EXECUTIVE COMMITTEE MEETING
FRIDAY, FEBRUARY 11, 2011
ADVISORY BOARD OFFICE
8:30 A.M.
MINUTES APPROVED AT THE APRIL 15, 2011 MEETING

Present: John Sullivan, BOSTON; John Sanchez, BURLINGTON; Bill Hadley, LEXINGTON; Jay Fink, LYNN; Katherine Dunphy, MILTON; Lou Taverna, NEWTON; Bernie Cooper, NORWOOD; John DeAmicis, STONEHAM.

Also in attendance, John Carroll, MWRA BOARD OF DIRECTORS; Joseph Favaloro, Matthew Romero, Maggie Atanasov and Mary Ann McClellan, MWRA ADVISORY BOARD STAFF; Cornelia Potter, MWRA ADVISORY BOARD CONSULTANT.

I. Welcome

Chairman Katherine Haynes Dunphy called the meeting to order at 8:36 a.m. MWRA Advisory Board Executive Director Joseph Favaloro requested that the May 13, 2011 Executive Committee Meeting be changed to May 12, 2011 so Mr. Favaloro can attend his daughter's graduation from college on May 13. The members agreed.

II. Action Item: To Approve a Sewer Connection From a Residence at 24 Dean Road, Weston, through a local connection in the Town of Wellesley Under System Expansion Policy OP.#4, Sewer Connections Serving Property Partially Location in a Non-MWRA Community (the Straddle Policy)

Mr. Favaloro noted that Harvey Boshart, the owner of the property at 24 Dean Road in Weston, came before the Executive Committee and the full Advisory Board, and will go before the Operations Committee as well, with a request to enter the MWRA sewer system between Weston and Wellesley via the Straddle Policy.

The applicant will pay $18,000+ to the MWRA for an entrance fee and additional funds will go toward the removal of more than 3,800 gallons of inflow from the Wellesley system through manhole covers.

A Motion was made **TO APPROVE THE CONNECTION FROM A RESIDENCE AT 24 DEAN ROAD, WESTON, LOCATED PARTIALLY IN THE TOWNS OF WESTON AND WELLESLEY, TO TIE INTO THE MWRA WASTEWATER SYSTEM VIA A CONNECTION TO THE WELLESLEY SYSTEM. THIS MOTION IS SUBJECT TO THE PARAMETERS SET FORTH IN MWRA POLICY # OP.4, SEWER SERVICE CONNECTIONS SERVING PROPERTY PARTIALLY LOCATED IN A NON-MWRA COMMUNITY (THE STRADDLE POLICY). BASED UPON THE PROVISIONS OF 310 CMR, SECTION 15.00 (TITLE 5), THE**

APPLICANT'S FLOWS WILL BE LIMITED TO 575 GALLONS PER DAY OF WASTEWATER. THE APPLICANT, HARVEY BOSHART, WILL PAY THE TOWN OF WELLESLEY A FEE OF $7,000 TO REMOVE 3,800 GALLONS PER DAY OF INFLOW. THE APPLICANT WILL PAY A CONNECTION FEE OF $18,033 TO THE MASSACHUSETTS WATER RESOURCES AUTHORITY, PURSUANT TO MWRA POLICY # OP.4. THE ENTRANCE FEE FOR A SINGLE-FAMILY RESIDENCE IS BASED UPON THE COST TO REPAIR OR REPLACE A FAILED SEPTIC SYSTEM. It was seconded and passed by unanimous vote.

III. Legislative Update

Mr. Favaloro stated all bills have been filed; lead sponsors of the bills are either Representative Ron Mariano or Senator Anthony Petruccelli. In the case of the tax on the Bottle Bill, Representative Thomas Stanley sponsored that legislation.

There has been a shake up on the House side with appointments. Robert DeLeo is still the Speaker of the House and Ron Mariano has moved up as the Majority Leader. With that, the two highest positions within the House leadership have been or are the Caucus Chairman for MWRA issues.

Staff worked aggressively with the State Administration and Finance Division to try to have the Bottle Bill included in House 1 (the Governor's Budget) but was unsuccessful. The Advisory Board continues to reach out to the Bottle Bill Coalition but the dynamic is dramatically different without the Advisory Board's bill being included in House 1. It is further complicated because the House side has been clear that anything that "smells like a tax" won't get through.

Mr. Favaloro noted that thanks to John Carroll, Katherine Dunphy and the other participants, the panel discussion at last month's MMA Conference was well received, with nearly 100 people in attendance.

IV. FY12 CIP/CEB Budget Review Process

Staff has begun to develop its approach to push forward on what will be the major issues in this year's process and has whittled it down to the five most important items, with many others still in the wings.

Matthew Romero said the first issue is recognizing that there is a short-term challenge. Last year the Authority developed a three-year budget approach and is taking a similar approach this year. The Advisory Board agrees and acknowledges that there is a short-term challenge; however, the rate revenue requirement increases by $150 million through FY15 – so in the next three years there is a significant jump in rates that has to be managed. One caveat is that at this point the Advisory Board is using the projections that were released with the final FY11 budget; when the proposed FY12 budget is released next week at the Board of Directors meeting, the projections will change slightly.

The challenge is how to ensure sustainable rates given these dramatic increases in the next few years while keeping an eye on the second issue, which is the long-term challenge of a huge “mountain” of debt that impacts the rate revenue requirements dramatically through FY22.

The third issue is that debt service is the driver and the components of that are threefold. The first is how to repay the existing debt; second, how to structure new debt knowing that there is still a mountain of existing debt to pay off; and third, determining a sustainable amount of capital spending.

In the past, MWRA has said that much of the spending has been mandated; by the end of this cap period, there will be a dramatic drop in mandated spending. The Advisory Board’s challenge to the Authority is that they have been using $200 million a year as a placeholder, which also included mandated spending. Now the Authority can look at the asset protection projects and other projects that have been deferred because of mandated projects. The question is (a) whether $200 million is the right level to be spending and (b) just because the mandated projects are complete, the Authority should not be considering replacing dollar for dollar what it was spending on mandated projects. The Authority must determine the correct and sustainable level of spending moving forward because the amounts spent now will determine how much debt the MWRA is going to have later.

The fourth point is discussing potential tools to manage debt service, most of which are not exceptionally different than what the Advisory Board has advocated for previously, but there are some nuances. One of them is defeasance, which is a typical strategy that the Authority employs; staff is hearing right now that the MWRA is going to perform a defeasance transaction specifically targeting FY14, with some benefit in FY12 and FY13. Staff expects that they will use some of the current year’s surplus to defease debt in the future. More detail will be available next week at the Board meeting.

Rate stabilization and bond redemption fund projections include amounts right now that the Authority cannot actually use. For example, the Authority projects they are going to use almost $30 million in FY14 to get rates down to an acceptable level; however, they are saying that is half of what they have in the rate stabilization and bond redemption funds. How to use the rate stabilization and bond redemption funds as a rates management tool is going to be up for discussion as part of the planning projections.

The released reserves had been projected to be available for FY14. One of the questions that staff posed to Finance personnel in the special Executive Committee meeting in December was whether the released reserves could be used in FY14 to help take away from the $30 million in rate stabilization that the Authority says is unsustainable and also bring the rates down. This is the first time that staff has heard from Authority staff that the reserves will more likely be released in the FY15 to 16 horizon, which poses a big problem for the short-term challenge. Other tools are going to have to be employed, which is likely why the Authority has been looking at a defeasance transaction that benefits FY14 using this year's surplus to begin to ratchet down that number.

With the released reserves, there are limitations on how they can be used, which is why Authority staff agreed to the larger long-term financial Rates Management Committee to help determine how the reserves can be used. Use of the $138 million in reserves has to be lined up with the correct number of bond series, when those come due; then certain amounts of reserves can be used to pay them. How that is structured is going to be a large undertaking and it is important to understand how it will affect rates through FY2022.

Another concern is investment income. Currently, a large source of investment income comes from the reserves earning interest. If the reserves are used, the corresponding investment income is lost; that revenue will have to be made up somewhere else.

The last point under potential tools for debt service is restructuring and rescheduling of debt. It is a potentially important tool in light of the mountain of debt. Authority staff has said there doesn't seem to be opportunities for restructuring in the near term (FY12-13); moving forward to FY14 to FY17, there will be hundreds of millions of dollars in rate revenue requirement increases; the Authority needs to begin to look at these tools and see if there is opportunity in the farther out years to begin to restructure that debt responsibly to make sure there can be manageable rate increases for ratepayers system wide.

The final piece is the Pension and the Other Post-Employment Benefits (OPEB) liabilities. The Authority and the Advisory Board have had discussions on this topic before but it has come back on the table because it is clear that the Authority intends to make a contribution into its OPEB liability in its proposed budget. It is a battle that the Advisory Board will continue to fight because at this point cities and towns are still struggling. In staff's opinion, it is not conscionable to be putting money into OPEB when there are so many other issues facing the Authority and rate increases are going to be difficult for cities and towns. Staff anticipates that this will be a heated battleground between Authority staff and Advisory Board staff.

John Sullivan asked what the projected rate increases are for the next five years. Mr. Romero said the rate increases are 3.95% for the next two years, 7.9% for the next two years after that and the 6% range after that. The trouble with the MWRA's projections is that they have conservative assumptions for those farther out years and they don't assume any surplus. The Authority usually has a significant surplus, especially in the last few years because of variable rate debt in general; they budgeted conservatively on their assumptions. This year, if trends continue, there will be a double-digit surplus in variable rate debt service alone, which can be used to mitigate some of those rate increases going forward.

Mr. Favaloro added that percentages don't really tell the whole story. Between now and FY15 it adds nearly $150 million to projected rates. After that point, the budget ramps up about $100 million over the next two years. On one hand a 7.9% increase sounds okay; at least it is not a double-digit increase. But on the other hand, when talking about $100 million divided among the communities, 40% to Boston and the rest by the other communities, it is a significant amount of dollars.

John Sullivan said the problem is that debt doesn't go away. It's not like you can control capital planning and spreading it out. If we keep rate increases at 2% year after year, all we are doing is postponing the date that the debt comes due. Is it better and fairer to ratepayers to take a little more of a hit in the 4% to 5% range, thereby raising the base and thereby lowering the percentage. The low variable rate isn't going to last forever. The debt is sitting out there and it is going to hit us. Mr. Favaloro said the Executive Committee will decide where we are going over the long haul; from a staff perspective, we are not planning to ratchet the rate increase down significantly. Staff may recommend a small tweak in the budget but the real focus will be on what the Authority's defeasance plans are and to whittle away at the issues coming in FY14 and beyond.

Mr. Romero added that it is a hard sell to the ratepayers that the Authority is contributing money into OPEB and has a surplus in excess of $20 million this year, yet there are no plans to change the rate increase for next year. The Advisory Board agrees that the Authority has to target the defeasance in FY14 because that is the problem year; by the same token, MWRA has to acknowledge that cities and towns are in tough financial circumstances this year. MWRA can ratchet the rate increase down by taking the low-hanging fruit, such as taking out OPEB or reducing it significantly; perhaps the defeasance could have some benefit in FY12 and 13, which could take the increase down slightly without sacrificing anything.

Mr. Sullivan said the problem is we talk about the long term but really focus on the short term; we really have to focus on the mid-term.

John DeAmicis said from a previous MWRA presentation, the mountain of debt that peaks and then goes away was done by design in anticipation of receiving Debt Service Assistance (DSA). Since the Authority is not getting DSA, why shouldn't we flatten that peak? Mr. Favaloro said staff is not just looking at next year. The comments are going to be couched in the context of sustainable and predictable over the mid-term and longer term if members are comfortable with that.

Mr. Romero said that is why we had advocated for, and the Authority agreed, that we should put together a long-term Rates Management Committee; part of its charge is to flatten the peak. The big problem has been that Authority staff has been having trouble getting the information that they need from the financial advisor and bond counsel to get enough information on the reserves to convene us around a table.

Mr. Favaloro said in the Authority's defense, there is a significant amount of money that will be released ($138 million), but it has certain prerequisites and commitments that have to match up and unfortunately they may not match up on the years you most want them to match. Until that piece of information is better established, having people in a room to talk about how we are going to use the reserves doesn't make a lot of sense. Where does defeasance play into this and how are we going to use rate stabilization funds? What about restructuring or refinancing for ways to take the top off the mountain? For every person that says let's just restructure or refinance, there are people that say no, we are just going to increase our costs even more.

Jay Fink said if we are looking at the mid-term and how to shave off the peak, one of the things indicated is that every year there is a surplus. Perhaps we should save the surplus and put it into a rate stabilization fund and use it a couple of years out to start to shave off the peak. At least it would be something that is targeted. Mr. DeAmicis said he got the impression that Finance staff was aggressively trying to manage this debt problem and a lot of that was in response to the pressure that the Advisory Board put on them. This Board should continue to put the pressure on the MWRA to flatten out the rate increases, to restructure or defease debt to stretch it out so it is manageable for the ratepayers.

Mr. Favaloro said it may be time to ratchet it up even more. How do we really strengthen how or what we are going to defease? What are we going to restructure and refinance? How are we going to use those reserves so that when we look out over the horizon we won't see a mountain?

Mr. DeAmicis added that it is not that hard to roll over debt if they want to do it. Mr. Favaloro said two of the major issues are OPEB and Pension expense. He said he would not argue that these are not black clouds that are looming; however, why does the Authority have to be in the forefront of those issues? MWRA should watch and see how these issues develop because everyone is faced with huge liabilities. On the Pension liability, many have gone to 2040 as a goal to be fully funded; the Authority is still on a path to be 100% fully funded by 2024. The only obligation on OPEB is to include the liability in a footnote on the balance sheet right now; there is no responsibility to begin to make contributions yet. If the Authority begins to address these things now, while trying to deal with its mountain of debt, there will be some huge numbers coming.

Mr. Fink said that is why any surplus should be put it into the rate stabilization fund rather than pay pension; then it is there for when the time is right. Chairman Dunphy said use of the rate stabilization fund is flexible; it can be used by choice and can be used if there is some kind of unexpected problem; it is an easier thing to move around. The whole purpose of a rate stabilization fund is rate stabilization.

Mr. DeAmicis said Wellesley and Massport seem to be the only two entities that have been able to begin to fund their OPEB liabilities; not even the state can do it yet. Why on earth is MWRA taking my money to fund OPEB when my town can't do it? I know the Advisory Board has fought this aggressively.

Bernie Cooper asked what kind of dollars are being discussed for OPEB in the coming year. Mr. Favaloro said we don't know yet. We are under the strong assumption that they are going to make some kind of contribution because Mr. Laskey has mentioned it to be fair to this office.

We will have a better idea later this week when the staff summaries come out. It is still a move toward the creation of an Irrevocable Trust. Mr. Favaloro said he is fearful of a Standard & Poors or Moody's that if we open an Irrevocable Trust and then don't make a contribution that the rating agencies will put the MWRA on a credit watch; they can't attack you if you don't do it. For example, last year the Authority made an aggressive payment toward some of their obligations and then reduced a little bit of their overpayment and then went on credit watch for not putting in the entire overpayment. Mr. Favaloro said this office single-handedly blocked the creation of the Irrevocable Trust in the past and has maintained that position.

Mr. Romero added that the Advisory Board believes the Authority should concentrate on funding the Pension liability first and then at that point, there might be a better indicator from other comparable agencies on how they are going to begin to fund the OPEB liability.

Mr. Favaloro said the Commonwealth of Massachusetts has a liability in the billions of dollars and has made an initial contribution of $328 million in 2008; it has not put any other funds in since then and has no intention of doing so. The Governor has said perhaps in FY13 they can make a contribution but they realize now that they cannot do it. The Commonwealth is also saying they want to push the pension out to 2040. MWRA likes its schedule for pensions of 2024 and the Advisory Board is not arguing that it isn't the best way to go; however, to keep that schedule, MWRA will have to make more aggressive payments to meet the pension obligation – they can't fund everything aggressively. This is clearly going to be a major debate point between the Advisory Board and the MWRA.

Lou Taverna asked if MWRA is still pursuing the staffing analysis and cutting back on chemicals. Mr. Romero said the Authority is still pursuing both of those things and the Advisory Board is watching the Direct Expenses as well, but compared to these larger issues, there are not as many dollars involved.

Mr. Favaloro said the proposals are in on the staffing study and he and Katherine Dunphy are on the Selection Committee. The Committee will meet early next week to determine the firm that will be doing the study and it is a duration from that of approximately 30 weeks. By the end of this fiscal year there should be some thoughts and ideas. Direct Expenses have not been going up at the MWRA and they are not the driving force of increases. There will be some unknowns coming. Fuel prices are expected to go up. Utility costs have a tendency to move upward but all of those increases combined are not the driver on why the rate revenue requirements are going up that much higher. It is all about the debt.

Mr. Romero said on the current year spending, on the CIP side, the Authority is $6 million under budget through January, which is about 22%. $11.9 million is due to CSOs and is likely due to timing and distributions and typically this category will close by the end of the year. About $8.4 million is due to under spending in the Local Water Pipeline Loan Program, which is an area that is constantly in flux because it is hard to predict accurately when and how the funds will be distributed.

There has been some overspending in other areas, particularly in the hyper-acceleration of the Hultman Project and redundancy projects that we were advocating after the main break; they are basically about 22% under budget at this point.

On the CEB side, MWRA is about $15.4 million under budget (4.5%) and $11.2 million of that is due to variable rate debt. This tends to be the largest driver of the surplus, particularly this year because rates continue to remain at unprecedented lows. The largest other driver is maintenance and often it is a timing-related issue and by the end of the year that category tends to tighten up as well.

Personnel costs, because of retirements and a lag in replacing positions and attrition, are also contributing to that but they are also under on chemicals and utilities as well. If this trend continues, we can expect to see a measureable surplus. Early indication from the Authority is that they are looking at a defeasance transaction included in their proposed budget next week using whatever they project their surplus to be, targeting it mostly at the FY14 problem year.

V. 2010 Water & Sewer Retail Rate Survey

Mr. Romero said the average increase in municipal water and sewer rates system-wide is 4.6%, which is the lowest retail rate increase in nine years. The good news for the MWRA ratepayers is that, in comparison with national cities, rates are starting to go down.

The bad news is that water consumption continues to decrease and costs continue to increase; the MWRA has to find a way to increase the base on how these costs are spread through system expansion.

VI. Approval of the Advisory Board Agenda for February 17, 2011

Mr. Favaloro noted that Joshua Das, Project Manager, Public Health, has asked to be added to the agenda because the regulators have determined that there are deficiencies in the community pages of the Consumer Confidence Report.

A Motion was made **TO APPROVE THE ADVISORY BOARD AGENDA FOR THE FEBRUARY 17, 2011 MEETING, WITH THE ADDITION OF JOSHUA DAS AS A SPEAKER ON THE CONSUMER CONFIDENCE REPORT.** It was seconded and passed by unanimous vote.

VII. Adjournment

A Motion was made **TO ADJOURN THE MEETING AT 9:46 A.M.** It was seconded and passed by unanimous vote.

Respectfully submitted,

Lou Taverna, Secretary