,600 or 20% over the \$238,000 budgeted in FY06. The chemical is used at Deer Island for odor control; use has been increasing as the Authority changes its practices and is relying more on a combination of chemical scrubbers and carbon.

Liquid Oxygen. The Authority is proposing a budget of \$568,015 for *Liquid Oxygen* in FY07, a 3% increase from the amount budgeted in FY06. Almost all the expense supports the ozone generation process at the new CWTP. The remaining \$10,000 is for emergency backup at Deer Island and is level-funded from FY06.

Carbon Dioxide. The Authority is proposing a budget of \$316,371 for *Carbon Dioxide* in FY07, a 3.4% increase over the \$306,073 budgeted in FY06. The chemical is used in Water Operations to control the alkalinity of the water. Spending through March reached \$193,691 or \$35,164 (15%) below the amount budgeted for the period. Staff project year-end spending will be \$30,000 below the budgeted amount.

Sodium Hydroxide. The Authority is proposing a budget of \$239,464 for *Sodium Hydroxide* in FY07, a 50% or \$80,293 increase over the \$159,171 budgeted in FY06. Much of the chemical is used at Deer Island for odor control, where spending through March came to \$71,508 or 21% (\$18,700) below the amount budgeted for the period. The proposed budget calls for \$135,233 for Deer Island in FY07, a \$15,175 increase over the \$120,058 budgeted in FY06. Staff report that quantities are declining but a price increase of 20% is projected.

Ferrous Chloride. The Authority is proposing a budget of \$86,232 for *Ferrous Chloride* in FY07, a 20% (\$21,161) decrease from the \$107,393 budgeted in FY06. Spending through March reached \$64,730 or 18% (nearly \$14,000) below the \$78,687 budgeted for the period. The chemical is used at Deer Island for odor and struvite control. The budget assumes lower usage than in FY06 but a higher price. Usage in FY06 has increased in recent months.

Hydrogen Peroxide. The proposed budget includes \$215,710 for *Hydrogen Peroxide*, an 8% or \$16,615 increase from the \$199,095 budgeted in FY06. The chemical is used at Deer Island for hydrogen sulfide control. Through March, spending was \$48,840 or

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- 7• 75% below the \$199,095 budgeted for the period. Staff project spending of \$69,000 by year end. **Revisit assumptions for Hydrogen Peroxide use at Deer Island and reduce budgeted amounts by at least \$75,000.**

Hydrofluosilic Acid. The Authority is proposing a budget of \$333,900 for *Hydrofluosilic Acid* in FY07, a 35% or \$86,548 increase over the amount budgeted in FY06. The chemical is used at the CWTP. Through March, spending reached \$212,530 or 14.5% more than the amount budgeted for the period. Staff now predict year-end spending of \$307,000.

Nitrazyme. The Authority is proposing a budget of \$199,430 for *Nitrazyme* in FY07, an 11% or \$25,725 reduction from the \$225,155 budgeted in FY06. Spending through March was \$217,548 or 31% more than the \$165,710 budgeted for the period due to timing of use. Staff project spending by year end will be at the budgeted level. The chemical is used to control corrosion in the sewer pipes.

Utilities

The Authority is proposing a 23.4% increase in *Utilities* expense for FY07, a \$5,928,632 increase from the \$25,338,636 budgeted in FY06 to \$31,267,267. Just over 73% of the amount is for *Electricity* or \$22,884,307. Other *Utilities* in this category of expense are: *Natural Gas* (\$1,048,642); *Water* (\$2,305,647); *Diesel Fuel* (\$4,864,345); plus smaller amounts for *Propane*, *#2 Heating Oil*, *Oxygen*, *Acetelyn*, and *Other Utilities* for the Central Laboratory (such as *Argon*, *Helium* and *Nitrogen*).

Utilities expense associated with the residuals pelletizing plant at Fore River (including natural gas and electricity) are incorporated into the pelletizing plant contract. This contract was rebid in 2001 for a fifteen-year period and all the contractor costs are budgeted under *Other Services*.

Electricity. At \$22,884,307, *Electricity* expense is 24% of all non-personnel related *Direct Expenses* (which total \$96,554,627). The proposed budget increases by \$2,960,355 or 15% over the FY06 budget. It is the largest single subline item of *Other Direct Costs*, followed by the pelletizing plant expense of \$11,830,000. Much of the increase is due to significant price increases over the past year.

The Authority's *Electricity* use is equivalent to the amount used by a small city's population. The proposed budget includes \$15,039,538 for the Deer Island Wastewater Treatment Plant, \$98,729 for the Central Laboratory, \$224,932 for the Clinton Wastewater Treatment Plant, \$1,977,176 for the CWTP, \$5,422,319 for all other facilities managed by the Field Operations Department (including \$334,695 for the Braintree-Weymouth Intermediate Pump Station), and \$121,612 for facilities managed by the Support Services Division.

The Deer Island Wastewater Treatment Plant accounts for 66% of the proposed *Electricity* budget. The Authority is proposing a 20% increase, or \$2,509,570 to

\$15,039,538 for FY07. A new power supply contract is expected to be negotiated in May to replace the existing contract, which expires May 31, 2006. Prices for oil, natural gas and electricity have continued to rise and have resulted in sharply greater than budgeted spending during FY06. Also influencing FY06 costs have been a power outage in October, raising concerns about the reliability of electricity service from NStar, as well as variability in self generation.

The proposed budget includes increased self generation from running the Combustion Turbine Generators, as well as increased generation from the hydropower turbines which were repaired and placed back into service during FY06. Steam Turbine Generator production is projected to fall, as compared to the amounts budgeted for FY06, based on using a three-year average to estimate quantities, an assumption to be revisited during the spring. In the proposed budget, the Authority is assuming the purchase of 128.74 million kilowatt hours of *Electricity* in FY07, a 6% reduction from the amount budgeted in FY06, due to lower usage in the pumping stations and to increased self generation. **Revisit assumptions for STG generation at Deer Island and reduce the purchased *Electricity* budget by an estimated \$87,750.**

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The Authority is considering the construction of wind energy generating capacity at Deer Island, subject to height guidelines set by the Federal Aviation Administration. The lower the height the less electricity can be generated by each generator and the longer the repayment period. There may also be other sites that could be considered by the Authority for wind generation. **Investigate the possibility of siting wind energy at other Authority locations, including Nut Island, Norumbega, the Quabbin Reservoir and the CWTP. Update assumptions for siting wind energy at Deer Island and report to the Board of Directors on costs and a schedule for installation, as well as the potential for siting at other Authority locations.** Even with a reduced height requirement from the FAA, rising prices for *Electricity* may still make wind generation economically viable, at least at Deer Island.

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MWRA has recently experienced a number of operational issues with the hydroelectric turbines at the Cosgrove Intake facility. One of the primary problems is use of the turbines can disrupt water flow to the CWTP. The CWTP is still in the emerging stages of start-up and staff continues to refine operational protocols and identify outstanding plant modification needs. Maintaining water quality has taken precedent over hydroelectric generation, however, MWRA staff is working to remedy this conflict and other issues related to the interplay between the treatment and hydrogeneration facilities. Staff anticipate electricity generation at the Cosgrove facility will continue to improve and help to offset charges to the Skyline Drive facilities, which use the hydroelectricity generated at Cosgrove. **Reduce the Water Operations – Electricity, Skyline Drive line item by \$50,000 reflecting MWRA efforts to enhance hydroelectricity generation at Cosgrove.** In an environment of rising electricity expenses, MWRA should continue to pursue strategies to maximize production of hydroelectricity. **Report to the Board of Directors at the rate hearing on the current operational issues with the Cosgrove hydroelectric turbines and the measures**

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staff plan to implement to maximize use of the turbines while maintaining the reliable operation of the CWTP.

Also out for bid this spring is the supply contract for *Electricity* for the Carroll Water Treatment Plant; the contract is due to expire in late May. The proposed budget includes \$1,977,176 for *Electricity* at the plant, as compared with the \$1,834,433 budgeted in FY06. Staff anticipate it will take another two years for the new plant to reach steady state operation.

The Authority has two supply contracts for the remaining water, sewer and office facilities. The contract for the profile accounts expires in November 2006, while the contract for the larger interval accounts expires in November 2007.

Water. The Authority is proposing a budget of \$2,305,647 for *Water* in FY07, a 38% increase over the amount budgeted in FY06. Through March, spending has been 36%, or \$457,704 more than the \$1,271,084 budgeted for the period. Funding covers use at a number of wastewater and water facilities and for the Facilities Management Department. Most of the water use (\$1,960,329) is for the Deer Island Wastewater Treatment Plant, where average use has been increasing. Through March, spending on Water expense reached \$1,218,341 at Deer Island, 36% more than the \$897,264 budgeted for the period.

Diesel Fuel. The Authority is proposing a budget of \$4,864,345 for *Diesel Fuel* in FY07, a 69% increase over the \$2,872,592 budgeted in FY06. Through March, spending reached \$3,814,120 or twice the \$1,903,368 budgeted for the period, reflecting a greater than budgeted price plus Deer Island usage for participation in the load response program (which results in lower purchased electricity and additional non-rate revenue) plus additional wet weather use. Some spending was partially offset by lower usage in the Field Operations Department. Staff have projected spending of \$4,622,000 by the end of FY06.

The CWTP uses diesel fuel primarily for the on-site back-up electricity generators. The FY07 CWTP \$722,797 budget for diesel fuel includes significant assumptions regarding self generation. MWRA is continuing to refine the water treatment process and has expressed concern regarding the potential impact on the treatment process by taking the plant off of the grid and relying on backup power. Staff anticipates the treatment facility will require additional time prior to the implementation of an on-site electricity generation program similar to the current initiative at the Deer Island Wastewater Treatment Plant. The CWTP diesel fuel budget can, therefore, be reduced drastically.

- 12• **Cut the CWTP *Diesel Fuel* budget by \$481,383, reflecting the scaled back use of**
- 13• **the on-site back up electricity generators. Report to the MWRA Board of Directors in September on the long-term plan to evaluate and control energy costs at the CWTP, including participation in a load response program similar to the current program at the Deer Island Wastewater Treatment Plant.**

Natural Gas. The Authority is budgeting \$1,048,642 for *Natural Gas* in FY07, a 40% increase over the \$750,279 budgeted in FY06. Spending through March reached \$896,519 or 58% more than the \$567,962 budgeted for the period due to higher prices, partially offset by lower use due to the relatively mild winter.

Maintenance

The Authority is proposing a budget of \$24,196,620 for *Maintenance* expense in FY07, an increase of 18.1% or \$3,705,031 over the \$20,491,588 budgeted for FY06. The proposed budget includes \$21,045,861 for *Maintenance* expense in the Operations Division (including \$11,148,390 for Deer Island; \$1,549,000 for Maintenance performed by NEFCo at the Fore River Pelletizing Plant; \$206,785 for the Clinton Wastewater Treatment Plant; and \$7,611,812 for the Field Operations Department (including funds to support the start-up of the Union Park CSO facility and full year costs of operating the CWTP); \$520,477 for Laboratory Services; and \$9,397 for Engineering and Construction. The Support Services Division includes \$2,800,759 (including \$2,233,941 for computer software and hardware maintenance in the MIS Department and agency-wide computer licenses and upgrades plus \$37,300 for Facilities Management and \$528,518 for automotive materials and services in the Fleet Services Department) and \$350,000 for support and maintenance of the electronic security systems in the Office of Emergency Preparedness (in the Executive Division).

Spending had been increasing by about \$1 million each year since at least FY02, when actual spending was \$16.35 million. Spending had risen to \$17.21 million in FY03, \$18.61 million in FY04 and reached \$20.169 million in FY05 (or \$0.419 million more than the \$19.75 million budgeted). Spending in FY06 is projected (as of early March) to remain within budgeted amount: at \$20,128,781 or 1.8% (\$362,807) below the originally budgeted amount.

Deer Island Maintenance. Just over 46% of all proposed *Maintenance* spending in FY07 is budgeted for the Deer Island Wastewater Treatment Plant. The proposed budget of \$11,148,390 is an 18.1% increase (\$1,705,763) from the \$9,442,627 budgeted for FY06 and is 46% of the \$3,705,031 increase for all *Maintenance* spending. Through March, spending came to \$7,034,583 or 7% (\$446,077) greater than the \$6,588,502 budgeted for FY06.

The Authority reports the primary reasons for the proposed increase in *Maintenance* spending in FY07 are higher preventive and corrective maintenance activities, as the Deer Island plant and equipment age, and increases in project and service contracts. A number of multi-year contracts expire just prior to the start of FY07 or during FY07. Staff project that *Maintenance* expense for Deer Island will continue to increase as the plant ages and certain equipment becomes obsolete. The FY07 CEB has funding for 145 maintenance positions and includes approximately 113 service contracts.

The Authority reports that approximately \$6.4 million or 58% of the Deer Island maintenance budget is for services; the remaining 42% or \$4.7 million is for materials

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and projects. Just over half the increase in the maintenance budget for FY07 (\$0.9 million) is for services, including a number of renewed and new service contracts.

Security Services are budgeted under *Professional Services*.

Pellet Plant Maintenance. The Authority is proposing a budget of \$1,549,000 for Maintenance spending at the Fore River Pelletizing Plant, a 60% or \$580,000 increase. Of this amount, \$119,000 is an inflation adjustment. The fifteen year operating contract with NEFCo, approved in March 2001, identifies annual levels of spending on operating and capital maintenance projects.

- 14• The Advisory Board has commented previously that future use of the plant, after the end of the multi-year operating contract, is uncertain. The maintenance plan should reflect the Authority's long-term plans for the plant or, at a minimum, preserve options beyond the 2015 period. **Report to the Board of Directors in September on plans for the pelletizing plant's long-term future, including maintenance scope and priorities in the upcoming Master Plan.** The report should include consideration of possible amendments to the NEFCo contract to ensure it reflects updated assessments of maintenance requirements.

Clinton Wastewater Treatment Plant Maintenance. The Authority is proposing a budget of \$206,785 for *Maintenance* spending at the Clinton Wastewater Treatment Plant, the same amount as budgeted in FY06. The Authority notes the plant will be fifteen years old in FY07 and that staff anticipate increased maintenance needs in the future.

Field Operations Department Maintenance. The Authority is proposing a budget of \$7,611,812 for *Maintenance* materials and services in the Field Operations Department in FY07. The amount represents a 34.3% increase (\$1,945,597) from the \$5,666,215 budgeted in FY06. The amount includes \$2.4 million for materials and \$5.2 million for services.

The Authority reports that \$270,000 of the increase is due to the transfer of Central Support to Field Operations. Other key areas contributing to the increase are: \$1.3 million for full-year funding of maintenance service contracts for the new CWTP; operation of the Union Park CSO Treatment facility of \$316,000; more funding for grounds contracts of \$335,000; division-wide service contracts of \$239,000; paving of \$100,000; Nut Island landscaping of \$25,000; Headworks initiatives of \$360,000; Nut Island projects of \$150,000; and Rutland-Holden line cleaning initiatives of \$100,000.

- 15• More recently, the Authority has awarded a contract for *Building and Grounds Services* at Nut Island and Hough's Neck. The cost for two years is \$53,478, which is below the annual assumption of \$50,000 in the proposed budget. **Update budgeted amounts for *Building and Grounds Services* in the Field Operations Department for a reduction of \$23,250.**

The grounds maintenance contract for Metropolitan and Western Operations will be bid in the near future. Since the submission of the Proposed FY07 CEB, staff has reassessed the scope of the grounds services contracts and intends to scale back the level of effort in the Final FY07 CEB. These decreases will be offset by the inclusion of a series of discreet maintenance projects, including repairs to the Shaft 8 Crane at the Lonergan Intake Structure and projected per unit cost increases for paving related to increased costs for oil.

The Authority expects the Union Park CSO and Pumping Facility will come on line during FY07, although updated schedules put the date several months later than assumed in the proposed budget. Included in the budget is \$500,000 for the operations and maintenance contract for the facility (as well as other, utilities and chemicals costs associated with operating the facility). **Update assumptions for operation of the Union Park CSO Facility in FY07 and reduce budgeted amounts by at least \$100,000.**

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Training and Meetings

The Authority is proposing a budget of \$207,363 for *Training and Meetings* expense in FY07, a \$46,327 (18.3%) decrease from the amount budgeted in FY06. The proposed budget represents reductions taken across most divisions, with the exception of Finance. Spending through March came to \$97,550 or 45% below budgeted amounts, reflecting continued tight management of this category of expense. Total spending in FY05 was \$237,690.

Professional Services

Spending on *Professional Services* is projected to rise by \$441,340 or 6.3% to \$7,462,937 in FY07 as compared to the \$7,021,597 budgeted in FY06. Nearly half this amount -- \$3,556,817 -- is for *Laboratory Testing and Analysis* expense and another 25% (\$1,872,157) is for *Security Services*.

Engineering Services. The Authority is proposing a budget of \$440,000 for outside *Engineering Services* in FY07, an increase of \$355,000 from the FY06 budget. Included in this category of expense are \$10,000 for mapping services; \$50,000 for local limits testing at Deer Island and the Clinton plant as expected to be required in the new NPDES permit; \$50,000 for two beach nourishment studies at Deer Island; \$200,000 for as needed service contracts to support Western Operations; \$25,000 to support a feasibility study for dredging Stillwater Basin; and \$100,000 for as needed engineering services for Metro Maintenance. **Reassess the frequency of beach nourishment studies at Deer Island and reduce Professional Services spending by \$25,000.**

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Laboratory Testing and Analysis. The Authority is proposing a budget of \$3,556,817 for Laboratory Testing and Analysis services in FY07, a 2.2% or \$77,118 increase from the amount budgeted in FY05. Most of the funding for this category of expense (\$3,335,693) supports harbor and outfall monitoring studies. The request is virtually at

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the same level as that budgeted in FY06, but is lower than FY03 and FY04 actual spending, due largely to modifications to the ambient monitoring plan and the transfer of some monitoring work from the outside consultant contract to the Central Laboratory on Deer Island. The Harbor and Outfall Monitoring contract was rebid in 2005 and three new contracts were awarded in November 2005 to support the ongoing Harbor and Outfall Monitoring program.

- 18• Legal Services. The Authority is proposing a budget of \$256,500 for a number of *Legal Services* in FY07, a reduction of \$45,584 (or 15.1%) from the amount budgeted in FY06. Actual spending was \$200,255 in FY05 and \$267,092 in FY04. Included in this category of expenses is \$170,500 for costs associated with the Labor Relations group in the Human Resources Department, the same level as funded in FY06. Most of the funding supports third-party claims administration for the Workers' Compensation program. Actual spending in FY05 was \$149,345. Spending through March has been \$74,021 or 35% below the \$114,735 budgeted for the period. **Reassess budgeted amounts for *Legal Services* in the Human Resources Department and reduce by at least \$15,000.**

Legal Services funding also includes \$86,000 for the Law Division for outside legal counsel, a 35% reduction from the \$131,584 budgeted in FY06. Actual spending in FY05 was \$50,810 and through March spending has been 61% below the amount budgeted for the period.

Audit Services. The Authority is budgeting \$200,000 for *Audit* services in FY07, an increase of 17.6%, or \$30,000 from the \$170,000 budgeted in FY06. Included is new funding for an actuarial study of post-employment benefits. Actual spending in FY05 was \$190,000.

- 19• The MWRA Board of Directors approved a new Audit Services contract at the May 10, 2006 meeting. The \$670,000 three-year award is split between \$300,000 for non-recurring consultation and audit services in connection with Authority debt issuances and the remaining \$370,000 will be for the annual organizational audit and other miscellaneous project audits. Budgeted spending for the annual audit and single audits within the Proposed FY07 CEB is slightly higher than the awarded level. **Reduce the Comptroller's *Professional Services* line item by \$11,000 to reflect the May 10, 2006 award of the new Auditing contract.**

Communications Services. The Authority is budgeting \$162,852 for *Communications Services* in FY07, a 0.7% increase over the FY06 budget. This budget supports the Wastewater Advisory Committee and the Water Supply Citizens Advisory Committee.

Other Professional Services. The Authority is budgeting \$973,211 for a number of *Other Professional Services* for FY07, a 15.8% increase from the \$840,194 budgeted in FY06. Included is \$250,000 for an infrastructure study at the Fore River Shipyard and Pelletizing Plant; \$10,000 for the Gulf of Maine ocean observing system; \$69,000 for maintenance-related services for Deer Island; \$50,000 for the insurance consultant and \$20,000 for the engineering consultant; \$110,000 for trustee services, \$35,000 deposit

services; \$30,000 for an energy consultant; \$90,000 for other professional services in the Law Division; \$24,000 for services for the Human Resources Department, \$161,500 for Technical Training and \$57,820 for Professional Development training; \$33,591 for medical services to comply with OSHA and other regulations; and \$25,500 for the employee assistance program.

The \$90,000 for *Other Professional Services* in the Law Division is a 28% reduction from the \$125,000 budgeted in FY06. Spending on this category of expense has been reduced in recent years; spending through March has been nearly 80% below the amount budgeted for the period.

Security Services. The Authority is proposing a budget of \$1,872,157 for Security Services in FY07, a reduction of \$109,272 (5.5%) from the amount budgeted in FY06. Included are \$916,496 for the security contract for Deer Island, \$383,953 for security at the Carroll Water Treatment Plant and \$569,194 for security services for the Chelsea Facility. Spending through March has been 8.1% below amounts budgeted for the period.

The budget for Security Services at Deer Island represents a 12% reduction (\$128,504) from the amount budgeted in FY06, due to updated contract costs and one-time improvements during FY06. Year-end projections anticipate spending at \$195,000 below the amount budgeted for FY06. **Update assumptions for Security Services expense at Deer Island and reduce budgeted amounts by \$40,000.**

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Other Materials

The Authority is proposing a budget of \$4,210,905 for a number of *Other Materials* in FY07, an increase of \$429,788 or 11.4% from the \$3,781,116 budgeted for FY06. The proposed budget includes \$187,064 for *Office Supplies*; \$172,340 for *Postage*; \$628,792 for *Lab and Testing Supplies*; \$268,889 for *Health and Safety* expense; \$278,330 for *Equipment and Furniture*; \$950,000 for *Vehicles Replacement*; \$284,655 for *Work Clothes*; \$1,056,914 for *Vehicles Expense*; \$105,121 for *Other Materials*; \$239,180 for *Computer Hardware*; \$30,300 for *Computer Software*; and \$9,320 for *Purchase Cards* expense.

Office Supplies. The Authority is proposing a budget for *Office Supplies* of \$187,064, virtually the same amount as budgeted for FY06. Staffing levels continue to decline although costs for certain items are rising. Spending through March reached \$159,534 or 15% greater than the amount budgeted for the period.

MWRA is budgeting \$82,550 in the Procurement – Materials Management Department for printer/copier paper. The budget for printer/copier paper is based upon an Authority-wide rate of \$65 per employee. The *Office Supplies* line item is generally well managed by Materials Management staff. Continued management over the *Office Supplies* line item and pursuit of economies of scale in printer/copier paper purchases should allow MWRA to reduce the \$65 per employee projection to \$60 per employee. **Reduce the**

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Procurement – Materials Management Printer/Copier Paper line item by \$6,350 representing a per employee projection of \$60.

Postage. The Authority is proposing a budget of \$172,340 for *Postage* expense in FY07, an increase of \$64,018 or 59% from the \$108,322 budgeted in FY06. Mailing the Consumer Confidence Report accounts for \$111,092 of the request. Postage for mailings from the Charlestown Navy Yard and from the Chelsea facility plus UPS charges account for another \$60,000 of the budget request.

Lab and Testing Supplies. The Authority is proposing a budget of \$628,792 for *Laboratory and Testing Supplies* in FY07, a 2.2% or \$13,649 increase from the \$615,142 budgeted for FY06. Spending through March reached \$504,136 or 9% more than budgeted for the period. Just over \$500,000 of the amount is for supplies for the Central Laboratory on Deer Island where the number of tests increased in the last two years as the Authority has brought more testing activity in-house; the amount is level funded from FY06. The remaining funding includes \$73,000 for Wastewater Operations and \$29,000 for Deer Island operations.

Health and Safety Materials. The proposed budget includes \$268,889 for *Health and Safety Materials*, a \$36,431 (16%) increase over the \$232,458 budgeted in FY06. Spending through March was \$315,874 or nearly double the \$174,516 budgeted for the period. Funding for FY07 includes \$60,000 for health and safety materials for Deer Island, as well as for spill containment and clean-up supplies, and \$189,000 for gas monitors, ventilation equipment, safety glasses, first aid supplies and site characterization supplies for the Field Operations Department.

Equipment and Furniture. The Authority is proposing a budget of \$278,330 for *Equipment and Furniture* purchases in FY07, an increase of \$27,380 or 11% from the \$250,950 budgeted for FY06. Spending through March has been \$64,617 or just under half the amount budgeted for the period, reflecting a later than assumed equipment purchase. Equipment for the Central Laboratory is budgeted at \$235,000 or 84% of the proposed budget.

Vehicle Replacement. The Authority is proposing a budget of \$950,000 for *Vehicle* and related equipment *Replacement* in FY07, an increase of \$282,500 from the \$667,500 budgeted for FY06. Actual spending in FY05 was \$1,237,289 and \$1,579,817 in FY04, as the Authority rebuilt its replacement program after spending was held to \$120,271 in FY03 when debt service assistance was discontinued. More than 200 vehicles met the criteria for replacement; the proposed budget funds 30 replacements. In the past few years, the Authority has reduced the vehicle (and related equipment) fleet by 11% and reports that more than nearly 60% of the remaining fleet is seven or more years old. Current replacement plans translate into a replacement cycle of 15 years.

Work Clothes. The Authority is proposing a 3.6% increase in *Work Clothes* expense, from \$274,887 to \$284,655. Funding includes purchases of safety shoes, replacement

boots and jackets and work uniforms or clothing allowances. Spending through March reached \$286,562 or 37% more than the amount budgeted for the period.

Vehicle Expense. The Authority is proposing a budget of \$1,056,914 for *Vehicle Expense* in FY07, a \$94,824 or 8.2% decrease from the \$1,151,738 budgeted in FY06. Funding covers tolls, mileage reimbursement and bulk diesel and gasoline purchases. The decrease reflects increases at the Chelsea fuel facility, which also explains the lower than budgeted spending for the year to date.

Other Materials. The Authority is proposing a nearly 21% decrease in budgeted amounts for a number of *Other Materials*, from \$132,421 to \$105,121. The amount would be the lowest in at least five years. The budget includes funding for water conservation kits, training materials, fill used as cover for the Clinton Wastewater Treatment Plant landfill, mapping and graphic artist supplies and oil spill containment supplies.

Computer Hardware and Software. The Authority is proposing to budget \$239,180 for *Computer Hardware* in FY07, an increase of \$100,244 from the amount budgeted in FY06. Through March, spending totaled \$32,562. *Computer Software* is budgeted at \$30,300. No funds have been spent through March.

Other Services

The Authority is proposing a budget of \$20,591,858 for *Other Services* spending in FY07, a reduction of 4.5% or \$965,939 from the \$21,557,797 budgeted in FY06. More than half of all spending under this category of expense is for *Sludge Pelletization* at the Fore River plant. Other major components of this category are \$3,391,638 for *Lease* and related costs, \$1,087,821 for *Grit and Screenings Removal* and \$1,306,146 for *Telephone* expense.

Printing and Duplicating. The Authority is proposing to budget \$347,822 for *Printing/Duplicating* expense in FY07, a 3.8% (\$13,695) reduction from the \$361,517 budgeted for FY06. The budget includes funding for printing the Consumer Confidence Report, education program publications, the Annual Report, budget documents and reports, lead in tap water reports and monthly water quality reports, and warehouse forms. Spending through March was \$135,529 or 17% below the \$129,450 budgeted.

The budget includes \$15,000 to print the *Annual Report*. The Authority has not published an annual report since FY 2000. Authority staff note that the agency plans to publish the Annual Report for FY 2006 during FY07. The Authority has also budgeted \$3,000 for mailing services for the Annual Report under *Other Services-Other Services*. Audited financial statements have also been published separately, posted to the Authority's website and included in each Official Statement.

The budget includes \$24,632 for *Printing* related costs for the Education Program, level funded from the FY06 budget. Actual spending for the previous three years had been

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- 22• between \$5,000 and \$10,000. **Reassess the *Printing* budget for the Education Program and reduce budgeted amounts by at least \$10,000.**

The Public Affairs Department is also budgeting \$5,000 to support production of an employee newsletter. Through March, YTD spending on the *Printing/Duplicating* line item is \$24,507, or 73% under budget. Reasons cited for the underspending include the decision not to publish an annual report in FY06 and newsletter production has been sporadic due to enhanced use of the organization's intranet to communicate updates to employees. Staff are working on developing a web-based newsletter that can be printed in-house for field crews who do not have access to computers. **Reduce the**

- 23• **Public Affairs – *Printing and Duplicating* budget by \$3,000 reflecting enhanced use of the intranet to communicate to employees and plans to develop a web-based newsletter in FY07.**

Health and Safety. The Authority is budgeting \$311,067 for *Health and Safety* services for FY07, a \$36,333 (10.5%) reduction from the \$347,400 budgeted in FY06. Most of this amount, \$286,067, is for ambulance, fire extinguisher and hazardous materials services at the Deer Island Wastewater Treatment Plant.

Telephone. The Authority is proposing a 2% increase in *Telephone* expense for FY07 to \$1,306,146. Costs include \$686,310 for all voice and data costs managed by the MIS Department. Another \$606,395 supports telephone related service for the Operations Division, including \$351,000 for Metering and Monitoring, a 6.7% increase over the \$329,076 budgeted for FY06. Through March, spending was 1% less than budgeted, as the shift from the more expensive landlines to cellular lines for the metering program took longer than expected.

Memberships/Dues/Subscriptions. The Authority is proposing a budget of \$372,322 for *Memberships, Dues and Subscriptions* in FY07, a 2% increase over the \$364,435 budgeted in FY06. Nearly \$290,000 of the amount is requested by the Operations Division and includes agency members in the national water and sewer agency organizations and the American Waterworks Research Foundation. Another \$64,261 is for the Support Division, including nearly \$41,000 for Library memberships and subscriptions. Another \$10,000 supports the Law Division. Agency-wide spending, through March, has been 7.7% over budget due to national organization dues at higher levels than budgeted.

- 24• *Advertising.* The Authority is proposing a budget of \$66,300 for *Advertising* expense in FY07, a 9% increase over the \$60,800 budgeted for FY06. Included in the budget is \$30,000 for recruiting advertising and \$30,000 for Procurement related advertising. Through March, spending on advertising for recruitment is 35% below budgeted amounts. **Revisit assumptions for *Advertising* in the Human Resources Department and reduce budgeted amounts by at least \$10,000.** Actual spending in FY05 was just under \$18,000.

Space/Lease/Rentals. The Authority is proposing a budget of \$3,391,638 for *Lease and Rental* expense in FY07, a 21% or \$909,048 reduction from the \$4,300,686 budgeted in FY06. The reduction reflects the continued downsizing of the space leased at the Charlestown Navy Yard. Included in the proposed budget is \$204,509 for rent, operating and tax costs associated with the final three months of the lease for Building 34. However, *Lease* costs for the remainder of the Building 34 lease were accrued in FY03 and FY04. **Reassess the budgeted amounts for Lease costs for Building 34 and reduce by \$190,168.**

•25•

As part of the renegotiated lease agreements, MWRA is moving staff from the Navy Yard to MWRA facilities in Chelsea and Deer Island. The revised agreement will be put into effect on September 1, 2006 and will allow MWRA to reduce space requirements in Building 39 by approximately 25%. This is a positive cost savings strategy, which the Advisory Board has previously advocated as part of the rates management action plan.

The Charlestown Navy Yard lease agreements include operating expenses and taxes which are assessed on the MWRA. While the rental costs for Building 39 have been reduced as part of the renegotiated lease, MWRA has neglected to make any corresponding adjustments to the operating and tax fees for Building 39. **Reduce the *Other Services - Space/Lease/Rentals* line item by at least \$35,000 to reflect the reduction in rented space at Building 39 beginning in September 2006.**

•26•

Other Rentals. The budget includes \$148,334 primarily for the rental of copiers and pagers for Authority staff.

Other Services. The Authority is proposing a budget of \$1,022,732 for a number of *Other Services* during FY07, a 1.4% decrease (\$14,764) from the \$1,037,496 budgeted in FY06. The budget includes funding for fax, copier and printer maintenance services, the annual oil boom service charge at Deer Island (\$21,000); \$195,000 for Eurasian milfoil removal; \$29,000 for hazardous waste removal from the Deer Island and Quabbin laboratories; and \$219,000 for Remediation projects. Also included in the *Other Services* category of expense is \$433,767 for the operating expenses of the *Advisory Board*, an increase of 2%.

The *Remediation Projects* involve four categories of work: \$43,000 for Lake Cochituate groundwater monitoring; \$60,000 for underground storage tank maintenance and inspection of the Authority's 41 tanks; \$30,000 for an assessment of cleanup work of pesticides found in the soil at Turkey Hill; and \$86,000 to continue an assessment and remediation of an oil plume at the Fore River Shipyard. The pesticide clean up initiative at Turkey Hill was completed in FY06 thus eliminating the need for funding in FY07. **Reduce the *Other Services - Other Services* budget within the Real Property and Environmental Management department by \$30,000 reflecting the completion of the Turkey Hill Soil Remediation project in FY06.**

•27•

Rates and Budget pay a service fee to a financial tracking firm to track Boston's Construction Cost Index on a monthly basis. The firm also provides an 18-month

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- 28• forecast of the Construction Cost Index which Rates and Budget staff utilize to assign an inflation factor on unawarded capital projects. The inflation projection service typically increases 3% annually; however, MWRA is projecting a 79% increase in this line item within the Proposed FY07 CEB. **Reduce the Rates and Budget *Other Services* – *Other Services* line item by \$2,424, reflecting an annual 3% increase in the inflation projection line-item.**

Grit and Screenings Removal. The Authority is proposing a budget of \$1,087,821 for Grit and Screenings Removal at Deer Island, Nut Island, certain pump stations, CSO facilities and the headworks facilities, a 1.6% increase (\$17,353) from the \$1,070,468 budgeted for FY06. While unit price estimates have been reduced (the new contract is about 8% lower than the previous one), quantities have been increased; \$17,000 of the increase is due to increased quantities, partially offset by \$3,000 in lower unit price. About one-third of the material is collected at Deer Island. The two-year contract expires in April 2007. Spending through March is 1% over year-to-date budgeted amounts. The budget also includes \$4,500 in estimated costs relating to Union Park, assuming a September 2006 start-up.

Sludge Pelletization. The Authority is budgeting \$11,830,000 for payments to the New England Fertilizer Company to process and dispose of sludge pellets. The amount is 7% or \$768,000 greater than the amount budgeted for FY06. The increase is based on an increase in excess quantities (over a base of 90 tons per day) plus an inflation factor, primarily for gas and electricity. Excess quantities are running at levels greater than those assumed in the proposed budget. Through March, spending has been 11% or \$896,847 greater than budgeted. Staff have forecast spending of \$12,512,000 by year end.

Utah Landfill Reservation Fee. Through this fiscal year, the Authority has been budgeting \$817,400 for the annual reservation fee for the backup landfill in Utah. The Authority had been required by the state DEP to maintain backup landfill capacity for sludge disposal, a requirement established in the early 1990's, prior to the completion and ongoing operation of the new pelletizing plant. The Authority, in the last year, has renegotiated the need for the backup landfill, and has filed for a change in policy with the Court, which accepted the revision. As a result, the Authority has not proposed to budget for this cost in FY07. However, Authority staff report that there remains some discussion with the City of Quincy and that the matter has not been fully resolved.

Permit Fees. The Authority is budgeting \$245,661 for *Permit Fee* expense in FY07, a 13% increase from the \$217,434 budgeted in FY06. Through March, spending has been 35% or \$48,683 below the amount budgeted for the period. Staff project \$20,000 that had been budgeted for technical support related to the sludge plant permit will not be used in FY06. Included in the proposed FY07 budget is \$35,000 for testing of two sludge dryer trains at the pelletizing plant; and \$105,000 for permit fees for the Deer Island plant.

Police Details. The Authority is budgeting \$403,100 for *Police Details* in FY07, a \$20,500 (4.8%) decrease from the \$423,600 budgeted in FY06. Nearly \$300,000 of the total supports expense in the Metropolitan Maintenance Unit. Spending through March has been \$78,005 (25%) below budgeted amounts.

INDIRECT EXPENSES

Insurance

The Authority is proposing an increase in the FY07 *Insurance* expense of \$150,000, or 6.4%, to \$2,500,000. The increase supports an anticipated rise in Premium charges. Payments/Claims are level-funded at \$700,000. Accruals through February are \$282,533 (18%) below the year-to-date budget.

The Authority is in the process of rebidding its insurance coverage and is assessing the limits of coverage and self-retentions. Staff has also developed a multi-tiered approach to achieve the best pricing available. At the same time, staff note the insurance market experienced massive losses because of the recent hurricanes and increased exposure to terrorism losses. Carriers are still not willing to commit to pricing for more than a one-year period. More recently, staff indicates the process of renewal is likely to result in competitive pricing.

Additions to Reserves

The Authority's bond resolutions require three reserve funds: the *Operating Reserve*, the *Insurance Reserve* and the *Renewal and Replacement Reserve*.

The *Operating Reserve* must equal two months of budgeted MWRA operating costs (which include Direct Expenses, Insurance, Mitigation, Retirement Fund deposits, BECo expense, and the Chelsea Lease payment). When required, additions to the CORE Fund are not considered Operating Expenses for purposes of the Operating Reserve Fund calculation. The proposed budget includes \$215,462,932 for FY07 Operating Expenses, which requires a reserve level of \$35,910,490. The current level of the Operating Reserve is \$32,933,000 or \$2,977,490 below the required level.

Acceptance of the Advisory Board's recommendations to reduce \$1,675,325 in Operating Expenses would reduce the Operating Reserve requirement to \$35,631,268. **Reassess the amount budgeted for the *Operating Reserve* deposit and reduce by \$279,221.**

•29•

The *Insurance Reserve*, which is maintained to mitigate the budgetary risk of self-insurance, currently stands at \$19 million. In September 2003, the insurance consultant reviewed the adequacy of the reserve and stated that the existing level of the Insurance Reserve Fund was "reasonably adequate" although in the low range for the assumptions and characteristics of the then existing insurance program. Furthermore,

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the Authority's expanded planning and asset protection program serve to enhance efforts to reduce property risk. The risk management consultants also emphasized the "excellent debt rating of the Authority ... provides the ability to quickly raise funds by floating additional issues." Even so, the insurance advisor "suggested" that the Authority increase the Insurance Reserve by \$3 million over three years to the mid-point of the "acceptable range of \$18 million to \$25 million."

Despite the Advisory Board's recommendation to hold the amount in the *Insurance Reserve* to \$18 million, the Authority accrued the \$1 million proposed to be added in FY05, but held the reserve amount to \$19 million in FY06, with no further increase. No further increase is proposed for FY07. The Authority is planning to call for a new review of the Insurance Reserve beginning this summer. Any suggested or recommended levels for the Insurance Reserve should be considered in the context of the Authority's entire budget, total reserves, and ability to raise funds in the event that the reserve might need to be tapped. **Direct the Insurance Consultant to discuss the size and need for the Insurance Reserve in its upcoming report.**

•30•

The most recent bond issue, this past March, included new funding for expenses that had been initially funded through the Tax Exempt Commercial Paper program. There is now more than \$150 million of excess capacity in the program, offering an alternative to separate reserves for the Insurance program and for the RRR. **Reassess the need for the Insurance Reserve and for the RRR, given the excess capacity in the Tax Exempt Commercial Paper Program.** The combined total in the two reserves is \$54 million, one-third the excess capacity of the Commercial Paper Program.

•31•

The *Renewal and Replacement Reserve* (RRR) is funded at \$50 million. The Consulting Engineer reviews the reserve fund balance for appropriateness no less than every three years. The most recent review, in the fall of 2005, confirmed previous reviews that the RRR could be reduced to \$35 million. The Authority plans to transfer the \$15 million difference from the RRR to the Rate Stabilization Fund in future years when withdrawals will be needed to modify projected rate increases. In the meantime, the Authority invests these funds and records interest income under *Investment Income*. (See *Non-Rate Revenue*.) The multi-year planning projections reflect this planned transfer.

•32•

Given the excess capacity of the Commercial Paper Program, the Advisory Board believes the recent report of the Consulting Engineer should be reopened. **Reopen and amend the Report of the Consulting Engineer to include a more thorough discussion of the size and need for the RRR given the excess capacity in the Commercial Paper program.**

Watershed Reimbursement/PILOT Payments/Debt Service

MWRA is obligated under state law to reimburse the Department of Conservation and Recreation (DCR) for services provided by the Division of Water Supply Protection (DWSP), debt service on DCR land purchases and payments in lieu of taxes (PILOT). These obligations are offset by revenues from DWSP operations that include forestry and hydroelectric power.

Table 6

EXPENSES	FY2005 Budgeted	FY2005 Actual	FY2006 Budgeted	FY2007 Budgeted
Division of Water Supply Protection Operating Costs	\$10,161,910	\$10,023,981	\$12,077,755	\$11,879,696
Debt Service	5,176,338	5,476,338	5,329,588	6,539,116
TOTAL	\$15,338,248	\$15,500,319	\$17,407,343	\$18,418,812
Payment In Lieu Of Taxes	5,217,267	5,076,338	6,894,824	6,567,200
TOTAL	\$20,555,515	\$20,576,657	\$24,302,167	\$24,986,012

Prior to FY05, the MWRA’s watershed system (comprised of the Quabbin, Ware, Wachusett and Sudbury Reservoirs) was managed by the Metropolitan District Commission (MDC). MDC became part of DCR in 2004. Funding for watershed management was subject to appropriation in the General Fund. The Commonwealth was reimbursed by the MWRA on a quarterly basis for costs associated with watershed management.

On March 10, 2004, the MWRA Board of Directors voted to enter into a Memorandum of Understanding (MOU) with DCR, “for the purpose of allocating and clarifying responsibilities with regard to the operation of the watershed and waterworks systems and to improve budgeting and accountability for the expenses currently reimbursed by the Authority.” The agreement replaced the 1992 MOU between MWRA and DCR and achieves two purported objectives: 1) establishing clear control by MWRA of important water related functions and 2) the instatement of fiscal accountability and oversight of DCR’s spending, work plan and activities.

Despite reimbursement from the MWRA, the watershed management fund experienced relatively steady cuts in funding over the years, consistent with reductions to the state budget. In an effort to provide sufficient financial support for watershed protection, the Advisory Board proceeded to work with MWRA and Senator Stephen Brewer (D-Barre) to move watershed management funding out of the General Fund and into a Trust to ensure a reliable stream of revenue for management and protection of the MWRA’s drinking water supply. The resulting Water Supply Protection Trust, established in the FY05 budget, moved the DWSP out of the General Fund. The Trust is overseen by a five-member Board of Trustees consisting of the Chairperson of the MWRA Advisory Board, the Secretary of the Executive Office of Environmental Affairs (or their appointee), the Executive Director of the MWRA, one person selected by the North Worcester County Quabbin Anglers and the Quabbin Fishermen’s Association and the

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President of the Swift River Valley Historical Society (or their appointee). Spending from the Trust is approved by the Board of Trustees and executed through the MOU.

During spring 2005, MWRA was informed by the Commonwealth of Massachusetts that the Water Supply Protection Trust is subject to an Executive Office of Administration and Finance (A&F) Overhead Charge to cover expenses incurred by the Commonwealth in managing the Trust. The A&F Overhead Charge is assessed upon all Trusts managed by state employees unless explicitly exempted by the Executive Office of Administration and Finance. MWRA was unaware the Water Supply Protection Trust would be subject to a supplemental fee from the Commonwealth. MWRA estimates the A&F Overhead Charge to be \$1.4 million in FY05 and \$2 million in FY06.

- 33• **The Advisory Board and MWRA are currently pursuing legislation to waive the A&F Overhead Charge and provide a refund for contributions made in FY05 and FY06. Continue to work with the Advisory Board in pursuing a legislative remedy to eliminate the A&F Overhead Charge. MWRA should also work with Advisory Board staff to have DCR establish a clear and effective methodology for establishing how administrative costs and expenses for shared personnel or agency resources shall be allocated among DWSP and DCR.**

In Section 8.2 of the MOU between MWRA and DCR, MWRA is assigned the right to “conduct periodic examinations of records to verify the appropriateness of watershed agency expenditures.” The Advisory Board maintains that with the recent establishment of the Trust, a neutral third party should review the emerging MWRA/DWSP administrative methodologies to ensure the fundamental assumptions made regarding the assignment of costs to both MWRA and DWSP is equitable and supportable. The MWRA Advisory Board accordingly requests the support of MWRA to have the State Auditor review the budget and cost sharing methodology for the MWRA/DWSP Trust.

- 34• **Work cooperatively with the MWRA Advisory Board to support the State Auditor’s review of the MWRA/DWSP Trust in an effort to ensure accountability for all participating parties.**

MWRA is budgeting \$6,817,200 for Payments in Lieu of Taxes for Commonwealth owned land in the watersheds. Massachusetts General Laws, Chapter 59, Section 5G directs MWRA to pay PILOT annually to the watershed communities for land held for water supply protection purposes. In January 2006, DCR reported to MWRA on the findings from the Department of Revenue (DOR) revaluation of State Owned Lands, which occurs once every five years. MWRA’s Final FY06 and Proposed FY07 budget estimates for PILOT were significantly higher than originally estimated. MWRA will update the Final FY07 CEB to include a DCR projected 1% annual increase for PILOT.

- 35• **The PILOT will increase 1% annually until the next DOR revaluation. Reflect the updated revaluation of watershed property within the Final FY07 CEB reflecting a savings of \$594,269 in the PILOT line item.**

MWRA staff provided the Board of Directors, in October 2005, with an informative update and staff summary on the PILOT program. Staff identified a number of potential

strategies within the staff summary for MWRA to reduce future PILOT obligations. Highlighted areas included divestiture of South Sudbury Watershed lands; amending DCR’s land acquisition policy to favor conservation recreation acquisitions and reduce fee acquisitions; continue to ensure existing valuations are appropriate; and, address Quabbin “annexed lands”. The Board of Directors commended MWRA staff for bringing to their attention potential tools for reducing MWRA’s long-term PILOT obligation and encouraged MWRA staff to further pursue the areas recommended for further refinement. **Report back to the MWRA Board of Directors at the rate hearing on staff’s progress in pursuing the cost reduction/avoidance measures outlined in the October PILOT staff summary.**

•36•

Massachusetts General Laws direct the Treasurer’s Office to charge MWRA for debt service on certain bonds issued by the Commonwealth to fund the purchase of land by DCR for watershed protection. MWRA requested the Commonwealth level out the MWRA’s reimbursement for outstanding debt estimated at \$87.1 million. The Commonwealth agreed to this request by restructuring \$32.9 million in outstanding principle limiting annual payments between fiscal years 2007 and 2022 to \$5.6 million annually. The Treasurer’s Office cooperative effort to revise the MWRA’s watershed-related debt will provide welcome stability in the watershed debt line item. **Reduce the Proposed FY07 watershed debt service line item by \$930,283, reflecting the recent agreement with the Commonwealth’s Treasurer’s Office to reschedule the watershed debt service payment schedule.**

•37•

HEEC Agreement

The Authority is proposing to budget \$4,681,380 in FY07 for payments to the *Harbor Electric Energy Company* (a subsidiary of the Boston Edison Company, now NStar). The amounts repay the investment over the 25-year period of installation of the cross-harbor electric cable to Deer Island and the construction of the power substation in South Boston. The capacity charge, representing the payment of debt-related expense, has been gradually decreasing as more of the asset is depreciated; the proposed budget includes \$3,841,380 or a 6% (\$245,970) reduction. The O&M charge has been increasing, with \$840,000 requested for FY07, an increase of \$380,000 or 83%. Through March, spending has been within 1% of budget for the two payments combined.

Mitigation

The proposed budget includes \$1,386,250 for Mitigation Payments of \$720,000 to the City of Quincy and \$666,250 to the Town of Winthrop in FY07. The combined total is within 1% of the amounts budgeted for FY06; the amount is set by an agreement with each community. The Authority, in the amended FY06 budget, accelerated the payment to Winthrop for a fire truck in FY06; the spring revisit for the FY07 *Mitigation* budget will, therefore, reflect this revised payment schedule.

Pension Expense

The Authority is proposing an addition to the Retirement Fund of \$4,053,207 in FY07, a 13.3% or \$475,207 increase over the \$3,578,000 budgeted in FY06. The Authority reports the increase is based on the most recent actuarial valuation report issued in January 2005. The Authority also prefunded the Retirement Fund addition during FY04, thereby reducing the required payments in FY05, FY06 and FY07. The pension fund addition also includes funds for the expenses of the Retirement Board, including four staff positions.

CAPITAL FINANCING EXPENSE/DEBT SERVICE

The Authority is proposing a budget for *Capital Financing Expense* of \$357,310,117 (before debt service offsets). Less *Bond Redemption Savings* of \$19,060,141, Capital Financing totals \$338,249,976. The Authority does not assume receipt of *Debt Service Assistance*, considered an offset to Capital Financing Expense, since an amount was not included in the Governor’s budget recommendations.

SRF Borrowings. The Authority is assuming debt service of \$41,517,084 relating to debt of \$920 million borrowed through the Commonwealth’s Water Pollution Abatement Trust (also referred to as the State Revolving Loan Fund or SRF). The Authority is assuming new borrowings in this fiscal year of \$75 million plus interest on an interim loan of \$20 million.

Table 7

Proposed Fiscal Year 2007 Capital Financing Summary	
Debt Service	
Senior Debt	\$211,241,406
Subordinate Debt	94,084,567
State Revolving Loan Fund (SRF)	41,517,084
Current Revenue/Capital	3,000,000
Chelsea Lease	3,217,060
Water Pipeline - Commercial Paper	4,250,000
<i>Subtotal</i>	\$357,310,117
Debt Service Offsets	
Bond Redemption Savings	\$19,060,141
Prior Variable Rate Savings	0
Budget Year Variable Rate Savings	0
Debt Service Assistance	0
<i>Subtotal</i>	\$19,060,141
Net Capital Financing	\$338,249,976

MWRA Senior and Subordinated Debt Service. The Authority is proposing a budget of \$211,241,406 for *Debt Service* on \$2,983 million in outstanding senior debt (including a new bond issue of \$150 million in FY07) and \$94,084,567 for *Debt Service* on \$1,687 million of subordinate debt. More recently, the Authority has updated some of its assumptions following the March 2006 bond issue. **Update assumptions for MWRA Debt Service for a reduction of at least \$2,032,137.** •38•

The Authority is also assuming a 4.75% interest rate for *Variable Rate Debt Service*. However, as of March, the Authority is reporting that the cost of its *Variable Rate Debt* is 2.93%. **Revisit assumptions for Variable Rate Debt Service and reduce budgeted amounts by at least \$3,028,125.** •39•

Local Water Pipeline Commercial Paper Program. Now in its seventh year, the Local Water Pipeline Improvement Loan Program provides \$25 million per year for a ten-year period to communities to replace and rehabilitate municipal water pipelines.

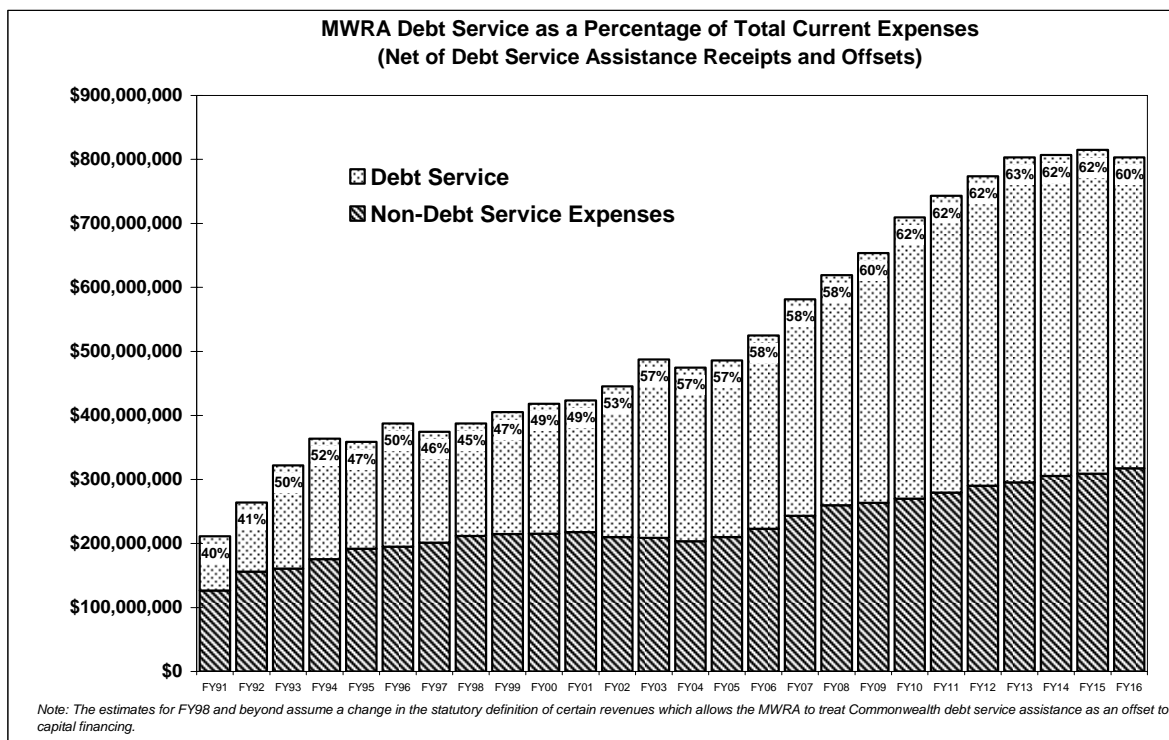
The Authority is proposing a budget of \$4,250,000 for debt service relating to the commercial paper issued in support of the Local Water Pipeline Improvement Loan Program. **Update assumptions for Local Water Pipeline Program Commercial Paper and reduce the budgeted amount by \$894,732.** •40•

Capital Lease. The Authority is budgeting \$3,217,060 for the fifth year of payments on the *Capital Lease* for the Chelsea facility. This is the same amount budgeted each year since 2002.

Debt Service Offsets. Among the credits that can be used to offset budgeted amounts for Debt Service (and also to offset each debt service coverage requirement) are *Bond Redemption Funds* and *Variable Rate Savings*. *Swap receipts* associated with the 2000D bond issues have more recently been treated as *Other Revenue* and were terminated as part of the most recent bond transaction in March 2006. The Authority is budgeting \$19,060,141 from the *Bond Redemption Account* in FY07.

Debt Service Assistance is also treated as a Debt Service Offset. The budget passed by the House of Representatives includes \$25,000,000 for the statewide *Debt Service Assistance* program. At this level of funding, the Authority estimates that it could be eligible for \$18,750,000 in *Debt Service Assistance*, equivalent to 3.97% in rate revenue in FY07. Receipt of that amount would lower FY07 rates to 5.83%. **Update budgeted amounts for Debt Service Assistance from the Commonwealth. Utilize Debt Service Assistance receipts during FY07 to reduce FY07 community assessments.** •41•

Figure 12



Use of Current Revenue to Fund Capital Projects. For FY07, the Authority is proposing to budget \$3,000,000 in *Current Revenue* to fund ongoing capital projects. The amount is \$100,000 less than the \$3,100,000 budgeted in FY06.

REVENUE

Non-Rate Revenue and Income

The Authority is budgeting *Non-Rate Revenue and Income* of \$63,179,171 in FY07: *Other User Charges* of \$6,924,717; *Other Revenue* of \$1,632,000; *Entrance Fees* of \$805,252; *Investment Income and Swap Receipts* of 33,880,204; and a drawdown from the *Rate Stabilization Fund* of \$16,603,999.

Other User Charges

City of Worcester. The Authority has proposed a budget of \$92,205 for payments from the City of Worcester.

Water Treatment Residuals. The Authority is estimating receipts of \$380,000 from nine water treatment plants whose residuals are discharged to the Authority’s sewer system for treatment at Deer Island.

Other Revenue

TRAC Permit Fee Income. The Authority is budgeting \$1,950,000 for fees charged to industries and other permitted customers that discharge toxic and other regulated wastes into the sewer system. The amount is a 2.2% increase over the \$1,908,000 budgeted for FY06. Through March, income has been 3.9% more than budgeted amounts.

Penalties. The Authority is level-funding anticipated *Penalty* income at \$250,000. Income is difficult to predict and varies from year to year. Receipts through March were \$55,450, well below the \$187,500 budgeted for the period. Receipts in FY05 were \$328,275; in FY04, receipts were \$71,075. There has recently been discussion about some large users that have not been in compliance with the Authority’s requirements, and have not been issued fines. **Utilize fines to ensure compliance with the Authority’s TRAC reporting and performance requirements. Report to the Board of Directors and the Advisory Board on the total number of violations in all categories over the last two years.**

•42•

Wilmington Emergency Use. On May 2, 2006, the MWRA Advisory Board Operations Committee approved a fourth emergency water connection to the Town of Wilmington. This request was later approved by Executive Committee on May 12th and the full Advisory Board on May 18th. Ultimate approval of the connection will require an affirmative vote of the MWRA Board of Directors. Considering this is Wilmington’s fourth request to MWRA for emergency water, Advisory Board and Board of Directors support for the connection is highly likely. The MWRA’s Emergency Water Supply Withdrawal policy (OP.05) calls for Wilmington to pay a 110% surcharge of MWRA’s prevailing water charge plus 110% of the annual payment associated with the asset value contribution payment amortized with interest over 15 years. Wilmington used 9.8 MG of water from October 7, 2005 to October 26, 2005. The surcharge was \$2,137 and the asset value contribution was assessed at \$10,481. Assuming similar consumption levels by Wilmington over their anticipated six-month approval period, MWRA should anticipate some level of revenue from Wilmington in the Final FY07 CEB. **Add \$15,000 to the Revenue – Other Revenue line item in anticipation of the fourth emergency water connection of the Town of Wilmington to the MWRA Waterworks System.**

•43•

Hydropower Revenue. The Authority has estimated hydropower revenue for FY07 at \$266,000.

Chemical Cost Reimbursement. The Authority continues to budget \$867,000 for Chemical Cost Reimbursement from the Commonwealth. The budget is based on the amount the MWRA is entitled to by statute, as a (now partial) reimbursement for the cost of chemicals used in wastewater treatment.

Comments on Line Items

Miscellaneous Other Income. The Authority is proposing to budget \$347,000 for income from several other sources, including: \$117,000 for *Lease Income*, \$30,000 for *Antenna Licenses*, and \$200,000 from *Other Income*.

Rutland-Holden Sewers. MWRA is budgeting \$100,000 under the Operations - Maintenance budget for the inspection and maintenance of the Rutland-Holden Sewers. The MOU between DCR and the MWRA delineates responsibility for the operations and maintenance of the sewer lines, including meter reading, gates and valves, manhole inspections and evaluations of the problem conditions. MWRA shall be reimbursed for incurred operations, maintenance and repair costs by Holden, West Boylston and Rutland through established payment mechanisms. FY07 marks the first year MWRA will budget for the operations and maintenance of the Rutland-Holden Sewer.

Another stipulation within the MOU requires MWRA and all of the serviced communities to "...mutually support efforts to transfer ownership and control of the Rutland-Holden Sewer and Relief Trunk Sewer to the user communities or such other sewer district or legal entity as may be deemed appropriate to assume such ownership and control." MWRA has met with some of the serviced communities to discuss the status of the Rutland-Holden Sewers; however, a long-term plan to transfer responsibility for the sewerage line has yet to be developed.

The Proposed FY07 CEB includes funding for the inspection and maintenance of the Rutland-Holden Sewers, but neglects to reflect the corresponding revenue as stipulated within the MOU that all operations and maintenance costs shall be reimbursed by the serviced communities. Additionally, MWRA should be actively working to transfer ownership and control of the Rutland-Holden Sewer to the line's user communities.

- 44• **Add \$100,000 to the Other User Charges – Non-Rate Revenue and Income line item, reflecting reimbursement of planned operations and maintenance expenses**
- 45• **on the Rutland-Holden Sewers. Provide an update to the Board of Directors at the June rate hearing on the status of the transfer of the Rutland-Holden Sewers to its user communities and provide a schedule for implementation of the transfer.** MWRA needs to work cooperatively with the Rutland-Holden Sewer communities to transfer this asset and ensure the long-term maintenance of the line.

Building 34 Sublease. MWRA moved all staff out of Building 34 at the Charlestown Navy Yard in FY03 as part of the space reconfiguration to the Chelsea Maintenance Facility. Building 34 lease costs were accrued in FY03 and FY04 and the lease is scheduled to expire at the end of August 2006. Over the last six-months, MWRA has been able to sublease a portion of the currently vacant Building 34. The sublet will cease at a point prior, or up to, the termination of the existing lease.

- 46• **Add \$15,000 to Revenue - Other User Charges line item to reflect the sublease of MWRA office space in Building 34 at the Charlestown Navy Yard.**

Energy Revenue. The Authority is proposing a budget of \$1,285,000 for energy-related revenue from participation in the Price Response Program and Renewable Portfolio Standard (RPS) credits; the amount budgeted for FY06 was \$500,000. Participation

rates are difficult to predict and are a function of weather, diesel fuel costs and changing structure of the programs. Through March, the Authority reports income of \$2,300,000 relating to these two programs.

Entrance Fees. The Authority is budgeting \$805,252 for *Entrance Fees* from Stoughton, Reading and the Dedham-Westwood Water District.

Investment Income

The Authority is assuming *Investment Income* of \$33,880,204 for FY07, a 13% increase or \$3,802,197. Income through March totaled \$34,627,830 or \$12,159,204 greater than the \$22,368,626 budgeted for the period, due largely to greater than budgeted income related to the Swap agreement. This agreement was terminated as part of the March bond issue and income budgeted for the FY07 budget of \$1,359,000 will need to be reversed.

Interest rates have been rising slowly over the past two years and are projected to increase in FY07. While some fund balances have been increasing, such as the Operating Fund and Debt Service Reserve Fund, other fund balances have been declining, particularly the Construction Fund. Even so, revisions to these assumptions arising from the March bond transaction and from lower utilization of the Rate Stabilization Fund, as a result of the Advisory Board's recommendations, allow for some modification to the proposed budget's assumptions. **Revisit assumptions for interest rates and fund balances relating to *Investment Income* and increase budgeted amounts by at least \$2,498,370.** (This recommendation is net of the \$1,359,000 budgeted for Swap receipts.)

•47•

Non-Recurring Revenue: Rate Stabilization Funds

The Authority is proposing the use of \$16,603,999 from the *Rate Stabilization Fund* in FY06. Incorporated into the Capital Finance line item is the use of \$19,060,141 from the *Bond Redemption Account*. Thus, the total amount to be withdrawn from the Rate Stabilization Funds in FY06 is \$35,664,140. The Authority is assuming all remaining monies in the Rate Stabilization Fund and the Bond Redemption Account, totaling \$84,073,000, will be drawn down in the next four years, with most of the funds (\$70,086,000) being drawn down during FY07 and FY08.

Advisory Board recommendations should be used to reduce the use of an equivalent amount of the *Rate Stabilization Fund*. **Reduce FY07 use of the *Rate Stabilization Fund* by \$12,062,462. Reserve these funds for future years to ease projected rate revenue increases.** This recommendation keeps the proposed rate increase at 9.8%, unless debt service assistance is funded for FY07.

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Rate Revenue

The Authority is proposing Rate Revenue receipts of \$518,497,238 for FY07, a 9.8% increase over the \$472,219,800 budgeted in FY06.

POLICY RECOMMENDATIONS

System Expansion

In fall 2005, the MWRA Board of Directors voted to supply water on a partial basis to the Town of Reading and the Dedham-Westwood Water District. Reading intends to utilize up to 219 million gallons, while the Dedham-Westwood Water District will be using up to 36.5 million gallons annually. The combined annual demand of Reading and the Dedham-Westwood Water District is approximate to the daily summer demand of the entire MWRA Waterworks System.

MWRA is budgeting \$805,252 in the Proposed FY07 CEB for Entrance Fee Revenue for the Towns of Stoughton (approved in June 2002), Reading and the Dedham-Westwood Water District. Reading has subsequently informed MWRA the town intends to pay their entire \$3.3 million entrance fee in one payment prior to end of FY06. The method MWRA chooses to allocate this unbudgeted revenue has yet to be determined. The MWRA water methodology ensures revenue raised for system expansion will be segregated for use exclusively to offset Waterworks expenses. MWRA's practice to offer communities the option of paying their entrance fee over twenty years, as is the case of Stoughton, has been evaluated by the MWRA Advisory Board System Expansion Committee, which will be recommending that all future entrance fee payments be made in one, up-front distribution.

The Board of Directors has, over the past six months, been actively discussing the topic of system expansion. The extensive work of MWRA staff to determine the impacts of system expansion on the existing member communities has further solidified the Advisory Board's stance that controlled growth of the MWRA Waterworks System is both financially and environmentally desirable. As the Executive Director of the MWRA outlined in a recent presentation, the growth of the MWRA Waterworks System could provide eligible non-MWRA communities with sufficient water to aid stressed watersheds and/or maintain economic development while providing MWRA with a new source of revenue and the capacity to spread system risk among a wider customer base. MWRA should affirmatively seek opportunities to extend the water system where appropriate.

- 49• **Continue to seek opportunities for responsible expansion of the water distribution system, which will provide economic benefit, while striving for no negative impact on the interests of the existing member communities.**

The ongoing interest in expanding the Waterworks System is based upon an important premise that both communities and consumers believe MWRA has high quality water worth pursuing. Through the foresight of the engineers who designed the Quabbin and Wachusett Reservoirs and the ongoing cooperation of multiple governmental and public interest groups, Metropolitan Boston and Chicopee Valley Aqueduct communities have one of the most pristine water sources in the nation. The quality of MWRA drinking water is one of the system's greatest assets.

Recognizing the value of the system's source water, the MWRA Board of Directors has asked, on a number of occasions, for MWRA staff to determine whether MWRA water could be marketed commercially. Responses to Board member inquiries have generally downplayed the potential to bottle MWRA water with a specific focus on the difficulty for MWRA staff to develop and manage the bottling, marketing and distribution of MWRA bottled water while maintaining the existing distribution system.

The Advisory Board believes there are significant benefits to bottling MWRA water. Stress placed upon the massive reservoir system would be nearly inconsequential. A clear message would be sent to all consumers that MWRA water is a quality product and the revenue generated from the bottling of MWRA water could be specifically dedicated to rehabilitating the water distribution system.

MWRA has already demonstrated the relative ease of bottling water with the production of the commemorative "Carroll Quencher" handed out at the dedication ceremony for the John Carroll Water Treatment Plant in August 2005. While the Advisory Board concurs with the legitimate concern of MWRA managing the bottling process on their own, there are a number of well positioned commercial entities that could package and market MWRA bottled water. **Develop a Request for Proposals (RFP) with the objective of identifying a commercial entity to package, market and distribute MWRA bottled water.** Bottling MWRA water is a serious proposal, which could provide meaningful benefits to MWRA and its ratepayers. The MWRA Advisory Board reiterates the point initially made by members of the MWRA Board of Directors and requests MWRA seek an economically viable proposal to bottle MWRA water.

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*Member of Executive Committee

**Chairman of Executive Committee

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Andrew Pappastergion – *Brookline*

Joseph Foti – *Chelsea*

