MWRA ADVISORY BOARD MEETING
JANUARY 18, 2007
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530 WASHINGTON STREET, WELLESLEY, MA
Minutes Approved at the March 15, 2007 Meeting

Forty-six people were in attendance, including twenty-five voting members: Teresa DeBenedictis, ARLINGTON; E. A. Maguire, ASHLAND; Peter Castanino, BELMONT; John P. Sullivan, BOSTON; Al Borgonzi, EVERETT; Peter A. Sellers, FRAMINGHAM; J.R. Greene and Barbara Wyatt, GUBERNATORIAL APPOINTEES; Ed Demko, HINGHAM; Jay Fink, LYNN; Bruce Kenerson, LYNNFIELD; Dana Snow, MARBLEHEAD; Doran Crouse, MARLBOROUGH; Ed Bates, MAPC; Ben Lagman, MELROSE; Katherine Haynes Dunphy, MILTON; Tim Dooling, NATICK; John Cosgrove, NEEDHAM; Lou Taverna, NEWTON; Bernie Cooper, NORWOOD; Peter Smyrnios, PEABODY; Ted McIntire, READING; Walter Woods, WELLESLEY; Earl Forman, WESTON; Bob Angelo, WESTWOOD; Richard Stinson, WAKEFIELD.

Also present: John Carroll and Andrew Pappastergion, MWRA BOARD OF DIRECTORS; Jon Norton, EVERETT; Thomas M. Holder, FRAMINGHAM; Barbara Stevens, LEXINGTON; Ron Seaboyer, MELROSE; Ryan Ferrara, NEWTON; Brian Carlisle, QUINCY; William Shaughnessy, WELLESLEY; Ed Bretschneider, WAC; Eileen Simonson, WSCAC; Ralph Wallace, Patricia Filippone, Rachel Madden, Pam Heidell, Jim Coyne and Paul McGee, MWRA STAFF; Joe Favaloro, Cornelia Potter, Matthew Romero, Christine Hevelone-Byler and Mary Ann McClellan, MWRA ADVISORY BOARD STAFF.

A. **WELCOME**
Chairman Katherine Haynes Dunphy called the meeting to order at 11:42 a.m.

B. **APPROVAL OF THE MINUTES FROM OCTOBER 19, 2006**
A Motion was made **TO APPROVE THE MINUTES FROM THE OCTOBER 19, 2006 ADVISORY BOARD MEETING.** It was seconded and passed by unanimous vote.

C. **REPORT OF THE EXECUTIVE DIRECTOR**
MWRA Advisory Board Executive Director Joseph Favaloro introduced new staff members Christine Hevelone-Byler, Government and Media Coordinator, and Matthew Romero, Senior Finance and Policy Analyst.

D. **PRESENTATION: MWRA PROPOSED FY08 CAPITAL IMPROVEMENT PROGRAM** – Rachel Madden, Budget Director

MWRA Budget Director Rachel Madden provided an overview of the proposed FY08 Capital Improvement Program (CIP). The document will be available by the end of the month both to the Advisory Board and online.

The FY04-08 spending cap, set by the Board of Directors in 2003, set a limit of $1.1 billion for the five-year period and also established an allowance of an annual spending threshold variance of plus or minus 20%; the Authority is well within these confines, coming in at $935.5 million for the five-year period and in compliance with the threshold variances.

For the FY09-13 cap period, staff is proposing a $1 billion threshold, with actual spending as part of the cap analysis coming in at $993.7 million (averaging $200 million per year, fluctuating from year to year). Staff also proposes to maintain the same variance of plus or minus 20% in any given year.

The Advisory Board has been a strong advocate for the MWRA releasing a comprehensive package and taking a longer term view of its capital needs; the Master Plan will be released simultaneously with the Proposed FY08 CIP. The Master Plan was used as the source of new projects to be incorporated into this particular cycle and also into the outyears for spending.

The Authority has increased the total budget, which extends well beyond the next five-year cap period and into the future, by $969 million; within that increase $952 million came directly from projects proposed and included in the Master Plan. There are 67 new projects or sub-phases incorporated from the Master Plan into the Proposed FY08 CIP. The vast majority of the spending is beyond the ten-year horizon. The Master Plan has built in spending that accounts for projects going out as far as 2048. Approximately $180 million of the new project spending from the Master Plan occurs in the FY09-13 timeframe. Spending went up in all the major categories except CSOs.

Debt service costs for capital improvements represent the vast majority of the MWRA's annual Current Expense Budget, or 59% of the final FY07 budget before offsets. The MWRA is constantly looking at ways of managing existing debt, as well as to build a structure that will allow the Authority to assume new spending to maintain its assets. The current debt restructuring is expected to generate approximately $400 million in rate relief to 2017.

The debt service class borne by ratepayers is mitigated to a certain extent by the receipt of Debt Service Assistance. The Commonwealth issued $25 million of DSA last year, of which the MWRA can expect to receive $18.75 million. Staff is hopeful, with the restoration of that funding by Governor Patrick, that it will be maintained in future years. Debt Service Assistance is always applied directly to the rate revenue requirements so it does resonate immediately with ratepayers.

The major changes in the proposed FY08 CIP are driven by new projects from the Master Plan – changes to ongoing projects, cost estimate updates, annual adjustments for inflation, as well as changes in schedules to reflect more information or changes in regulatory requirements. The net impact of all these changes is $969 million.

The West Roxbury Tunnel has been built back into the budget from the Master Plan and will allow redundancy.

Deer Island asset protection has a large increase to $250 million for total spending, with $200 million being spent beyond FY13.

The CSO Program is one of the few programs that had a slight reduction in spending and the North Dorchester Bay Tunnel was less than budgeted.

New drinking water improvements are mostly driven by the Master Plan.

The MWRA has moved forward with amendments to the bond resolution. While the benefit of these amendments won't be felt for eight to ten years, ultimately it will free up reserve funds that can be used to pay down debt in the outyears after the affects of this restructuring start to wane.

E. **COMMITTEE REPORTS**

Executive Committee – Katherine Haynes Dunphy

❖ **LEGISLATIVE UPDATE**

Mr. Favaloro noted that two pieces of legislation that were discussed at the Advisory Board's November meeting were not filed. Staff opted for a late file on the initiative that called for full reimbursement for the Clinton Wastewater Treatment Plant to provide an opportunity to speak with the legislator from that area who has been a strong ally.

A second bill that staff opted not to file pertained to PILOT payments for non-watershed lands in the South Sudbury. Staff has begun to move administratively to eliminate PILOT payments that relate to lands that are no longer used for watershed purposes.

There has been a lot of discussion between central and western Massachusetts, the Authority and the Advisory Board relating to system expansion. Diversion of the Connecticut River was a major concern by people of that area. Senator Brewer filed a bill, to which the Advisory Board has no objection, that says the MWRA cannot, under any circumstance, divert the Connecticut River.

❖ **STATUS OF DEBT SERVICE ASSISTANCE**

Staff was successful in restoring Debt Service Assistance (DSA) for FY07; however, sagging revenue numbers for the Commonwealth lead to uncertainties for the FY08 budget.

Staff met with the Chairman of House Ways & Means and the Senate President, as well as the Secretary of Administration & Finance, and broached the topics of DSA and the MWRA's debt restructuring plan. Staff noted the benefits the MWRA would get from the restructuring plan were based on an assumption of continued DSA, level funded, to provide for rate increases in the 5+% range. In the event DSA is off the table, rate increases would be closer to 8%.

The Authority is planning to present its CEB budget to the Board on February 7. History indicates the Authority provides communities with proposed water/sewer assessments on the Friday before the budget goes to the Board. This time, communities will likely receive assessments with and without DSA.

Finance Committee – Bernard Cooper

- **MWRA'S DEBT RESTRUCTURING/BORROWING PLAN** – Patricia Filippone, Director of Finance and Ralph Wallace, Treasurer

Director of Finance Patricia Filippone stated that the Authority underwent a bond issue yesterday. Staff priced close to $850 million worth of bonds at virtually all-time low interest rates, providing close to $500 million worth of rate relief through 2020 and ended up with present value savings of $4.9 million. The actual interest cost was 4.34%.

Treasurer Ralph Wallace stated the MWRA has completed and placed into service five major projects; from the perspective of the rating agencies and the bond-buying community, MWRA's completion risk has gone down and the Authority has a well demonstrated capacity for implementing large and complicated capital programs.

The Authority has spent $5.1 billion on these completed projects, which are the Boston Harbor Project and the Integrated Water Supply Improvement Program and account for the debt the Authority is trying to manage today. In addition, the Authority has an ongoing capital program and anticipates spending of roughly $200 million per year. Staff must be sure that it can manage rates and manage the existing debt burden so the MWRA can continue to fund that capital program.

In terms of debt service, MWRA is facing a steep climb through 2022. The Authority has over $3.7 billion in fixed rate debt; more than $900 million borrowed from the state revolving loan fund at an interest rate of 2%; about $715 million in variable rate debt; and $218 million of Commercial Paper (short term debt of less than 270 days in maturity) that is used to fund construction progress. Once a project is complete and placed into the asset base, staff will convert it with either fixed or variable rate debt.

Interest rates were at historically low levels and the yield curve flat, meaning the difference between short and long term interest rates was small making it relatively efficient and cost effective to borrow money long as opposed to borrowing it short. When staff made a presentation to the Board on December 13, rates had just gone through a near term low. Since that time, rates went up by 13 to 17 basis points but are still attractive. When staff made its presentation to the Board, it assumed that the interest rate would be 20 basis points higher as a contingency.

Because of a favorable interest rate environment, the MWRA combined issuing new money and refunding existing debt to achieve a higher interest rate or arbitrage yield on the escrow created to pay off the existing debt. Staff was able to blend the two together to allow the federal government to essentially subsidize the bond deal. The Authority is now trying to match the average maturity of its debt to the remaining useful life of the assets being financed. The average life of the MWRA's debt is 17 or 18 years, but the useful life of its assets is 50 years.

The Authority has an indenture that was established back in 1990 when it did its first debt issuance under its own credit. Because the MWRA was a new agency, it took a conservative approach in terms of the reserve requirements established for its debt. The Authority now has well-respected credit ratings and people are interested in buying the MWRA's debt; therefore, staff believes the bond resolutions can be amended or modernized to free up reserves to use for rates management.

Staff plans to reduce the debt service reserve from 100% of the average annual debt service to 50% of the maximum annual debt service, essentially cutting that reserve in half. The Authority will eliminate the Community Obligation and Revenue Enhancement (CORE) fund, which was created at the time the Authority issued its first debt to ensure coverage for some of the ratepayer communities that had less than an investment grade credit rating to provide additional security to the bond buying community. All of the ratepayer communities now have investment grade credit ratings and BWSC, which is the Authority's largest customer accounting for one-third of the rate revenues, is rated AA, which is an exceptional credit rating.

Additionally, some of the Renewal and Replacement Reserve (RRR) will be replaced with a Commercial Paper facility. The Authority has the capacity to raise funds in the Commercial Paper market quickly if an unforeseen condition arises. The MWRA will reserve a portion of its Commercial Paper capacity for the purpose of providing the same security that the RRR now provides.

The Authority will not change its coverage requirements and remaining reserves will stay as they are. The coverage requirement changes were a sensitive issue for the rating agencies and the bond buying community; therefore, staff focused the amendments to the resolution on items that gave the most "bang for the buck" and would not adversely affect the MWRA's rating. All three of the rating agencies (Fitch, Moody's and Standard and Poor's) reaffirmed the Authority's AA credit rating despite the fact that it is refunding debt and pushing out the maturity and initiating these amendments.

The Debt Service Reserve is the Authority's largest reserve at $254 million. When two-thirds of the Authority's outstanding debt is under the amended bond resolution, $172 million will be available to pay down debt, which should take eight to ten years. The rating agencies understand that the debt burden is the most important financial challenge the Authority faces; taking the reserves and trying to solve the problem with it is a prudent financial plan.

MWRA staff was authorized to refund up to $675 million worth of bonds to provide rate relief from FY07 to FY2020. Additionally, $200 million in new money will be issued to retire some Commercial Paper that is outstanding and to fund ongoing capital programs. The total bond deal is $848 million, the largest bond deal in the history of the MWRA.

This deal gives $4.9 million in present value savings and will generate $425 million in rate relief through FY2017; that is $40+ million in rate relief per year and $502 million in rate relief through 2020. There is a price to be paid in total debt payments; interest and principal payments through 2046 or 2047 will be $451 million higher but this debt will be paid in a timeframe with much lower debt requirements and communities and ratepayers will be able to absorb that cost more easily than in the coming years.

The next steps are to close the bond issue on February 1, when the Authority will actually get the money; staff will continue to refine the bond defeasance plan to provide further rate relief in the 2010-2013 period. Further, staff has to incorporate the restructured debt service into the FY08 Current Expense Budget (CEB), which will be presented to the Board in February.

Mr. Favaloro stated without discussion regarding how the restructuring benefits rates, the presentation is incomplete. Mr. Wallace said it is a complicated question to answer because the Authority has reserves and other assumptions it has to make about the Current Expense Budget. In the proposed FY07 CEB, the rates estimates showed we would have 8.9% rate increases with DSA. With this restructuring plan, staff believes it can achieve a 5.9% rate increase.

John Carroll asked Mr. Wallace to explain the meeting staff members had with the Secretary of Administration and Finance (A&F) regarding the bond issue. Mr. Wallace said at one time staff had looked at doing a third piece to this debt issue. In addition to issuing new money, which the Authority did, staff was going to restructure debt for rate relief and look at refunding debt for the purpose of generating savings. Staff would refund the debt with new debt that was lower cost, but keep the maturities in the same place. The idea was to achieve present value savings in the near term, but in terms of rate relief, it was not great because the debt being looked at matures past the 2020 to 2025 timeframe. To make it cost effective, it is necessary to issue it as non-callable debt, which means the Authority would be giving up the option to call them in ten years, which it presently has with this debt.

Based on discussions with the newly appointed Secretary of A&F and her staff, A&F staff was concerned about trading off that call option for the present value savings; in response, MWRA elected not to do that at this time. The Authority has $600 million in debt that could be refunded for the purpose of regenerating savings; it does have some modest rate relief benefit in the next ten to 15 years, in the $1 million range per year. That tool is still available should the Authority need it for rates management in the future.

Ms. Potter noted this tool is available as long as long-term rates stay relatively low. Mr. Wallace agreed, stating staff would have to take advantage of a low interest rate environment.

Chairman Dunphy thanked MWRA staff for their hard work on the bond issue; Advisory Board staff, who were responsible for initiating some of these ideas; and former legislator Paul Haley of Lehman Brothers who did some initial runs for the Advisory Board to say the initiatives being proposed did have value and should be pursued.

Mr. Favaloro recognized as part of its CEB comments for FY07, the Advisory Board asked for a Rates Management Committee. With the agreement of the Authority, that Committee was created and included MWRA Board Members John Carroll, Vincent Mannering and Cile Hicks. Additionally, Advisory Board Chairman Katherine Haynes Dunphy also served on that Committee, which met on numerous occasions and was instrumental in bringing this plan to reality.

Mr. Favaloro noted these are probably the most important steps the Authority could take to help make rates sustainable, predictable and manageable over the next dozen or so years. As Advisory Board staff traveled to nearly every community last year talking about the $230 million rate revenue increase that was going to occur between FY07 and FY13 and what we could do and couldn't do, it led everyone to look for alternatives, which included restructuring the Authority's debt. What could have been near double-digit increases will now be somewhere between 5.5 or 5.8% or a little higher; that is significant. It happened because the Authority listened to the Advisory Board and Authority staff worked diligently to get it done. Mr. Favaloro stated that he did not want to diminish what the presentation really will mean, not only for FY08 but well beyond.

- **CIP/CEB UPDATE**

Cornelia Potter stated Authority staff expects to send out the proposed FY08 CIP document by the end of this month; with it should be coming the Master Plan, which will be part of the Advisory Board's review this year. This will be a more complicated review because of that addition, because of the 67 new projects or project phases that come from the Master Plan into the capital program and because of the proposed cap for the next five-year period. Advisory Board staff will do a thorough review on a wider base of challenges and proposals from the Authority.

Because the materials weren't ready before the middle of January, the formal 60-day review period is pushed into April and the Advisory Board's vote will be at the April 19 meeting.

The Authority will move forward with the proposed CEB budget number for the next Board of Directors meeting in February. The Advisory Board's CEB vote will be at the May 17 meeting. The CEB review is expanded and complicated by the addition of these important projects from the Master Plan and will also create an overlapping review period. One week after the April CIP vote, Advisory Board staff will need to have an internal draft of the CEB comments.

Operations Committee – Jay Fink

- **OPERATION ISSUES UPDATE**

Mr. Favaloro noted that Operations Committee meetings will be scheduled for the February/March timeline, just prior to Advisory Board meetings. Staff would like to update the Committee on the status of system expansion. The Town of Wilmington has hired a contractor to begin construction soon. Staff has had discussions with the Naval Air Base in Weymouth, now know as Southfield; the Town of Hingham relating to the addition of single connection, a fire station, on the wastewater side; and the

Town of Reading is now going through a second regulatory process to become a formal full time MWRA member on the water side.

Breyer's Ice Cream (Unilever, Inc.) had an expectation that it would be in intermediate compliance by April 1 on the levels of biochemical oxygen demand they are putting into the system; however, they will miss that date and now expect intermediate compliance by June.

F. **ADJOURNMENT**

A MOTION WAS MADE TO ADJOURN THE MEETING AT 12:48 P.M. It was seconded and passed by unanimous vote.

Respectfully submitted,

Edward Sullivan, Secretary