MWRA ADVISORY BOARD MEETING
OCTOBER 16, 2008
WELLESLEY FREE LIBRARY
530 WASHINGTON STREET, WELLESLEY, MA – 11:30 A.M.
MINUTES APPROVED AT THE JANUARY 15, 2009 MEETING

Thirty-eight people were in attendance, including twenty-three voting members: John F. Bean, ARLINGTON; E. A. Maguire, ASHLAND; Peter Castanino, BELMONT; John Sullivan, BOSTON; Ed Sullivan, CANTON; J. R. Greene, GUBERNATORIAL APPOINTEE; Ed Demko, HINGHAM; Bill Hadley, LEXINGTON; Bruce Kenerson, LYNNFIELD; Katherine Haynes Dunphy, MILTON; John Cosgrove, NEEDHAM; Lou Taverna, NEWTON; Peter Smyrnios, PEABODY; Ted McIntire, READING; Don Goodwin, REVERE; Michael Collins, WAKEFIELD; Patrick Fasanello, WALPOLE; Walter Woods, WELLESLEY; Earl Forman, WESTON; Bob Angelo, WESTWOOD; Zig Peret, WILBRAHAM; Michael Woods, WILMINGTON; Anthony Blazejowski, WOBURN.

Also present: John Carroll, MWRA BOARD OF DIRECTORS; Ryan Ferrara, NEWTON; William Shaughnessy, WELLESLEY; Rob Antico, WILMINGTON; Ed Bates, MAPC; Ed Bretschneider, WAC; Mary S. Booth, WSCAC; Rachel Madden, Tom Durkin and Kathy Soni, 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 11:46 a.m.

B. REPORT OF THE EXECUTIVE DIRECTOR
MWRA Advisory Board Executive Director Joseph Favaloro stated that 9C cuts have resulted in the loss of Debt Service Assistance (DSA). Advisory Board and MWRA staffs have agreed that there will not be a mid-year rate increase. The loss will be made up through budget cuts, increased revenues and other opportunities. Advisory Board staff has made suggestions to the MWRA Board on areas that can be utilized to make up this shortfall. An official amendment to the budget will be transmitted to the Advisory Board for a 30-day review and comment period.

Advisory Board staff sent a letter to Ian Bowles, Secretary of the Executive Office of Energy and Environmental Affairs, stating that the Authority should not amend and redesign an odor control facility because one abutter has raised concerns. There was an official process in the siting of the facility over many years and the abutter, Corcoran Jennison Companies, never raised any concerns during that process.

The Authority sited the facility, went through the process and got Article 97 legislation, which is a two-thirds roll call vote of both the House and the Senate. Two and one-half years later, Corcoran Jennison has decided to build luxury condominiums and a high-end mall and is now objecting to the facility's location and wants it placed underground at the expense of the ratepayers. The Advisory Board believes the additional expense should be picked up by the developer.

C. PRESENTATION: NAVIGATING THROUGH STORMY FINANCIAL WATERS – IMPACTS OF WALL STREET CRISIS AND LOOMING STATE BUDGET CUTS – Rachel Madden, MWRA Chief Financial Officer

MWRA Chief Financial Officer Rachel Madden stated that the MWRA planned its FY09 budgets under the assumption that it would receive $11.25 million in DSA; upon the loss of DSA, staff needs to find that amount within the confines of its existing budget and will be doing a budget amendment.

The MWRA Board of Directors has charged Authority staff with making up that loss without a mid-year rate increase to get through not only FY09 but well into the future. The Commonwealth has cut DSA and it will not likely be restored next year. The Authority has to make some tough decisions and structurally change some of its funding to get through this with as little harm to the communities as possible.

MWRA Treasurer Tom Durkin said the Authority has been riding a roller coaster in this tough economy. Events are changing, companies are buying one another, others are going out of business and some are declaring bankruptcy. Nearly all of the events that you read about in the newspapers are affecting the Authority and the ratepayers.

All communities and the Authority are experiencing losses in the values of retirement portfolios. The Authority, year to date for September, has lost 12%. Imagine that there is a stool supported by three legs that pays for the MWRA's 260 to 270 retirees $500,000 every month. Where does that money come from? One revenue stream comes from the money withheld from paychecks through payroll deductions. The second place is the investment returns, assuming an interest rate earned at 8%; but how long can we continue assuming 8% if the portfolio is losing 12%. In the past three years, the portfolio has only been up 3.6% and in the past five years it was up 7.2%, which is still not 8%. The third leg is the plug – the difference needs to be made up by the taxpayers in a community; it is an appropriation and it begins to squeeze out other things like the police, fire or the DPW.

If this pattern continues, assessments that are currently in the $5 million range for the Authority will begin to grow.

For investments, the Authority has a strategy to invest the cash it holds; it is broken up into liquid assets (operating) and a fixed-income component. Staff would like to take advantage of interest rates that pay higher as you invest longer; however, it cannot do that too often because of operational needs. The Authority can invest longer for the long-term debt service reserve funds that are going to be here until 2015. If it can be kept from one year to fifteen years, staff tries to get that into the fixed incomes.

The Authority's indenture states to the bondholders that if they invest with the MWRA, the Authority will invest it in "AAA", very safe, investments. Fannie Mae and Freddie Mac were in that category and the Authority had invested in them. The share values of these corporations are plummeting. The Authority does not invest in the stock but does invest in the bonds. The good news is that the federal government came in and supported the debt, so the MWRA's bonds are safe there.

The Authority also had a Guaranteed Investment Certificate (GIC) with AIG. AIG first received a credit downgrade and they have been issuing insurance policies that are not regulated or reserved like traditional insurance would be so they are going to post collateral. The Authority's investment, which had been paying 6%, was going to go through 2013 but was now in jeopardy. The Authority talked with its financial advisor and carefully read the documents and found that it could liquidate this investment in ten days. On one hand, a good investment was given up but on the other hand staff wanted to preserve the assets of the Authority. The Authority always operates on the "SLY" principal, which is security, liquidity then yield. Mindful of the security of principal, staff called the investment in and got $18 million back, which will be reinvested.

A ten-day notice was just given for a GIC with Wachovia to get a $14.4 million investment back, however, options for investing have become limited.

After assessments from the communities, the next biggest revenue source for the MWRA is investment income, for which the Authority budgeted at more than $20 million. Staff is now faced with the challenge of how to get that return.

Retirement has been very difficult, which is going to make budgeting even harder. Investments that have been budgeted and counted on are not going to return what they were predicted to, which causes additional budget pressures.

Debt takes the majority of staff's time and is the single largest budgetary issue for the Authority. The Authority has nearly $5.6 billion worth of debt, broken into fixed, variable and senior and subordinate debt. For fixed debt, the investors are at risk, not the Authority.

The subordinate category is variable rate debt, which is $1.4 billion. This is where staff has had to spend a lot of time and effort. Variable rate debt is for a short period of time, with resets on a daily, weekly and some 30 day issues. Currently, the Authority has two dailies and seven weeklies.

One of the Authority's remarketing agencies, Lehman Brothers, declared bankruptcy. Lehman was doing two bond series for the Authority (a weekly and a daily). The Authority entered into an agreement with Barclays for these bonds. Thus far, staff has been successful in addressing these issues.

The Authority plans to do an issue in November for $200 million that it will need to borrow. Should the Authority do a fixed-rate deal or a variable-rate deal, which exposes the Authority to weekly volatility? Long-term is usually more expensive. A "swap" would provide something in between. The answer is to have a variable rate issue with a swap on top.

A swap exchanges the Authority's risk to volatility with a counterpart – Goldman Sachs, Morgan Stanley, Lehman Brothers. On these swaps, the Authority makes a deal to pay a counterpart a fixed rate, gotten through a procurement, in exchange for the counterparty paying the MWRA a variable rate that will be sent to the MWRA's bondholders. The Authority gets to budget and plan at a fixed rate and reduces its risk and exposure to variable rates.

There are risks with swaps. The basis risk is when the money that the counterparty is paying the Authority isn't exactly the money that is owed to the bondholders. The counterparties are paying the Authority on an index and the Authority is just a piece of the index so there is a variance at times between what the counterparty pays and what the Authority pays the bondholders. It typically is not a problem. It has always been very close.

There is also counterparty/provider risk, which is the risk that the counterparty would not be around to continue this deal. Who would have ever thought that Lehman Brothers, the single largest investment bank, would go bankrupt, but it did. In this case, another counterparty would be sought through a request for proposals to replace Lehman Brothers. There will be no budgetary impact.

If variable interest rates come down, the banks have to pay the Authority less even though the Authority is paying a fixed amount, which could be advantageous for the counterparty. If it becomes so advantageous that the Authority wanted to stop the deal right now, it would have to pay a termination payment to stop the deal. The risk of paying a termination payment is very remote. Staff is very optimistic about its ability to shift this deal from one counterparty to another.

The $200 million deal in November will be a fixed-rate deal.

Chairman Dunphy asked the size of the problem with Lehman Brothers. Mr. Durkin said the Authority had five different swaps worth nearly $80 million against the Authority (on paper, which changes every Friday). Two swaps were with Lehman. The most troubling is with Lehman Brothers Financial Products and was valued last week at about $50 million. As interest rates rise, it becomes more in the Authority's favor and that $50 million becomes $40 million.

The documents used for these swaps are boiler plate documents from an organization called the International Swap and Derivative Association (ISDA). The ISDA documents lay out what the mechanism is to determine what that value is. The value comes from the difference of what the Authority is going to have to pay over the next number of years and what they are going to have to pay to the Authority. The difference is that the Authority is paying them more than they are paying the Authority traditionally and that is why the Authority gets a fixed rate locked in and that removal of the variable risk is where the Authority gets the value.

The Authority has another much smaller seven-year short swap with Lehman Brothers Special Financing, now worth $2 million. Mr. Durkin stated that staff is optimistic about its ability to move this deal to another counterpart.

Pat Fasanello said the Authority has $5.6 billion in debt; what percentage is debt service of the total budget? Ms. Madden said debt service is between 56% and 57% of the Authority's budget; therefore it is the biggest driver. It is also one of the areas where staff has very limited options when making cuts because the vast majority of the Authority's debt is fixed. The biggest portion of the budget is the one where staff can find the least relief at the loss of DSA.

Ryan Ferrara asked what the general assumption is for the Authority on interest income. Mr. Durkin said in the short-term portfolio, staff assumed a 2% interest earned and is actually doing a little bit better than that for the first quarter of this fiscal year, which is an $800,000 surplus. If the Fed interest rates come down, the Authority's will fall, so staff is not too optimistic about maintaining that $800,000 surplus.

D. COMMITTEE REPORTS

Executive Committee – Katherine Haynes Dunphy

❖ PREVIEW: 2008/2009 ADVISORY BOARD LEGISLATIVE PACKAGE

Mr. Favaloro stated that the Commonwealth of Massachusetts has a two-year legislative cycle so the groundwork put forward over the next couple of months will be the foundation for the discussion throughout the Legislature and communities over the next two years.

Staff has developed some legislative approaches to guide us through the Legislative cycle if the full Advisory Board agrees.

Two new initiatives, an *Act to Expand the Bottle Bill* and the *Water Resources Funding Act* are really two alternative approaches to develop a new revenue stream that deals with either a deposit or an excise tax on bottled water.

An *Act Relative to the Sewer Rate Relief Fund* and an *Act to Expand the Septic Tax Credit* are two approaches to deal with Debt Service Assistance. These initiatives try to strengthen the Authority's ability to keep and maintain DSA in some form.

An *Act to Expand the Bottle Bill* expands the bottle bill to include a deposit on bottled water. Many environmental groups and the City of Boston have joined forces in trying to not only add bottled water containers, but also juice containers and others onto the list of things that require a deposit. The Advisory Board's bill specifically deals only with bottled water containers. Discussion has focused on a five-cent deposit on each unit that would provide a dedicated revenue stream for the Water and Sewer Infrastructure Fund, which could be utilized by municipalities and authorities to do capital improvement water and sewer projects. To put it in perspective, a five-cent deposit, assuming that 66% of the bottles would be redeemed, would bring in $30 million to $50 million per year for the dedicated infrastructure account.

Last January, the City of Chicago adopted a five-cent excise tax on bottled water that goes directly back into Chicago's water and sewer infrastructure. With that in mind, the Advisory Board has further proposed a "user fee" or "excise tax" of five cents per container. Again, these revenues would go to the water and sewer infrastructure fund. The value of the excise tax would be approximately $65 million per year. On the other hand, if people decide not to use bottled water anymore it could increase the use from the tap. MWRA water use is down 7% for the year; five out of the last seven months were the lowest water use ever, which is causing trouble for the communities in trying to determine how low the usage number is going to be as they try to develop the next year's budget.

For DSA, the language currently says up to 20% of eligible sewer debt and the MetroWest Tunnel, which could be $65 to $80 million; although the number has been $5 to $15 million to zero. Proposed language would change the "up to 20%" to "20% of annual debt service obligations". At the very least, it would identify the real eligible number; it still would be subject to a state appropriation. That is why it is critical to identify and implement a dedicated funding source.

On par with the *Septic Tax Credit*, in 1995, with the change at DEP about the law on working septic systems, language was placed on the books under the Department of Revenue that provides any homeowner up to a $6,000 credit to be given to them over five years for the replacement of their septic system. It is not debated every year on the legislative level or the gubernatorial level. It is insulated and out of the legislative process so it will not be cut.

Staff has crafted the bill, *Expand the Septic Tax Credit,* using the exact language it has for the septic users to say that an individual homeowner, provided that their municipality gives them a break out of the sewer debt that is a component of their retail bill, will be able to receive a tax credit for 20% of that eligible debt service. It levels the playing field and provides relief for homeowners.

This initiative is not likely to go anywhere but over time it may lead to discussion that a commitment to protecting the environment on the wastewater side shouldn't matter if it is a septic system or a municipal sewer system.

Staff will also re-file bills done in the past on liability on the Authority's part and PILOT payments in central and western Massachusetts.

Finance Committee – Bernard Cooper

- **CEB/CIP UPDATE**

Cornelia Potter stated staff has now received the first quarter numbers for spending for both the operating and capital budgets this year. On the capital side, the Authority has spent $61 million thus far, which is within 5% of the budgeted amount; two-thirds of that amount is for wastewater projects of over $40 million, while waterworks projects spending was nearly $20 million for the year to date.

CSO spending came to $32 million, just over half of all capital spending for the year to date. During the course of this year, two projects are going to represent just over 30% of all spending – the North Dorchester Bay CSO project and the East Boston CSO project.

On the direct expense side, the current expense budget for the total year is nearly $580 million. For the first quarter, spending came within $7.7 million of the budgeted amount, of which $3.3 million represents holding back spending for the pension fund associated with the estimated actuarial cost of the GASB 45, or post-retirement benefits, number. That is an important number to keep an eye on because it represents the withholding of that deposit while the Authority works out filling the gap that was caused by the absence of DSA and will be an important tool as the Authority works through its strategies in the coming months.

The Current Expense Budget is two and one-half times all capital spending that is budgeted for this year and, in fact, capital financing itself is fully $100 million more than capital spending. The debt service role is a dramatic component of both budgets.

Operations Committee – Jay Fink

- **RESCHEDULED JOINT WAC, WSCAC AND ADVISORY BOARD OPERATIONS COMMITTEE MEETING – NOVEMBER 6, 2008**

Mr. Favaloro noted that the joint Wastewater Advisory Committee, Water Supply Citizens Advisory Committee and Advisory Board Operations Committee meeting has now been rescheduled for November 6 in Southborough. The goal is to determine where the three groups can interact as one to focus on issues that benefit all of the constituencies.

- **DISCUSSION: THREE-YEAR WASTEWATER FLOW AVERAGING MEETING – DECEMBER 4, 2008**

Staff has spoken a lot since the creation of the Sewer Rate Methodology, and the subsequent creation of the three-year flow averaging, about reviewing the method to have a better understanding of how it has worked or has not worked.

Walter Woods has put together a body of work that dissects and analyzes flows and costs for communities based on the three-year averaging. The Executive Committee felt the topic deserved a meeting of its own and scheduled it for December 4.

- **UPDATE: COMMUNITY USE OF BAY STATE FERTILIZER**

In emails last week, staff conveyed a message from the MWRA about getting pellets from the Authority to communities that are interested. As of today, the Authority has provided 85 tons of pellets to communities.

E. ADJOURNMENT

A MOTION WAS MADE TO ADJOURN THE MEETING AT 1:13 P.M. It was seconded and passed by unanimous vote.

Respectfully submitted,

Edward Sullivan, Secretary