

**EXECUTIVE COMMITTEE MEETING
FRIDAY, APRIL 15, 2011
ADVISORY BOARD OFFICE
MINUTES APPROVED AT THE SEPTEMBER 9, 2011 MEETING**

Present: John Sullivan, BOSTON; John Sanchez, BURLINGTON; William Hadley, LEXINGTON; Jay Fink, LYNN; Katherine Dunphy, MILTON; Wiff Peterson, NATICK; Lou Taverna, NEWTON; John DeAmicis, STONEHAM; Carol Antonelli, WAKEFIELD; Walter Woods, WELLESLEY; Zig Peret, WILBRAHAM.

Also in attendance, Andrew Pappastergion and Joseph Foti, 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. Approval of the February 11, 2011 and March 11, 2011 Minutes of the Executive Committee

Chairman Katherine Haynes Dunphy called the meeting to order at 8:35 a.m. A Motion was made **TO APPROVE THE FEBRUARY 11, 2011 AND MARCH 11, 2011 MINUTES OF THE EXECUTIVE COMMITTEE**. It was seconded and passed by unanimous vote.

II. Advisory Board's Emerging Comments on MWRA's Proposed FY12 CIP/CEB (PowerPoint Presentation)

Matthew Romero, Manager for Finance and Policy Review, provided an update on the *Integrated Comments and Recommendations on the MWRA's Proposed FY12 CIP and CEB*. Because staff heard from the Executive Committee that there was an interest in looking at rates in the long-term scheme, this year's recommendations will be framed within the context of this long-term challenge.

In FY11, the rate revenue requirement was \$570 million; the furthest out the Authority goes in its projections is ten years, which shows the rate revenue requirement in FY21 at \$934 million. So, for the next six years, MWRA is looking at a \$40 million average increase. This information helps to put into perspective the long-term and even the immediate term challenge. This period is also characterized by a couple of long-term obligations that are facing the Authority – pension and debt service.

Staff put together various scenarios showing the projections if rate increases were maintained at certain percentages over the years. For example, exercises were done with rate increases that were maintained each year at 3.95%, 5%, etc. and then the differences would be the challenges the Authority would have to find ways to make up. The lower the rate increases, the greater the balance that has to be made up.

There are tools available to help ratchet the increases down, including the released reserves, which will likely become available close to FY16.

Additional tools include reduced capital spending of \$79.8 million based on a \$25 million per year reduction in the capital program. These numbers were part of an exercise that the Authority conducted to see what the effect would be on debt service and debt service obligations in the future if capital spending were reduced by \$10 million, \$25 million, etc. The Advisory Board had already challenged the Authority to reduce the CIP and CEB by \$100 million. As mandated spending drops off in the capital program, and since the MWRA does not tend to spend fully the amount it budgets, Advisory Board staff believes that a \$25 million reduction could be achieved without sacrificing its asset protection mission moving forward. The caveat with this tool is that again, the benefit is greatest in the later years.

Future debt service surplus or increased investment income can also be used as a tool. The Authority is extremely conservative in budgeting for variable rate debt, which could easily be ratcheted down. If MWRA did, its debt service obligation would be reduced.

The next exercise would not even touch the Authority's assumptions for the variable rate debt in its planning projections. Assuming the interest rate assumptions are left as they are currently, MWRA is going to have a surplus in the variable rate line item. Averaged out over the planning projections, there would be an average of \$7 million per year. If rates continue as they are, MWRA will likely be looking at a greater benefit in FY12 and a lesser benefit in FY13; if the economy improves, MWRA will not be seeing the levels of surplus it is currently seeing. Considering in the last four years MWRA has had a \$23.3 million average surplus in this line item, it is not an unreasonable thing, especially if the MWRA's conservative assumptions are not touched.

For direct expenses, historical trends over the course of these planning projections would be \$60 million or more in reduced budgeted spending in future years. Additionally, the Authority typically manages its direct expenses toward an under-spending of 1 to 2% for a total potential benefit of \$20 million over the course of the planning projections. At \$200 million in direct expenses, that would be \$4 million per year.

There is a benefit of \$35.8 million that can be removed from the planning projections by removing funding for other post-employment benefits (OPEB). This figure is based on the \$1.9 million "token" amount, as the Authority refers to it, that Authority staff wants to contribute to the OPEB line item for FY12 and the amounts budgeted from FY13 to FY22. As a placeholder, the Authority has budgeted half of the annual required contribution according to its current actuarial study.

Indirect expenses, similar to direct expenses, can be reduced by \$30 million based on historical trends. The Authority's projections tend to differ than the actual amounts used. Over the course of ten years, an average savings of \$3 million can be achieved.

At a recent Board of Directors meeting, the Board approved an amendment to one of the existing swaps that changed the index to which it was tied that resulted in a savings of about \$500,000 per year; staff has taken out \$5 million from the planning projections based on this incremental benefit that will occur over time.

Additional tools that could be used, but are difficult to assign a dollar value to, include a reduction in the operating reserve as operating expenses are reduced or updated; actual distributions of the Local Pipeline Assistance Program versus the amount that is budgeted. Additionally, the Authority's current planning projections have issued a moratorium on issuing new variable rate debt for the short term, as the economy gets better, staff may issue variable rate debt once again. Considering MWRA's long-term variable rate debt assumptions of 4.25% and long-term fixed assumptions of 6.25%, if it issues debt at some point in the next ten years at the variable rate, there is at least an incremental amount between the 4.25% and 6.25% that can be assumed as a savings.

As elements of the budget are tweaked, there could be less need for current revenue for the capital program.

Over the course of a ten-year horizon, there could be new communities or entities joining the MWRA system and providing entrance fees; however, staff was not comfortable assigning a number to this concept.

Staff has been focusing on the long-term, uphill climb and it seems that the downhill descent has been forgotten; in fact, debt service will not return to the levels MWRA is at today until FY30, which is already partially up that mountain. Even beyond FY21 and FY22, this continues to be a significant factor and driver of the Authority's budgets moving forward. The Authority plans to fully fund its pension liability by 2024.

OPEB is currently a moving target. There has been a lot of discussion about what to do with OPEB and what the liability is truly going to be. Contribution levels are unsustainable as they currently are. Staff believes that by 2024, the OPEB liability will not stand as it is today. Real ways of ratcheting down this liability for municipalities, universities and the public sector in order to meet or reduce that obligation must be developed. The larger recommendations include treating Pension and OPEB as one liability, something the MWRA has actually adopted. When OPEB first became an issue, MWRA discussed the best way to look at these liabilities with its financial advisors. The financial advisors said that the rating agencies will look at pension and OPEB as one liability. If the MWRA is going to direct more money than is required toward its liabilities, MWRA should just direct these funds to pay down pension faster and then get to the OPEB liability. Paying down pension faster still addresses the large liability that these two line items represent.

Because the economy took a downturn, the MWRA backed off, at the Advisory Board's insistence, the "over-and-above" payments to the pension and stuck to the current funding

schedule. The Authority is allowed to go up to 2030 to fully fund its pension and the governor is pushing to allow municipalities and the Commonwealth to push it further out to 2040. The Advisory Board is not advocating that the Authority push this liability out to 2030 or 2040, but the argument can be made, at 2024, compared to most of the other entities in the Commonwealth, the Authority is already aggressively funding its pension schedule if it continues to stay the course as it is; then the Authority can address the OPEB liability after the pension is fully funded. An advantage of doing this would be that hopefully by 2024 the moving OPEB target will have settled down and there will be a better idea of what that liability is. Maybe there will be additional options beyond an irrevocable trust that will provide a better return or better management for the Authority by that time. The biggest issue that the rating agencies have is having a plan and sticking to it.

The Authority had been funding its pension then making over and above payments; when it stopped the over and above payment, it resulted in the MWRA being placed on a negative watch. Having a plan and sticking to it is the most important thing to the rating agencies. This is a doable plan because it is aggressively meeting the pension schedule and the MWRA can stick to it; then when the MWRA gets to 2024, it can look at its OPEB obligations and see what that number will be.

Focus on debt service. What can be done between now and 2022 when the debt peaks to begin to manage the debt? Defeasance through prudent use of rate stabilization funds or through potential restructurings that might be available moving forward may be an option. Staff reiterates its recommendation that the MWRA said they would follow through on last year, which was the Long Term-Rates Management Committee. The Authority has had trouble getting information back from bond counsel; at some point, however, this needs to move forward sooner rather than later. The Authority has to start looking at this in the long-term. You can't begin to deal with the short-term challenge until you know how to manage the long-term challenge.

Reducing capital spending by \$25 million a year is a continued recommendation. Particularly because the mandated programs are beginning to drop off, staff believes this is something the MWRA can do. Just because those mandated projects are gone does not mean that the MWRA has to replace all of those mandated dollars of spending with asset protection dollars of spending. Staff does not believe this would jeopardize the MWRA's asset protection plans. The only way to reduce debt service costs moving forward is to control and reign in capital spending now.

With regard to the FY12 CEB, this is likely the biggest discussion point that staff is looking to the Executive Committee for direction. Staff believes that the rate increase could be reduced to 2.95% reasonably and responsibly but would not recommend going much lower than that for FY12. The range could be anywhere from 2.95% up to the 3.95% that the Authority recommended. To put that in perspective, 1% is equivalent to \$5.7 million; that would be the challenge that staff would have to find out of the FY12 budget if the lower end is chosen.

John Sanchez said you were showing areas where savings can be found through the \$25 million capital expense reduction; have you come up with what the savings would be overall. If all those savings were to be realized over the next ten years, what would the rate increase have to be? Mr. Romero said the reason we adopted this approach is because it is difficult because all of the tools cannot be used over the whole time. For example, the \$139 million in released reserves can't just be spread over ten years or used evenly; first, these funds will not come into play until 2016, so there is no benefit for FY12 to FY15. There is a restriction on how these funds can be used and that is the information that the MWRA is waiting to receive from bond counsel so that the Long-Term Rates Management Committee can meet. Whatever series the reserves are tied to is the only series that they can be used for; when payments are coming due varies over the course of time.

Mr. Favaloro said under any scenario there are significant challenges over the mid- and long-term. One of the principal points of this review is that there are tools and opportunities, not necessarily predictable as to where and when and how much in any specific year, but there are tools that can significantly impact the rather dark, bleak picture that the Authority has out there as part of its projections. Let's not give up on today to protect tomorrow. There are some opportunities for the Authority.

John Sullivan said in the last slide you showed a range of 2.95% to 3.95%; anybody would say if 2.95% is doable, that is what you should do. I'm not sure this is a responsible way of presenting this. If the options are a little or a lot, who is going to say let's go for a lot? If you think you can get to 2.95%, that is what is responsible but I'm not sure showing that range is responsible. The only responsible answer from any Advisory Board would be that if you can get to 2.95%, then get there.

Mr. Romero said staff had previously heard from the Executive Committee a little bit of reticence to go too low in the immediate years because we wanted to have an eye on the future so that is part of why we are trying to show that there are tools for the future and to find out whether the Executive Committee considers it to be too low or not.

Mr. Favaloro said the goal was to put on the table for the Executive Committee because we have clearly heard it might be better to keep it level over many years versus let's get as much as we can in any one given year. We wanted the Executive Committee to have the full opportunity to have that discussion, which will then allow staff to put something together for the full Advisory Board that would be more concrete.

John DeAmicis said, from a negotiating standpoint, if we push too hard this year, will we not be able to push them too hard next year when they will want more of an increase? Maybe we should say okay to a 4% increase this year and fight a hard battle next year. Mr. Favaloro said from the Authority's perspective, and some of the Board Members, what the Authority believed they committed to was a three-year management plan that had an

increase of 1.49% for this year and a 3.95% increase for FY12 and FY13. Then there is a significant pick up going forward with increases of 7.2% and up. Our comeback to them has always been that we argued for a 0% rate increase for FY11 but embraced and supported the 1.49% and always said that 3.95% was a good starting point for FY12 and FY13. Today staff brings the case that the 3.95% isn't really out of the ballpark based on all that we know and don't know; however, we have provided some tools to lower them.

Mr. DeAmicis said if I wanted to play hard ball with them I would say your surplus is going to be \$27 million; that is 4% of the budget. So the budget for FY12, with the 4% increase is the same as the budget for FY11, so you get zero. I could argue for a zero, but I am not doing that. The biggest increase in my town's budget is the sewer bill. It is not acceptable when you can do something about it. However, we can't have a low rate this year and then have things skyrocket. What is reasonable?

Mr. Favaloro noted, to be fair to the Authority, that it may not be possible to get to a 3% increase in all of the years because of all of the variables. Mr. Sanchez said if we all know the average is going to be 3%, we can all set our Enterprise funds to account for that. We can raise the amount the same every year and that would be a tool for our towns to work with. Mr. Favaloro said the Authority will say if it is one year 2% and another 4% that is okay, but they will come back and say one year may be 1% and the next year will be 11% and then three years later it will be 0%. It is the balance that is going to be difficult. Mr. Sanchez said if overall it is going to be 3% we can all have our own balancing tools and figure out what we need to do in our own towns.

Mr. Favaloro said staff does not want to put something on the table and not provide you with the potential counter arguments.

Mr. Peterson asked how a three-year running average would be to shoot for. Mr. Favaloro said MWRA would still have the same concerns because the short-term years are going to be more difficult than the long-term years because of the uncertainty of some of the tools.

Chairman Dunphy asked if there is a consensus that we would like to see long term over ten years between now and FY22, which is the peak year for the debt, that the increase be about 3% on average and we would like to see 3% for next year – if it is doable come back to us and tell us how that would work on the first five years and the next five years and see what they come back with.

Zig Peret suggested adding that after a year, we should revisit this to see whether we are gaining or losing on it and use that for modifying it and giving us direction each year.

Chairman Dunphy said there are a couple of caveats. First if a town says it is going to be an average of 3% over the next years you are going to have the ups and downs of how you use more water one year than another, or you have a big sewer problem, but it would

be a good tool to have. The other issue is that there are always the unknowns. If gasoline goes to \$5, that is a direct cost.

Mr. Romero said basically what we would do for the purposes of next week would just to show the 3% increase.

Mr. Favaloro said the Executive Committee clearly has the first perspective and say but I'm not sure if we don't want to show the other pieces of it. To get to what we believe is the best case but I'm not sure we shouldn't show the other components of it. Mr. Romero said we will show the various options.

III. Advisory Board's FY12 Operating Budget

Mr. Favaloro said the bottom line number for the Advisory Board's FY12 Operating Budget is \$434,000. Staff manages seven banking accounts. There is a capital fund with a current balance of \$34,000 plus; a legal fund that hasn't been touched in some time that will be available if the NPDES permit language doesn't play out the way it should; an accrued payroll liability account that takes care of all the policies that this board has established in regard to sick time upon leaving or retiring and vacation buy back; and additionally, the Advisory Board's accountant requires a balance to cover costs based on standard operating procedure to have approximately a two month reserve that doesn't get touched and is available for an emergency situation.

New computers have been purchased and the Advisory Board bought out the lease on the copier. Thanks to Matt the Advisory Board will be storing our data information in the "cloud" and we will not have to make any capital expenditure for data storage. If we joined the Authority's system, we would have spent \$5,000 to \$7,000 for hardware to store all the information.

IV. Process to Elect Advisory Board Representative to the MWRA Board of Directors

Next month will be the election for an Advisory Board representative to serve on the MWRA Board of Directors. John Carroll is running for reelection.

V. Recognizing 25 Years of MWRA/MWRA Advisory Board

Mr. Favaloro said in recognizing 25 years of the MWRA and MWRA Advisory Board, we have invited a whole array of speakers and will acknowledge the group of individuals that have been around for the 25 years. On the Authority side, there are approximately 125 employees that are still here.

VI. Executive Director's Annual Performance Evaluation

Mr. Favaloro said he has no plan to take an increase for this fiscal year. Packages are available with the contract as it is now along with the accomplishments for this year. Staff has met with every new legislator and leadership in both the House and Senate. There will

be a small amount of funding for Debt Service Assistance (DSA) in the House Budget to keep the line item alive.

Staff met with Senator Brewer, Chairman of Senate Ways and Means, to lay out a strategy for the fringe rate for DCR; he asked staff to put language together that will allow for fringe rate payments going forward and also allow MWRA to keep the \$5+ million that is in that account to be used for watershed-related projects like the Clinton Wastewater Treatment Plant, which needs a major capital investment, and also allows for invasive species treatment, etc. Mr. Laskey and Mr. Morris were with us as well. Further, staff noted to Senator Brewer that the MWRA has found \$2.8 million for the state and perhaps the senate could find some funding for DSA as well.

System Expansion will be on the agenda for next month.

VII. Approval of the Advisory Board Agenda for April 21, 2011

A Motion was made **TO APPROVE THE ADVISORY BOARD AGENDA FOR THE APRIL 21, 2011 MEETING**. It was seconded and passed by unanimous vote.

VIII. Adjournment

A Motion was made **TO ADJOURN THE MEETING AT 10:13 A.M.** It was seconded and passed by unanimous vote.

Respectfully submitted,

Lou Taverna, Secretary