

**EXECUTIVE COMMITTEE MEETING
JANUARY 12, 2007**

Minutes Approved at the February 9, 2007 Meeting

Present: John Sullivan, BOSTON; Andrew DeSantis, CHELSEA; Jay Fink, LYNN; Ron Seaboyer, MELROSE; Katherine Haynes Dunphy, MILTON; Lou Taverna, NEWTON; Ted McIntire, READING; Walter Woods, WELLESLEY; Zig Peret, WILBRAHAM.

Also in attendance, Andrew Pappastergion and Joseph Foti, MWRA BOARD OF DIRECTORS; Ralph Wallace and Patricia Filippone, MWRA STAFF; Joseph Favaloro, Cornelia Potter, Matthew Romero, Christine Hevelone-Byler and Mary Ann McClellan, MWRA ADVISORY BOARD STAFF.

I. Approval of the October 13, 2006 and November 9, 2006 Minutes of the Executive Committee

Chairman Katherine Haynes Dunphy called the meeting to order at 8:32 a.m. A Motion was made **TO APPROVE THE OCTOBER 13, 2006 AND NOVEMBER 9, 2006 MINUTES OF THE EXECUTIVE COMMITTEE**. It was seconded and passed by unanimous vote.

II. Legislative Update: Status of Legislative Filings

MWRA Advisory Board Executive Director Joseph Favaloro said the Advisory Board's legislative initiatives were filed this past week; however, two items were not submitted. Staff decided to late-file the bill related to 100% reimbursement of the Clinton Wastewater Treatment Plant costs in order to speak with Representative Naughton from Clinton to explain that the MWRA is not asking for the money to come from Clinton, but rather the Commonwealth, before the initiative moves forward.

The second initiative that was not filed relates to Payments in Lieu of Taxes (PILOT) for non-watershed lands. MWRA General Counsel Steven Remsberg believes these payments can be eliminated legally through an administrative process.

The remaining initiatives were filed by Caucus Chairman, Representative Ron Mariano, or Senator Bob Havern.

Mr. Favaloro introduced the Advisory Board's two new staff members, Matthew Romero (Senior Finance and Policy Analyst) and Christine Hevelone-Byler (Government and Media Coordinator).

III. Restoration of Debt Service Assistance (DSA): Outlook for FY08

Mr. Favaloro stated on Tuesday Governor Deval Patrick officially restored the 9C cuts made by his predecessor. The MWRA will not have to make mid-year rate increases for FY07. Discussions on DSA for FY08 and beyond have already begun. Messrs. Laskey and Favaloro met with House Ways & Means Chairman Bob DeLeo and Administration

and Finance Secretary Leslie Kirwan to talk about the restructuring plan, which includes a component for continued DSA. It will be difficult to significantly increase DSA in FY08, but staff is cautiously optimistic that \$25 million will be included in FY08.

Twice in the last six months the Boston Globe has been critical of the MWRA in its editorial section. After the 9C cuts were made, the Globe printed an op-ed piece agreeing that the Governor should eliminate the “MWRA subsidy”. Messrs. Laskey and Favaloro went before the Globe’s editorial board to present the MWRA and the Advisory Board’s perspective. A map of Massachusetts listing every community that ever received DSA from the Commonwealth was provided to the editorial board. Further, there was a long, engaged debate over the Title 5 tax credit.

Additionally, information was provided on system expansion in the hope that an editorial might be written on the merits of selling more water to communities.

IV. MWRA Restructuring Deal

MWRA Director of Finance Patricia Filippone stated the Authority plans to issue a bond deal that will restructure debt in conjunction with a new borrowing. The plan received the approval of the MWRA Board of Directors on January 10.

Treasurer Ralph Wallace gave a presentation on the Authority’s planned 2007 Series A & B Bond Issue. This restructuring came out of direction and guidance of the Advisory Board. The MWRA Board of Directors created a Rates Management Committee to develop a strategy to manage rate increases on a long-term basis. The bond issue is the next step in that rates management effort.

The Authority’s completion risk has largely decreased over the last 10 to 15 years, having successfully built the Inner Island Tunnel, the Outfall Tunnel, the MetroWest Tunnel, the CWTP, DIWTP, and most of Braintree-Weymouth, thus a significant amount of the Authority’s capital program has already been implemented. This fact has been conveyed to the three rating agencies and, in fact, Fitch has already affirmed the Authority’s rating on this issue as AA for senior debt and AA- for subordinated debt.

The MWRA Board of Directors approved transmittal of the proposed \$200 million FY08 Capital Improvement Program (CIP) in December. From 1992 to 1997, the duration of the Boston Harbor Project, the Authority spent \$3 billion or roughly \$500 million annually; that massive amount of investment is the challenge the Authority is facing today.

Staff has stressed to the rating agencies, and will stress to the bond buying community, that the MWRA Board of Directors has been presented with a Master Plan, which is designed to guide Authority capital spending over the next twenty to thirty years. At one time the Authority’s capital program was driven by court orders and regulatory compliance. Now the Authority is assuming more control over how it invests its money based on its own judgment and priorities. The Master Plan is the vehicle by which the MWRA will frame its capital program in the long term.

Key themes that have come out of the Master Plan are an increasing focus on the repair, replacement and maintenance of existing infrastructure and shifting to place greater emphasis on enhancing the redundancy of the water system, both in terms of eliminating single points of failure in the transmission and distribution system and ensuring that there

is adequate covered storage capacity centrally located within the seven service areas to meet the one day emergency storage standard of the MWRA's planning and guidance documents.

The proposed FY08 CIP is the first CIP to reflect the guidance of the Master Plan; high priority projects that were identified in the Master Plan with spending over the next five to six years have been added to the CIP causing a significant increase in the projected level of spending going from \$674 million to nearly \$900 million, an increase of over \$200 million. This confirmed the notion that the Authority should target a sustainable Capital Program of about \$200 million per year.

The mountain of debt that was created to fund the Boston Harbor Project and the Integrated Water Supply Improvement Program, as well as other capital initiatives, will continue to grow until it peaks in 2021 and 2022, after which the existing debt structure tapers off. The Authority has an opportunity to fill in some open space with debt for the money it is going to be borrowing in the future to sustain its capital program. Getting over that mountain is the challenge it is facing.

The Authority has about \$5.6 billion in outstanding debt, most of it is fixed but there is some variable rate debt, including a Commercial Paper Program, which is used for construction period financing; when the completed project is moved into the fixed asset base, the commercial paper is refunded with fixed or variable rate long term debt.

The Authority is seizing an opportunity in current market conditions. Long-term interest rates are at historically low levels and the yield curve is flat, meaning the difference between long and short term interest rates is narrow. The down side is that long-term rates have moved up slightly since staff first began briefing the Board in December, losing about 20 basis points, or two-tenths of a percent, on the long-term interest rates. Two-tenths of a percent doesn't seem like much, but on a borrowing of \$800+ million, it translates into \$1.6 million in interest costs annually. Staff assumed a higher interest rate in its scenarios and will move quickly to ensure the best interest rate possible.

The MWRA plans to initiate some amendments to its bond resolution, as recommended by the Advisory Board, to modernize it and make it more consistent with the current structure of bond resolutions; most importantly, these amendments will free up a lot of reserves to further manage rates. This restructuring will provide significant rate relief over the next eight to ten years; at that point, the bond resolution changes will become affective, freeing up some reserves that can be used to manage rates until the Authority gets over the hump in 2021 and 2022.

This bond issue will be the first under the new resolution. When two-thirds of the MWRA's debt, including monies borrowed from the SRF, is under the new resolution, then the resolution becomes effective and the reserves can be freed up; it will take eight to ten years. Reserves released would be used to pay down debt. Bondholders and rating agencies love to have reserves, but the fact that the Authority will use those reserves prudently to address debt demonstrates that the Authority is fiscally responsible and staff believes the amendments to the resolution will be well received by the bond community.

The Debt Service Reserve will be reduced by 50%; the Community Obligation Revenue Enhancement fund will be eliminated; and staff will substitute the Commercial Paper

Program for a portion of the Renewal and Replacement Reserve. The Authority has a large Commercial Paper Program, which can be used to raise money quickly in an emergency.

The Authority does not plan to change any of its Insurance coverage requirements. In a presentation made last year, changes to the Insurance coverage were an issue with the rating agencies so staff scaled down its amendment and focused on the things that would give the most “bang for the buck”.

Currently the Authority has about \$360 million in reserves. After the amendment, approximately \$175 million will be freed up to pay down debt.

The Authority will refund about \$600 million of bonds for the purpose of achieving rate relief between FY07 and FY19 and will issue \$200 million in new money to fund ongoing capital programs; doing them together is beneficial because the new money, which is out a little longer, increases the arbitrage yield, which means the escrows created to pay off the old debt will earn higher interest rates and, therefore, the Authority has to borrow slightly less money to achieve its objectives. Further, this is a good time to borrow money for the long term so staff is maximizing the amount of new money borrowed, hoping to avoid another bond issue for at least 18 months.

Staff will issue the restructuring bonds as non-callable debt since this debt is being placed in its final resting place. New monies will be issued as callable debt, which means after ten years, MWRA has the right to call it. There is a premium for that call option. Staff will begin amortizing this debt in 2018.

At one time, staff considered refunding additional debt for savings; this debt was in the 2020 to 2030 timeframe. Staff elected not to refund for savings because it would not have much impact on near term rate relief and still leaves this option open. Staff identified \$600 to \$700 million to refund because interest rates are low and it will generate present value savings, not so much for near term rate relief.

Although this restructuring will increase rate relief in the earlier years, there is still a sharp increase in rates in the 2010 to 2013 timeframe. The Authority does not have any debt in that little window that can be refunded right now because it has already been advanced refunded. Staff plans to try to generate extra revenues in the next couple of fiscal years to create escrows to defease this debt. Approximately \$400 million in rate relief will be provided between 2007 and 2017, generating \$3.4 million in present value savings.

Assuming 4% escalation in direct expenses, and a level \$200 million CIP, model runs assume the Authority will use rate stabilization and bond redemption funds to smooth rates; there is also an assumption that there will be a sustained allocation of \$18.75 million in Debt Service Assistance, which will result in 5.7 to 6.2% rate increases for the next several years as compared to 9%.

In FY2012, staff will have to take monies freed up in previous fiscal years and apply them to that problem by escrowing debt. The next challenge will be in FY2017, when debt runs up to the next peak. The freed up reserves of \$175 million can solve that problem. Percentages are being applied to an ever-increasing base.

Based on guidance received from the Board in December, staff issued a preliminary official statement on January 11, which is now in the hands of the bond buying public. Staff will hold a teleconference with institutional buyers on Tuesday afternoon with a goal to price this issue next Wednesday, January 17.

Zig Peret said most of the borrowing and spending was in the mid 1990s, why does debt service go up and not level off? Mr. Wallace said in order to manage its rates, the Authority has not amortized principal as quickly as you might think it should have. The assets the Authority financed have a long useful life. An example is the effluent outfall tunnel, which has received more SRF money than any other project in the history of the Commonwealth. All the SRF money is primarily 20-year debt, the outfall has a useful life of 100 years. Staff is now trying to match debt to the useful life of the assets.

Mr. Peret said staff has 20 basis points in its contingency, and the rating agency says you are AA, so when the debt service increases in five to six years, does that infer that the rating agencies will lower the MWRA's rating because the debt service is higher than it is today. Mr. Wallace said no. The rating agencies understand the dynamics of the Authority. As long as the Authority demonstrates, through prudent management of debt, control of its budget, a demonstrated willingness to raise rates as needed to pay off debt and supports the maintenance and management of its assets, then the MWRA can sustain its credit rating.

Mr. Woods asked when this bond will hit the market. Ms. Filippone said the preliminary official statement hit the market last night at about 9:47 and will be priced on January 17. Ms. Filippone believes it will be sold in about 15 minutes.

Mr. Favaloro noted this was not an easy project and complemented MWRA staff for their efforts. Further, Mr. Favaloro acknowledged Board members John Carroll, Vincent Mannering and Lucile Hicks and Advisory Board Chair Katherine Haynes Dunphy whose efforts in serving on the Rates Management Committee were instrumental in keeping the discussion focused to maximize the benefits of this restructuring tool. Mr. Favaloro further recognized the labors of Paul Haley of Lehman Brothers who was instrumental in running the models to allow the Advisory Board to push for this plan.

Chairman Dunphy expressed thanks to Joe Favaloro and Cornelia Potter for their efforts as well.

V. FY08 CIP Review Process/Schedule

Cornelia Potter stated the Advisory Board's Capital Improvement Program (CIP) 60-day review period will formally run into April, with the vote scheduled for the April 19 meeting. Authority staff is working on the document, which should be received by the designees by the end of the month, triggering the start of the formal review period. In the meantime, Advisory Board staff has begun gathering background materials, which are slow in coming.

This year's review process will be complicated in that it will include the Master Plan, 67 new projects or project phases, the regular budget review and the proposed cap for the next five-year period, which runs from FY09-13.

Budget Director Rachel Madden will make a presentation at the January 18 Advisory Board meeting on the highlights of the proposed capital program and budget.

The Advisory Board's vote on the Current Expense Budget will be held at the May 17 meeting. The Authority still intends to come to the Board at the February 7 Board of Directors meeting with the proposed rate increase, which will be developed in the next few weeks to meet the needs of the communities.

Walter Woods asked if the Advisory Board feels that the \$200 million per year the Authority plans to spend is a valid number or does staff think it will be reduced. Mr. Favaloro noted that most of the Authority's spending has been to meet federal mandates; in fact, in the next proposed five-year cap, mandated CSO projects are a dominant component of the capital program; yet, there is still a large infrastructure that needs to be addressed. The Master Planning process has indicated there is \$2+ billion of additional capital needs. Advisory Board staff will scour the Capital Budget and the Master Plan but it is unlikely that the number will be lower than \$200+ million; in fact, Advisory Board staff may say it is too low in some instances, when looking at the other pieces of the system that haven't been addressed, that have had to wait for the Deer Island projects, the safe drinking water projects and now have to wait for CSOs.

Ms. Potter said one of our focuses will be what the priorities are for the projects that have been identified in the Master Plan. How has the MWRA combined those priorities between water and wastewater? Of the new projects identified in the Master Plan, only the first two top priority projects made it into the capital program. Priorities three, four and five, while described in the Master Plan, are not included at all in the capital budget. The definition of priority one and two is critical or at risk of service interruption; the Authority has said it is moving into more of a maintenance mode. Will the Authority have to let the maintenance go until something is critical or at threat of service interruption? There is a built in contradiction.

VI. System Expansion Update

Mr. Favaloro stated in the past month MWRA and Advisory Board staff have met with the Towns of Hopkinton, Ashland and Milford and the Hingham Fire Station to provide information on joining the MWRA system. Further, staff had a discussion with Hingham on the potential for further hookup into MWRA sewer system. The Town of Reading is currently pursuing full-time water use with the MWRA and the Town of Wilmington has hired a contractor to build its connection for partial water use with the MWRA. In its formal regulatory filings with the Commonwealth, the South Weymouth Naval Air Station (now called Southfield) has stated that the MWRA is its preferred option for water.

In many ways, the exercise the Advisory Board pushed for was to get system expansion on the table to sell up to 36 MGD. Staff has been in communication with Senator Rosenberg and has had Eileen Simonson outline the Water Supply Citizens Advisory Committee's (WSCAC) concerns and questions. The Advisory Board now has a listing of five areas that WSCAC wishes to address.

Chairman Dunphy asked about WSCAC's positions. Mr. Favaloro said WSCAC's concerns principally center on withdrawals. It is an answer that is determined by who asks or answers the question. If you are interested in fish hatcheries, your position is different from someone else's. This issue will be difficult to get our hands around but staff can try to find some solutions.

Currently, there are minimum releases into many of the rivers in that area, with withdrawals at 10 MGD; the MWRA is doing 100 MGD. In mid January, the Quabbin is spilling millions of gallons of water. It is like a cash register ringing with lost opportunity. When all is said and done, staff believes there will be expansion of the system, but probably not near 36 MGD.

Staff has convinced Senator Rosenberg that the MWRA does not oppose smart growth, but it is not smart for the MWRA to do it. There is ample water to provide for growth in central and western Massachusetts.

Mr. Favaloro noted that Senator Brewer filed a bill last Wednesday that says the MWRA will not divert the Connecticut River. It is a moot point because the MWRA has no reason or plans to divert the river.

VII. Approval of the Advisory Board Agenda for January 18, 2007

A Motion was made **TO APPROVE THE ADVISORY BOARD AGENDA FOR THE JANUARY 18, 2007 MEETING.** It was seconded and passed by unanimous vote.

VIII. Sick Leave Buy-Back Comparisons

Advisory Board personnel policies were adopted by the Executive Committee more than eight years ago. The sick time buy back policy allows an employee, upon retirement or resignation in good standing, to receive 30% of unused sick time after 35 days have been accumulated. This package was recently provided for a long-term employee. Based on this policy, the Advisory Board maintains a deferred liability account, which is audited every year.

With recent news stories regarding Massport's sick time buy back policy, staff provided a chart to the Executive Committee comparing the Advisory Board's policies to the MWRA, the Massachusetts Turnpike Authority, the Commonwealth, Massport and the Boston Water and Sewer Commission.

Andrew DeSantis asked if the liability account has enough to cover the costs if two long-term employees were to leave at the same time. Mr. Favaloro replied in the affirmative.

IX. Executive Director Annual Review

Chairman Dunphy provided a copy of the Executive Director's current contract to each member. The Contract is a rolling three-year contract. Upon satisfactory review, the Executive Committee can add another year to the contract, which gives the employee and the organization some stability.

Mr. Favaloro provided the Executive Committee with a list of accomplishments made by the Advisory Board in the past year, as well as goals for the coming year.

Mr. Favaloro stated the Advisory Board has evolved over the years to focus on the bigger picture. The bigger picture includes pushing to bring closure to the ever increasing CSO Control Program through a series of five three-year variances, to which the regulators agreed. The Advisory Board pushed for a Master Planning document to guide the Authority in the development of its CIP. Further, the idea for restructuring to get to sustainable and predictable rates began at the Advisory Board, as did the idea for system expansion, as part of our "blueprint" for success at least six CEB processes ago. The

Advisory Board will now push for wind energy, be it at Deer Island or the John Carroll Water Treatment Plant or other locations.

The Advisory Board pushed for the creation of the Water Supply Protection Trust (Trust) to make the Department of Conservation and Recreation more accountable to the MWRA ratepayers. There is more paperwork passing hands from staff to staff, but there is still a long way to go. Staff was successful in its efforts to eliminate the Indirect charge assessed by the State Administration and Finance Division resulting in a savings of \$1.5 million; further a reduction in shared costs of nearly 40% was achieved. The Advisory Board convinced the State Auditor to audit the Trust.

Most recently staff went before the Rutland Board of Selectmen in regard to the Rutland-Holden sewer line, which is in dire need of capital improvement. The communities agreed to work with the Authority and the Advisory Board to develop a long-term solution in regard to ownership of this line.

Chairman Dunphy stated the Executive Director's evaluation will be placed on the agenda for next month.

X. Adjournment

A Motion was made **TO ADJOURN THE MEETING AT 10:30 A.M.** It was seconded and passed by unanimous vote.

Respectfully submitted,

Edward Sullivan, Secretary