

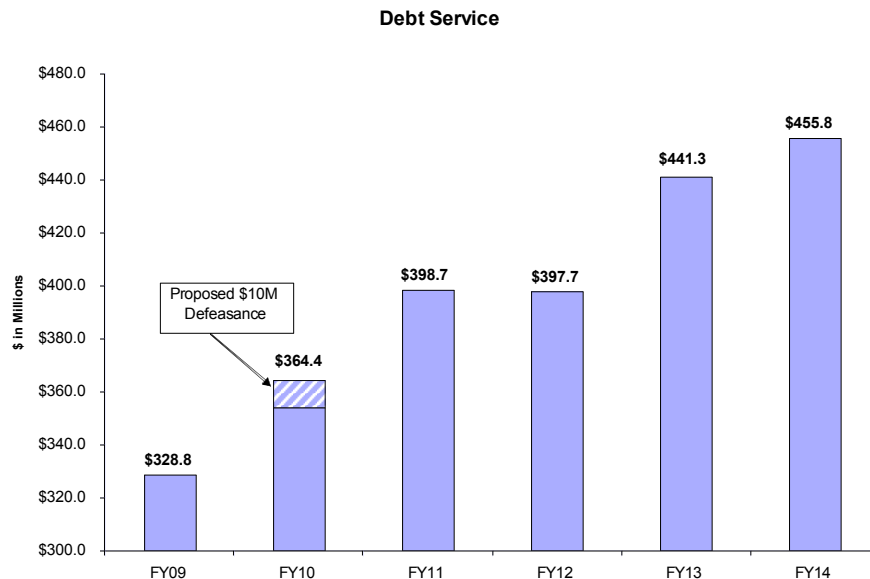
Massachusetts Water Resources Authority
Overview of the Proposed FY2010 Current Expense Budget
February 12, 2009

The MWRA's Proposed Current Expense Budget for FY2010 is \$603.5 million, representing an average combined water and sewer rate increase of 4.8%. Per MWRA's procedure, staff are recommending that this proposed budget now be transmitted to the MWRA Advisory Board for its review and comment. The final FY10 budget and community assessments will be approved in June.

The proposed budget recommends a reduction of \$5.7 million in the operating budget (direct expenses are lower by \$1.4 million and indirect expenses are cut by \$4.3 million). However the reduction in the Authority's operating budget is overwhelmed by the massive increase in debt service.

Debt Service

Debt service on the bonds that financed the major capital improvement projects remains the largest driver of MWRA's budget. Close to 80% of these projects were mandated by the federal court or state regulators, such as the successful Boston Harbor Clean-up and modernization of the drinking water system. For the Proposed FY10 budget, the debt service obligation soared to \$364.4 million, an increase of \$36 million over FY09 levels. It is important to note that debt service represents 58.1% of the MWRA's total budget.



In light of the economic downturn, the Commonwealth was forced to eliminate the MWRA's \$15 million FY09 appropriation for debt service assistance part way through the fiscal year. At the direction of the Board of Directors, an intensive budget cutting process began and an amendment to the budget was filed to avoid a mid-year rate increase in FY09. The budget cutting exercise, combined with some favorable trends in certain major accounts, should create a \$10 million surplus that staff are recommending be used to defease debt service payments due in FY10. This proposal reduces the FY10 debt service requirement to \$354.4 million.

Staff are also recommending the inclusion of \$7 million in Debt Service Assistance (rate relief) tied to the Governor’s proposal to expand the Bottle Bill to include bottled water. This is a proposal originated by the Advisory Board.

Direct Expenses

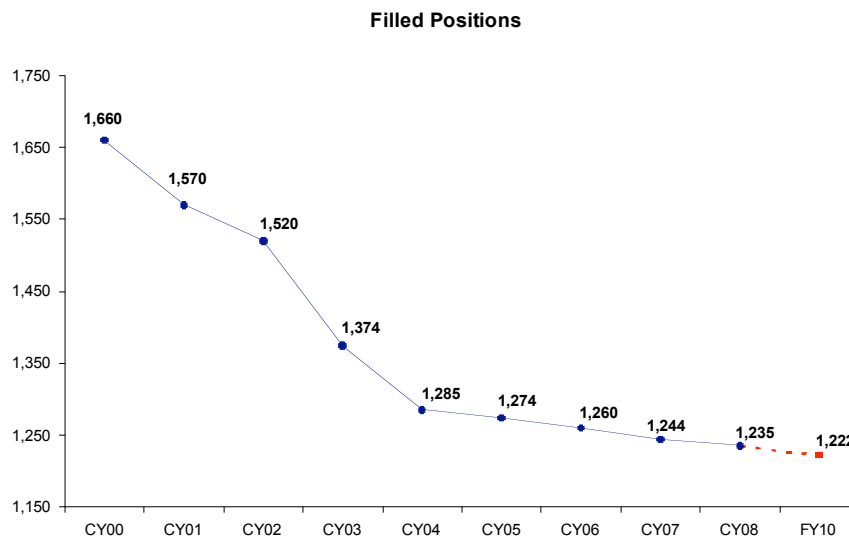
In response to financial uncertainties facing the agency and its customer communities, MWRA staff have reviewed every direct expense line item and made aggressive reductions to achieve level funding of direct expenses at \$214.5 million.

MWRA’s Proposed FY2010 budget includes a number of cost-cutting measures, described below, to reach this goal.

Staffing

Personnel costs are the second largest line item in the budget. The proposed budget recommends a reduction of 24 positions from the FY09 funding level of 1,246 to meet the FY10 actual target of 1,222. After the 9C cuts to MWRA’s rate relief funding, a modified hiring freeze was instituted driving the headcount down to its current level of 1,235. The continuation of the modified freeze will allow us to meet our staffing reduction goal through attrition.

The continued reduction in staffing is consistent with the Authority’s multi-year strategy of staffing reductions (see below). In fact, since the peak staffing level in 1997, MWRA staffing has been reduced by over 530 positions.



The FY10 target of 1,222 positions emanates from a comprehensive consultant report prepared for the Authority in 2002 that studied staffing levels necessary to operate in a “steady state” after the start-up of new facilities and achieving efficiency improvements through automation.

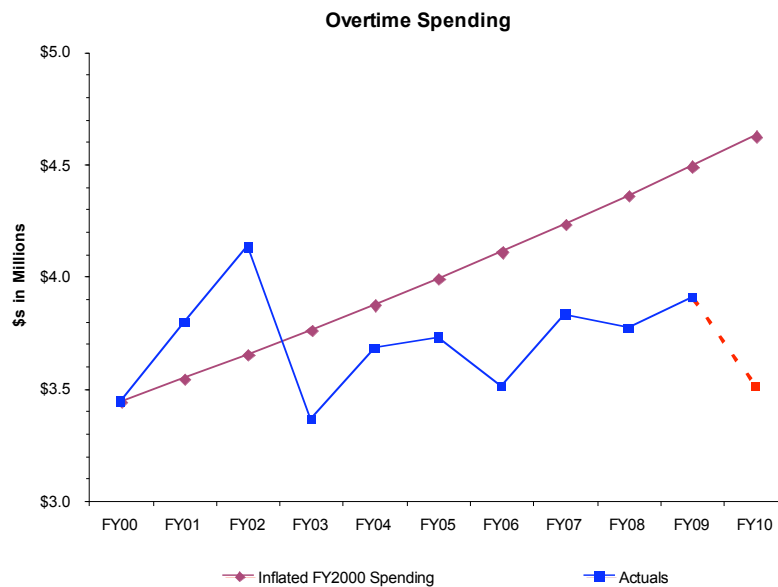
Staff are recommending the elimination of 9 unfilled or vacant positions, which comes on top of the elimination of 45 such positions in December. Other than a handful of critical positions that will require a backfill, the only vacant positions remaining on the Personnel Control Register (PCR) are those that have or will be posted for backfilling internally through the promotional process.

Managers Pay Freeze

The Proposed FY10 budget includes a pay freeze for the agency's non-union managers, resulting in a savings of \$227,000. MWRA's five collective bargaining units have contracts that run through FY10, but MWRA will work closely with union leadership to identify any possible savings.

Reduced Overtime

The Proposed FY10 budget includes a 10% reduction in overtime spending across the agency - limiting overtime to operational coverage, wet weather events and critical maintenance projects, for a savings of \$362,000. Much of these savings will be achieved through ongoing initiatives that have been presented to the Board of Directors.



The graph above shows visually the success staff has had in controlling overtime expenses. If overtime spending in FY00 were inflated by 3% each year (roughly equal to the increase in wages), it would be over \$1 million higher in FY10 than the proposed levels. It is important to note that there is risk in funding this account at these levels because a substantial portion of overtime is driven by events beyond our control - storm events, in particular.

OPEB/GIC

In the last two budget cycles, the Board has thoroughly studied and debated the Authority's responsibility under the rules of GASB 45 regarding Other Post Employment Benefits (OPEB). Staff are proposing two actions regarding OPEB. One recommendation will be discussed in Pension Section below.

The second recommendation relates to a statutory proposal made by the Governor. The proposal would require an increased financial participation in the cost of health insurance for all employees who are members of the Group Insurance Commission. If the proposal is approved, it will require MWRA employees to contribute an additional \$1.4 million toward their health insurance.

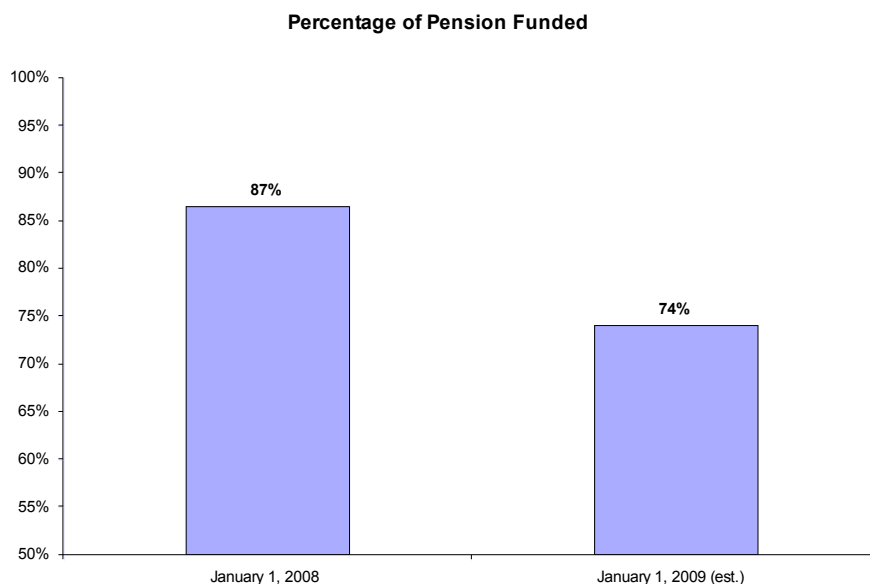
This budget recommends that, if the Governor's proposal is approved, this \$1.4 million be contributed toward the Authority's OPEB liability with consideration for depositing these funds into an OPEB trust established by the Commonwealth. The newly established fund would allow MWRA and other authorities to establish an account within the larger state trust to fund future health benefits for MWRA retirees. While this amount is substantially below the required funding level, it shows a good faith effort on our part.

Pension

Staff are recommending three important actions on the pension account.

As part of a multi-year strategy to address its unfunded liabilities for OPEB and pension, the Board approved accelerated payments toward MWRA's unfunded pension fund. In FY09, all but \$3.3 million of the accelerated funding has been transferred to the pension fund. Due to uncertain market conditions, staff are recommending that the remaining \$3.3 million not be transferred to the pension fund, but instead be rolled into the FY09 surplus. This will allow for the defeasance of \$10 million in FY10 debt that has been described above.

Like pension funds across the country, MWRA's pension fund has been decimated by the market, losing 22.4% in 2008. The \$10.4 million contribution made to the retirement fund reduced that loss from 26.6%. When compared to the actuarial assumed 8% growth and projected fund value, MWRA's pension fund lost \$81.6 million or 29.8% last year. When adjusted to account for the additional benefit of the \$10.4 million OPEB payment the loss becomes 33.6%. Based on common stock market indices, there is no immediate relief in sight as the market continues to drift downward. As it stands the MWRA's pension is now estimated to be only 74 % funded.



The Authority's annual funding level for its obligation to the retirement fund is determined by a biannual actuarial report. We are currently in the first year of the two-year funding levels and the \$5.6 million level recommend for FY10 is now artificially low because it is based on an 8% growth last year, not an 22.4% loss.

In an effort to bring some reality to the situation, we asked the actuary to rerun next year's funding level based on the current conditions and he has determined that the funding level should be \$8.4 million, even when extending the amortization period by 4 years to 2028 the maximum

allowed under the current law. Therefore, the FY10 budget reflects this funding level versus the minimum required contribution of \$5.6 million. In addition, staff recommend that the Retirement Board extend the schedule for full funding out to 2028, as allowed by statute.

Energy Savings

MWRA has made a major commitment to reduce energy consumption at its facilities in an effort to reduce both operating costs and environmental impacts. Energy audits at the Deer Island Treatment Plant, the Carroll Treatment Plant and the Chelsea facility, along with new initiatives such as the Deer Island solar panels, have provided annual savings of about \$730,000. Going forward, audits are planned at other facilities, and new renewable energy projects like wind turbines at Deer Island will generate even more savings.

Potential Increased Revenue

MWRA has also been reviewing all of its existing revenue sources and evaluating ways of maximizing revenues for FY10 and beyond. This analysis will be reviewed with the Board of Directors in a separate staff summary.

Other Reductions in the Proposed FY10 budget include:

- Deferral of \$1.3 million in planned maintenance projects – the FY10 budget still reflects a slight increase in maintenance spending compared to FY09;
- Deferral of over \$1 million in potential chemical increases by assuming no new NPDES permit in FY10 and \$1.3 million reduction in diesel fuel purchases, based on lower current prices than predicted and reduced purchases;
- 50% reduction in planned vehicle replacements, for a savings of \$600,000;
- \$540,000 cut in professional services contracts, either deferring projects or assigning the work in-house;
- 68% reduction in computer replacements, for a savings of \$170,000;
- \$330,000 cut in memberships including the elimination of the Authority's participation in two major industry research organizations, and travel only approved for critical training, vendor visits, or meetings;
- Deferred the purchase of laboratory equipment for a savings of \$100,000.

There is a certain level of risk involved in reducing the budget for items over which MWRA has no control, such as fuel and electricity costs. Other items, such as overtime and chemical costs, are directly affected by the weather. MWRA must balance the need to keep its operating costs as low as possible with its obligation to provide critical water and wastewater services to the 2.5 million people in its 61 customer communities.