**EXECUTIVE COMMITTEE MEETING**
**FRIDAY, FEBRUARY 15, 2008**
**ADVISORY BOARD OFFICE**
**8:30 A.M.**

**MINUTES APPROVED AT THE APRIL 11, 2008 MEETING.**

Present: John Sullivan, BOSTON; Ed Sullivan, CANTON; Bill Hadley, LEXINGTON; Jay Fink, LYNN; Ron Seaboyer, MELROSE; Katherine Haynes Dunphy, MILTON; Lou Taverna, NEWTON; Bernie Cooper, NORWOOD; Ted McIntire, READING; Walter Woods, WELLESLEY; Zig Peret, WILBRAHAM.

Also in attendance, John Carroll, Andrew Pappastergion and Joseph Foti, MWRA BOARD OF DIRECTORS; Peter Tassi, READING; Joseph Favaloro, Cornelia Potter, Matthew Romero, Christine Hevelone-Byler and Mary Ann McClellan, MWRA ADVISORY BOARD STAFF.

**I. Approval of the January 11, 2008 Minutes of the Executive Committee**

Chairman Katherine Haynes Dunphy called the meeting to order at 8:38 a.m. A Motion was made **TO APPROVE THE JANUARY 11, 2008 MINUTES OF THE EXECUTIVE COMMITTEE**. It was seconded and passed by unanimous vote.

**II. Presentation: Sewer Assessments Utilizing Three-Year Averaging[1]** – Walter Woods, Wellesley Designee

Advisory Board Designee Walter Woods stated that a 1993 Committee of the Advisory Board met to establish a sewer rate based on flow for one calendar year; in Fiscal Year 2001, the method was changed to a three-year averaging. The sewer rate is based on Operations and Maintenance (O&M) and capital. O&M costs are calculated based on flow, while capital costs are calculated by a combination of peak flow and sewered census population.

Mr. Woods provided members with a breakdown of the volumes of biochemical oxygen demand and total solids, based on numbers from the Authority's budget. The volume is a large percentage of the bill for O&M and is based on three-year averaging of the solids that Deer Island measures and the amount of oxygen that is consumed.

On population, Mr. Woods suggested looking at the population that each town is using because the Authority bases its population on the ten-year U.S. Census average. In between, it is all estimated.

The population factor of 75% amounts to about $140 million so towns that have a large population are paying a lot of that bill. If the population numbers are incorrect, you are paying more. The concept should be that you pay what you do and nothing more. Other than that, the numbers seem reasonable.

[1] Mr. Woods's presentation was accompanied by a full report that he provided for members, along with a PowerPoint presentation, that will be part of the official record of the meeting.

Mr. Woods provided members with Charts 1 and 2, which were the basis of his analysis, and detailed the difference between the three calendar year rate less the one calendar year rate. The charts also kept a running tally of these differences annually on whether a community was ahead or behind. For example, if a town pays $300,000 more the first year because they are on a three-year rate and the second year they pay $300,000, the running total is $600,000 more than they should have.

Andy Pappastergion asked if Mr. Woods is advocating for a one-year rate. Mr. Woods said his intention is to show members how the rate that has been adopted is performing.

Mr. Woods noted that 25% of the communities have not averaged out their running total; how much longer do they have to wait to average out? In FY04, Boston reached a maximum $5 million benefit. This is a case of winners and losers; the total sum is zero, other towns have to pay that bill.

Mr. Woods said Ashland benefited by more than $300,000 or 19%. Ashland's running total continuously goes down, which means that their flow rate has been increasing. That is the fallacy of this type of situation. It doesn't benefit those that are reducing their flows. In other words, Ashland's flows have been increasing and they have been paying less based on three calendar year versus one. Ashland has built up a new sewer system. In the early 1990s their flows were very low; now their flows have been increasing.

Mr. Woods said one thing unique about Boston is when he calculated a similar situation from 1991 figures, Boston showed just the reverse. They had been overpaying about $6 million because they have made a remarkable reduction of flow; now it has gone the other way.

Dedham has overpaid, in FY08, to the tune of $800,000. That is a small town and that represents 18% of their bill.

Needham has overpaid $600,000 or about 13%. In the total eight years, Needham has not averaged out. To average out, it has to come down to zero. The question is how much longer should Needham have to wait before they get their investment of $600,000 back, another five years, two years? Flows are unpredictable; that is the difficulty of a flow rate.

Natick has significantly overpaid. Natick's flow rates are fairly consistent from 3.4 in 1999 to 3.32 in 2005 and 2.94 in 2006. It went down, which means their rate skyrocketed based on the three-year average. They did benefit by a reduction in the existing rate. Something could be wrong with the reading. On a one calendar year basis Natick would benefit by the reduction of flow.

Mr. Woods said in my view, we have never looked at this rate to decide if it has accomplished what it was designed for. When the legislators directed the Authority and the Advisory Board to come up with a rate based on flow, they asked us to make sure that is was fair, equitable and maximizes the reduction of flow. The question is: is it doing the job?

Mr. Fink asked if Mr. Wood's purpose was to look at the averaging of the flows or the overall calculation of how the flows are calculated. He noted that Mr. Woods talked about communities increasing their flows and yet they are increasing on the benefit line. Mr. Fink said when you talk about getting a return on your investment, you have to talk about capital costs. Three-quarters of the capital cost charge is based on population; when Mr. Fink hears of something based on population, he thinks of a tax. It would be great if communities, or the residents paying that portion of the bill, could get tax relief based on that and be able to deduct it from their income tax, however, he didn't think it would happen.

Mr. Fink noted if it is based on population, there are communities that have high industrial components to their wastewater flow. They may show up in the operations charge under BOD and suspended solids but cities and towns look at the difference between residential and commercial and what is the commercial benefit. As long as population remains a 75% component of the total capital cost, you can argue all you want with changing three-year averaging, which Mr. Fink believes was used to minimize spikes and assist communities in budgeting. Just looking at the flow situation won't change a lot.

Mr. Woods said the concept of including population isn't bad; originally it was designed to make the cities and towns pay more if their population increases. A lot of the rates are based on the investment that the Authority has to make to provide the ample pipe size. Including population moderates the effect of the flows on the O&M side.

Mr. Cooper asked if Mr. Woods is focusing on the three-year averaging or the formula. Mr. Woods said he is not concerned about the formula; it is as good as any other formula that was agreeable to the Sewer Rate Methodology Committee at that time. It is reasonable. However, is the change we made adding the three-year averaging doing the job that we expected?

Bernie Cooper said the job we were trying to accomplish was smoothing the rate to prevent ups and downs. Mr. Woods said it might smoothen them too much; it means that there are winners and losers. Mr. Cooper said a lot of that had to do with the way the formula was put together, not the averaging. Mr. Woods said the averaging wasn't part of the discussion when we were determining the formula, the averaging came much later. Mr. Cooper said at the time, the rates were based strictly on population. Then we went to a rate that had a substantial flow-based component and became the largest component on the O&M side. If the formula itself is as fair possible, it is unclear what will be accomplished.

Mr. Woods said the purpose of this is to create an interest that you might want to resurrect a group to study the pros and cons and might have some ideas on whether a two-year averaging might work better; the Authority should be involved.

Zig Peret said some of this was based on population from a ten-year census. Mr. Woods said the ten-year U.S. Census is adopted by the Authority as the proper census but in between the ten years, the numbers don't look correct. For Wellesley, the numbers are much higher and when the ten-year average comes they have to make a big adjustment.

Mr. Favaloro added there are two parts to the population. In the methodology, there is the census population (the overall population) and the sewered population. It is fair to say that there is less change on the sewered population from year to year and the census population does have some variations to it. Those are the two components on the capital side.

Chairman Dunphy summarized that Mr. Wood's proposal is not to go back to look at the methodology, which took two years and countless meetings, but rather to look at the issue of three-year averaging versus single years to determine whether it is fair, equitable and whether it has done the job that was expected.

Mr. Woods said he would go on the concept that everyone should pay whatever they owe and that he is in favor of going back to one calendar year.

Mr. Cooper recapped that it is Mr. Woods contention that because rates are climbing if you have an increasing consumption number you're paying for part of that three years later at a

much higher rate. If rates were the same over a ten-year period, then it wouldn't make any difference, your flow would come back and you would recover in three years. Because rates are going up, the averaging is either accelerating or delaying. Mr. Woods said both are going up; even the one calendar year is using the same total figures. Mr. Cooper said flows have not been rising. Mr. Woods said the difference is the secret. A group studying it might have some ideas. Someone suggested a six-year or a two-year average. There are some thoughts of moderating a little bit less and trying to get the seven-year cycle back to a four-year cycle or something reasonable. I don't think it can be accomplished.

Mr. Cooper noted that the dollars are continually climbing for the same unit volume so that partly distorts the recovery either way.

Jay Fink asked when three-year averaging took affect. Mr. Favaloro said the methodology was in place for two years before the three-year averaging began in 2001. Because of a fairness factor, we pushed it out in order that they could not know what their flows were going to be. Mr. Fink asked when the meters were replaced. Mr. Favaloro said three years ago.

Mr. Cooper said there may be an impact but I don't think rate averaging in and of itself is the problem. Averaging was something we all decided made some sense given some of the gyrations and I am going to be very reluctant to support any change in it.

Chairman Dunphy said the Operations Committee should look at other things that might be going on other than the three-year averaging as well. Is it related to the issue of the census? We should take a look at the effect of meters because when the new meters went in, numbers changed for communities; there were, at that time, what you might call winners and losers. Chairman Dunphy stated unless we are totally knowledgeable, I am uncomfortable talking about having communities pay other communities because certainly those who are asked to pay are not going to just go along with it. Places like Ashland may be increasing in population or may have new industries that are increasing their flows.

Mr. Cooper made a **MOTION TO REFER THE THREE-YEAR AVERAGING VERSUS ONE-YEAR ISSUE TO THE OPERATIONS COMMITTEE FOR DISCUSSION.** It was seconded and passed, with John Sullivan opposed. Mr. Sullivan stated that he thinks it is a waste of resources and time.

Mr. Favaloro suggested that the Operations Committee take up its deliberations after budget season. This study would be a better activity for the fall.

Chairman Dunphy said the Operations Committee can take a look at other components that may be causing the changes. Jay Fink said when it comes down to it we are going to take the rate apart and take the running total on what is based on just flow and what is based just on population and pick it apart to see what is making the winners and losers. It is a zero sum game any way you play it. There may be a few other things driving these conclusions.

## III. CIP/CEB Update

Cornelia Potter stated for the CIP review, staff has been conducting a series of briefings with Authority staff during the months of January and February. The Authority mailed the document last Friday and it is posted on their website as well.

Advisory Board staff is beginning to develop its *Comments and Recommendations* and will continue to work on that draft in the coming weeks. Because the document didn't get to members soon enough for a March vote, the first draft will be sent out on Friday, April 4, in

anticipation of the Executive Committee's meeting the following Friday; later the same day, a second draft will be mailed to all the members of the Advisory Board in preparation for the April 17 Advisory Board meeting when the vote will take place.

For capital spending in FY08 the Authority budgeted $228 million of which nearly two-thirds is for wastewater spending at $144 million and one-third is for water projects at $77 million.

Spending through January reached $94 million, which is still more than 20% under budget. During the Advisory Board's last review, staff commented on the Authority's ability to spend and whether it should be requesting monies in its budget that they cannot spend. The CIP Committee, formed at the Advisory Board's urging, has issued a draft that is being reviewed internal to the organization. Staff hopes to get a read from the Authority on its expectations for its ability to spend going forward. It is important because during this budget cycle the Authority is establishing a capital spending cap and staff should think about whether the Authority can spend the monies it is requesting, although it is important to remember that the cap isn't a goal, it is a ceiling.

In preparation for the FY09 budget, the Authority will revise its expectations on what it will spend during the current fiscal year; it is always a little less. Staff is now projecting that their FY08 spending will be $203 million; to reach that the Authority will have to spend $109 million in just the next five months, well over what they have spent during the first seven months. That would still put them at 11% under budget for the year.

For Current Expense Budget spending, this year's budget was set at $565 million; it is actually slightly higher than that because of the way they treat as an offset any bond redemption spending and any receipts from DSA. Spending through January reached $314 million, which is 2% under budget for all expenses – direct, indirect and capital. Revenue has been over budget and reached $307 million, largely because of higher investment income and some unexpected and unbudgeted income. The year-to-date surplus is $17 million, of which $7.8 million is from receipts for Reading's entrance fee, which were not budgeted in the FY08 budget because of the uncertainty of the timing of receipts; therefore, the actual surplus this year is under $10 million so far, which is under 2%. The Authority now projects their surplus by the end of June to be $18 million.

The Authority is proposing to reduce debt service over the next four years with a defeasance transaction. The Board has authorized a transaction up to $20 to $25 million but using as an example a particular maturity that would affect principal of $17.9 million, together with the interest earned associated with the transaction, the savings would be nearly $20 million over the next four years. For FY09, the budget assumes $5.25 million in reduced debt service as a result of this transaction so they have already factored it into the proposed FY09 budget.

The sub-prime crisis is affecting people across the country. The bad news is that the bond insurers have been down-graded by all three ratings agencies, which translates into higher interest payments for the Authority on insured variable rate debt. The markets have reduced investment interest so the Authority has to pay more to induce people to keep investing in the variable rate debt even as the Fed has reduced its interest rate. The Authority should be paying half of what it currently is paying because of this crisis.

The good news is the Authority has a strong basic credit rating despite the insurers who have dragged the Authority's position in the market down; further, the Authority has over $200 million available for immediate borrowing through its Commercial Paper Program.

In particular, the Authority is reaffirming its strong credit rating on its subordinate debt and getting, for each of the three rating agencies, this reaffirmation applied to each of the variable rate issuances. The Authority previously got those ratings on all of its subordinate debt as a group; presently, the Authority is getting a reaffirmation of their good rating on each maturity so as the Authority moves forward to reissue or refinance its debt, they have already got that rating on each issuance. The Authority will use the Commercial Paper Program to take out some of the most risky areas of debt and then they have proposed to refinance up to $575 million of its subordinate debt in the coming months. The advisors say it should take 30 to 90 days maximum to go through this process.

**IV. Legislative Update**

MWRA Advisory Board Executive Director Joseph Favaloro stated this will be a difficult year in many aspects for the state budget, from local aid to early education to Debt Service Assistance (DSA). Staff is working with House Ways and Means Chairman Robert DeLeo and Caucus members and has received a commitment from Representative DeLeo that if more money becomes available he will add it to the DSA line item.

During this budget cycle, the Advisory Board's strategy has been to hold the $15 million in the Governor's budget and to work with the Senate to try to match the number in the House Budget for DSA.

**V. Annual Evaluation of the Executive Director**

Chairman Dunphy noted the accomplishments of the Advisory Board over the past year. The evaluation for the Executive Director is a two part process; first the Committee does a performance review and if it determines that Joe's performance has been satisfactory or greater, his contract can be extended for one year and the second step is compensation.

Jay Fink made a **MOTION THAT THE COMMITTEE RATE EXECUTIVE DIRECTOR JOSEPH FAVALORO'S PERFORMANCE AS GREATER THAN SATISFACTORY.** It was seconded and passed by unanimous vote.

Following a favorable performance review on February 15, 2008, the Executive Committee **VOTED TO EXTEND THE TERM OF THE EMPLOYMENT AGREEMENT FOR THE EXECUTIVE DIRECTOR UNTIL JUNE 30, 2010** and proceeded to consider compensation for Fiscal Year 2008. **THE EXECUTIVE COMMITTEE VOTED TO PROVIDE AN INCREASE IN COMPENSATION RETROACTIVELY TO JULY 1, 2007 IN THE AMOUNT OF $110,100.** It was seconded and passed by unanimous vote.

**VI. Approval of the Advisory Board Agenda for February 21, 2008**

A Motion was made **TO APPROVE THE ADVISORY BOARD AGENDA FOR THE FEBRUARY 21, 2008 MEETING.** It was seconded and passed by unanimous vote.

**VII. Adjournment**

A Motion was made **TO ADJOURN THE MEETING AT 9:55 A.M.** It was seconded and passed by unanimous vote.

Respectfully submitted,

Edward Sullivan, Secretary