Table 23

Proposed Fiscal Year 2016
Indirect Expenses Summary
($s)

Line Item/Description	*Final FY15*	*Proposed FY16*	*Δ ($s)*	*Δ (%)*
Pension	$7,808,155	$8,159,521	$351,366	4.5%
Scheduled updated contribution to retirement fund. Amortization payment: $5.48 million. Employer normal cost: $2.68 million.				
Post-Employment Benefits/Additional Pension Deposit	4,821,320	5,062,470	241,150	5.0%
OPEB is considered all other benefits for retirees (e.g. health insurance).				
Insurance	2,128,155	2,160,797	32,642	1.5%
Insurance and payments/claims.				
Mitigation Payments	1,605,967	1,400,000	-205,967	-12.8%
Mitigation payments to Quincy and Winthrop.				
HEEC Payments	3,198,174	1,946,157	-1,252,017	-39.1%
Cross harbor cable to Deer Island (includes both debt service and O&M components). Contract expires after FY15.				
Watershed Reimbursements	27,466,790	28,061,183	594,393	2.2%
Supports the operations and related costs of the state's Department of Conservation and Recreation, Office of Watershed Management.				
Additions to Reserves	482,953	962,449	479,496	99.3%
1/6th of all planned Operating Expenses.				
TOTAL INDIRECT EXPENSES	**$47,511,514**	**$47,752,577**	**$241,063**	**0.5%**

Other Highlights

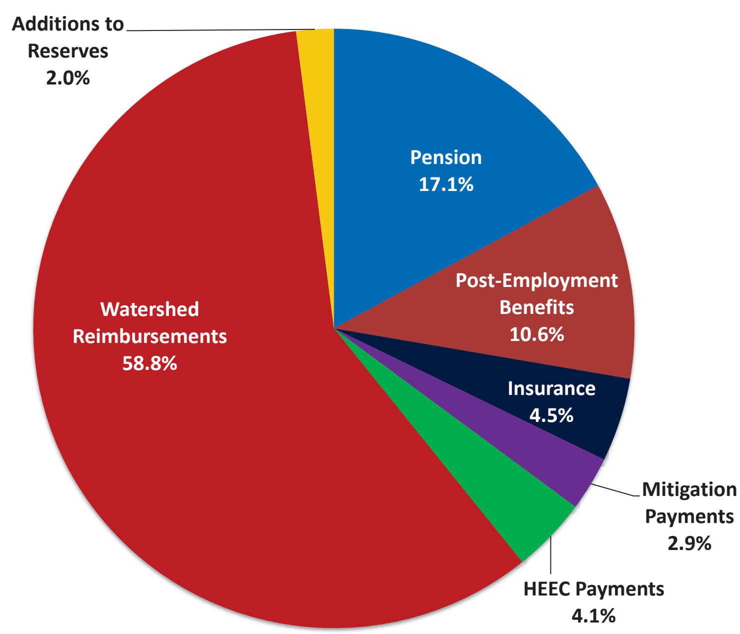

Figure 23

- Pension is 98.3% funded[40]
- "Virtual Full Funding" is an industry te recognizes how difficult it is to get to exa funding of the pension liability; it is co between 95% and 105% funded
- FY16 Pension annual required contribution $8.2 million is based on:
  - A valuation report as of January 20
  - A FY24 funding schedule
- Other Post-Employment Benefits (OP treated together with pension obligations a marks the first payment; going forward, t liability will be actively funded
- The OPEB/Additional Pension Deposit li ($5.1 million) is expected to be deposite newly created OPEB Trust Fund in FY16
- Insurance expense based on five-year average
- HEEC payments for O&M and debt service charges decline. The current agreement runs until May 2015
- Costs of the Office of Watershed Management are treated as a reimbursement to the state and include PILOT payments and debt service on watershed land purchases, as well as direct operating expenses

[40] As of January 1, 2015

“DELTA REPORT”

Indirect Expenses Increase $241 Thousand

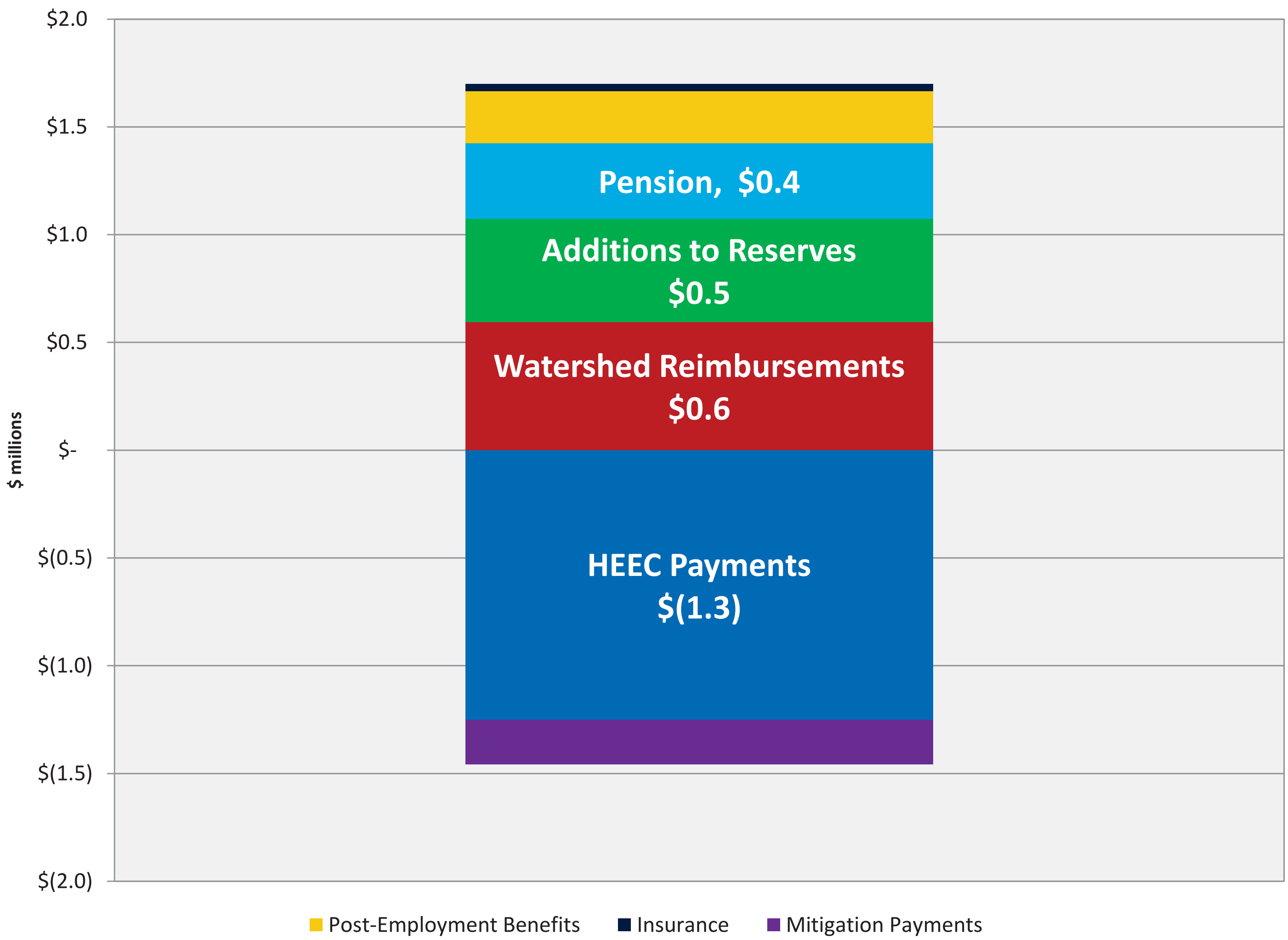

Figure 24

Other Post-Employment Benefits (OPEB) and Pension

- Retirement fund currently scheduled to be fully funded by 2024
- FY15 pension expense: $12.6 million
  - $7.81 million = annual required contribution
  - $4.82 million = optional contribution
- Proposed FY16 pension expense: $8.2 million
  - $8.16 million = annual required contribution (ARC)
  - Additional Pension Deposits had been made each year to fully fund the pension before beginning to fund the OPEB liability. Because the pension fund has reached virtual full funding, this expense will go to OPEB.
- Proposed FY16 OPEB/Additional Pension expenses: $5.06 million
  - Authority will make the first OPEB contribution out of the CEB now that the pension fund has reached virtual full funding
- Governmental Accounting Standards Board (GASB) Statement No. 45 governs the accounting and financial reporting of OPEB
  - Governmental entities are not currently required to fund OPEB
  - All entities comply with GASB 45 by accounting and reporting on its OPEB liability

- The Authority has met all current provisions of GASB 45

Policy Point

Other Post-Employment Benefits

"From Heads to Tails"

History of Other Post-Employment Benefits (OPEB)

The interrelated topics of the MWRA's Retirement Fund and Other Post-Employment Benefits (OPEB) liability have been a perennial subject of the Advisory Board's review, both from a financial and a policy standpoint.

Beginning in FY 2007 the Authority was required to begin accounting for and reporting its unfunded OPEB liability under the terms of the Governmental Accounting Standards Board Statement 45 (GASB 45). At the time, discussion of the Authority's OPEB liability centered on whether or not to pre-fund it, and the fact that for any contribution to reduce the unfunded liability it would need to be made into an irrevocable trust.

At the time, the Advisory Board expressed a few concerns with prefunding its OPEB liability, some of which were related to the irrevocable trust. First, there was a concern that placing funds in an irrevocable trust would make them entirely inaccessible later on. Subsequently, an understanding that the funds could be drawn down to fund the "pay-as-you-go" (PAYGo) expenses was reached; however, the Advisory Board had another concern related to the irrevocable trust. Namely, that the creation of a trust *without* funding could potentially be viewed negatively by the rating agencies, which might in turn pressure the Authority into making regular contributions. Moreover, as the Advisory Board pointed out at the time and repeated in the intervening years: there is no obligation to fund any of the OPEB liability other than the PAYGo. The only requirements of GASB 45 were and are to account for the unfunded liability and disclose said numbers on the balance sheet. The Authority, therefore, has met and continues to meet the requirements of GASB 45 as they currently exist.

The other reason the Advisory Board advocated for a measured approach toward OPEB was the fact that the pension was not yet fully funded, and (unlike OPEB) had a legal deadline to be met through sizable annual payments. Fortunately, the Authority and its financial advisors proposed a way of viewing both the pension and OPEB liabilities not as two separate liabilities, but rather as one total unfunded liability. The phrase that came out of these discussions was that each of the liabilities were, in fact, "two sides of the same coin."[41]

In light of this new outlook, the Advisory Board formally recommended that the Authority continue its aggressive schedule to fully fund the pension by 2024 (the Commonwealth at the time allowed for funding schedules to be extended to 2040, and only then turn its attention toward addressing the unfunded OPEB liability.[42]

At the time of this writing, another major milestone for the Authority has been reached. The MWRA retirement fund has reached "virtual full funding." The concept of "virtual full funding" was raised by MWRA staff in response to questions about how to determine and maintain full funding of the pension. Indeed, almost the instant the pension reached 100% funding, it would invariably move away from this 100% mark. If investments gained, funding would exceed 100%, and if investments experienced loss, funding would dip below 100%. How, then, could the retirement fund be defined as fully funded with these inevitable variations? The solution they determined from industry accepted practices was the concept of "virtual full funding," which is defined as funding anywhere in the range from 95% - 105%. The most recent Retirement

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[41] July 2008 MWRA Board of Directors staff summary (http://mwraadvisoryboard.com/wp-content/uploads/2015/05/July-2008-OPEB-Staff-Summary.pdf)

[42] Recommendation was in the *Integrated C&R* for the proposed FY12 CEB/CIP.

System Valuation has identified the pension as 98.3% funded as of January 1, 2015, well within the "virtual full funding" range.

Understanding this was a likely scenario, the Advisory Board had engaged in discussions with Authority staff about beginning to address the Authority's OPEB liability, consistent with the Advisory Board's prior recommendation. In April 2015, the MWRA Board of Directors voted to establish an irrevocable trust to begin accepting contributions toward the OPEB liability.

There was, however, one last concern the Advisory Board raised about OPEB contributions as they related to the Operating Reserve Requirement. The General Bond Resolution requires that the Authority maintains a reserve equal to no less than one-sixth of the annual operating expenses for the current fiscal year. Included in the "operating expenses" enumerated were contributions to the retirement fund. The Advisory Board had long conceded this point; indeed, given the legal requirement to fully fund the pension by a date certain, arguing that such contributions were required operating expenses made sense. However, the Advisory Board questioned OPEB contributions as triggering the Operating Reserve Requirement. If, as noted before, there was no obligation to fund OPEB, the Advisory Board reasoned that such expenses should not be included in the calculation of the annual operating reserve balance. To give an idea of the impact, a $10 million annual contribution would require an additional $1.7 million to be raised and placed in the Operating Reserve.

When discussing the next steps to begin funding OPEB this spring, the Advisory Board once again raised this concern. Finance staff at the Authority, being in general agreement, inquired further with bond counsel who similarly agreed that OPEB contributions should not be subject to the Operating Reserve Requirement. The Advisory Board thanks Authority staff for pursuing this issue further, which will allow for a savings of $850 thousand in the FY16 CEB (see below). The Advisory Board also congratulates the Authority on maintaining its strategy to aggressively bring the pension to full funding and then turn toward addressing the OPEB liability.

Strategy to Fund OPEB

Pension Funding Level

First, the Advisory Board officially endorses the "virtual full funding" concept, which defines the pension as fully funded if the system's valuation is between 95% - 105% of the targeted funding level. By adopting this definition, the current valuation of the retirement system (98.3% funded as of January 1, 2015) means the pension is virtually fully funded.

OPEB Irrevocable Trust

Understanding that funds cannot reduce the OPEB liability unless they are placed in an irrevocable trust, the ***Advisory Board officially supports and endorses the MWRA Board of Directors' establishment of the irrevocable trust as presented at the April 2015 Board of Directors meeting.***[43]

The Advisory Board expects that future contributions to the OPEB trust will not trigger the need for the one-sixth Operating Reserve Requirement, per the opinion of bond counsel.

The Advisory Board notes that should funding OPEB become a legal obligation according to a specific schedule similar to the retirement fund, these contributions may subsequently be subject to the terms of the Operating Reserve Requirement. Authority staff has also identified one other scenario that would make OPEB contributions subject to the terms of the Operating Reserve Requirement, which is a policy voted by the MWRA Board of Directors on OPEB funding. **In order to avoid triggering this requirement, the Advisory Board recommends that any strategy toward funding the OPEB liability**

[43] http://mwraadvisoryboard.com/wp-content/uploads/2015/05/BOD-Pack-2015-04-15.pdf

be framed as the Authority's "approach" or "practice" rather than as a formally voted policy of the MWRA Board of Directors.

FY16 OPEB Contribution

As noted in the Capital Financing Chapter (see Long-Term Rates Management, page 54), the MWRA Board of Directors voted to implement the Long-Term Rates Management Committee's recommendation to use a portion of the released reserves as an initial contribution toward OEPB. ***As noted in that chapter, the Advisory Board supports the Long-Term Rates Management Committee's recommendation and the subsequent MWRA Board of Directors vote to use $10 million of the unencumbered released reserves as an initial deposit into the OPEB irrevocable trust.*** Indeed, at the time of this writing, the irrevocable trust has been established and the $10 million has been deposited.

The Authority has also noted that in FY08 there had been an additional $800 thousand placed in an account (though not an irrevocable trust) intended as a contribution toward the OPEB liability. Similar to the $10 million discussed above, this amount has already been added to the irrevocable trust. ***The Advisory Board supports the Authority's actions in making this $800 thousand deposit into the OPEB irrevocable trust.***

Separate from these deposits, the Authority has included in the proposed FY16 CEB approximately $5.1 million for "Postemployment Benefits/Additional Pension Deposit." In recent years, the Authority renamed this line item to indicate that the amount budgeted could be used for either an OPEB contribution or an additional pension contribution. In practice, the Authority had acted consistent with its "two sides of the same coin" strategy to address the pension liability first before addressing OPEB by depositing the budgeted amount into the retirement fund.

This year, however, the landscape is a bit different. Having achieved virtual full funding, the Authority is now in the position to "flip the coin over" to begin directing these funds to the OPEB liability if it is the will of the MWRA Board of Directors.

Given the virtual full funding of the pension and consistent with its prior recommendation the Advisory Board endorses designating the $5,062,470 in the proposed FY16 CEB as an intended contribution toward the OPEB liability rather than as an additional pension payment.

Especially since the market dislocation in FY 2007, one of the Advisory Board's aims is to preserve the Authority's flexibility to address unforeseen financial circumstances. Toward that end, the Advisory Board recommends that the $5,062,470 in the proposed FY16 CEB be deposited on the final day of FY 2016 to allow the Authority flexibility to use these funds for other purposes if deemed necessary.

Consistent with the recent opinion of bond counsel and the Advisory Board's earlier positions, **the Advisory Board recommends that the FY16 CEB be reduced by $843,745 - the amount that had been budgeted in case OPEB contributions were found to trigger the Operating Reserve Requirement.**

Future OPEB Contributions

The Authority currently includes in its planning projections an assumption of 50% of the Annual Required Contribution (ARC) defined in the OPEB actuarial report. The Advisory Board would like to take this opportunity to point out one misnomer as it relates to the OPEB contribution. Because there is no actual requirement to fund OPEB, the term "Annual Required Contribution" as it relates to this unfunded liability can be somewhat misleading. To avoid confusion with the pension ARC, which is actually a required minimum level of payment, the Advisory Board will henceforth refer to this term as the Actuarial Calculated Contribution (ACC). In reality, if there were a requirement to fund this liability similar to the pension, the Authority would not be able to opt for a 50% of the ACC level of payment.

Authority staff has shared that other public agencies that are funding OPEB are funding at 50% of the ACC or less, so the Advisory Board recognizes this level as an emerging trend; however, **at this time the Advisory Board recommends that contributions to OPEB be no greater than 50% of the ACC.** As has often been the Advisory Board's perspective, the Authority should be aiming for targets similar to like entities, but not necessarily "lead the pack" as it were.

Similar to the recommendation above, the Advisory Board wishes to preserve the Authority's flexibility to use any or all of these funds to address any unexpected needs that may arise. **Therefore, the Advisory Board recommends that the Authority adopt the practice of depositing any funds intended as an OPEB contribution on the last day of the fiscal year in which they are intended to be deposited.**

Insurance

- Based on three-year average
- Insurance program is out for bid with award anticipated spring 2015
    - Has been on an annual renewal schedule, though multi-year bids are currently being reviewed

Additions to Reserves

- The Operating Reserve level requirement: 1/6th of all designated expenses
    - Proposed FY16: $962 thousand
    - Final FY15: $483 thousand
- Throughout these *Comments*, the Advisory Board is recommending updates and other modifications to the proposed budget, which will result in the need to update the proposed budget for increased deposits to the Operating Reserve
- **The Advisory Board recommends that the Authority reduce the "additions to reserves" line item by $207,404 to reflect reductions to applicable expenses as recommended by the Advisory Board (see Appendix C).[44]**

Watershed Reimbursement

- Other costs relating to watershed management have been added in recent years to both the Authority's CEB and CIP budgets. These include funding for new acquisition of watershed lands, dam repairs and PCB removal, as well as dam inspections and invasive species surveys and control.
- Watershed related debt service reflects an even, multi-year payment schedule and remains at $5.6 million per year

Table 24

Watershed Reimbursement

EXPENSES	FY15 Budget	FY16 Proposed	Δ ($s)	Δ (%)
Operating Expenses	$14,833,003	$15,157,350	$324,347	2.2%
Debt Service	5,608,833	5,608,833	0	0.0%
Revenue	1,000,000	1,005,000	5,000	0.5%
SUBTOTAL	$19,441,836	$19,761,183	$319,347	1.6%
Payment in Lieu of Taxes (PILOT)	8,100,000	8,300,000	200,000	2.5%
TOTAL	**$27,541,836**	**$28,061,183**	**$519,347**	**1.9%**

[44] Note: this reduction does not include the reduction related to the OPEB contribution.

Table 25

Watershed Revenues				
EXPENSES	**FY15 Budget**	**FY16 Proposed**	**Δ ($s)**	**Δ (%)**
Interment Fees	$0	$0	$0	0.0%
Fish & Boating/Deer Hunt	260,000	240,000	(20,000)	-7.7%
Rents	0	0	0	0.0%
Forestry Sales	125,000	125,000	0	0.0%
Miscellaneous	15,000	50,000	35,000	233.3%
Prior Year Refunds	0	0	0	0.0%
Hydropower/Tr Lines	600,000	590,000	(10,000)	-1.7%
TOTAL	**$1,000,000**	**$1,005,000**	**$15,000**	**1.5%**

Policy Point

Watershed Green Certification

"One Twig at a Time…"

During FY 2010, both the Department of Conservation and Recreation (DCR) and the Division of Water Supply Protection (DWSP) had received some press coverage related to reports of "clear cutting" in some areas of forest. DWSP acknowledged that some of the forestry activity had been done outside of the guidelines established and allowed by DCR.

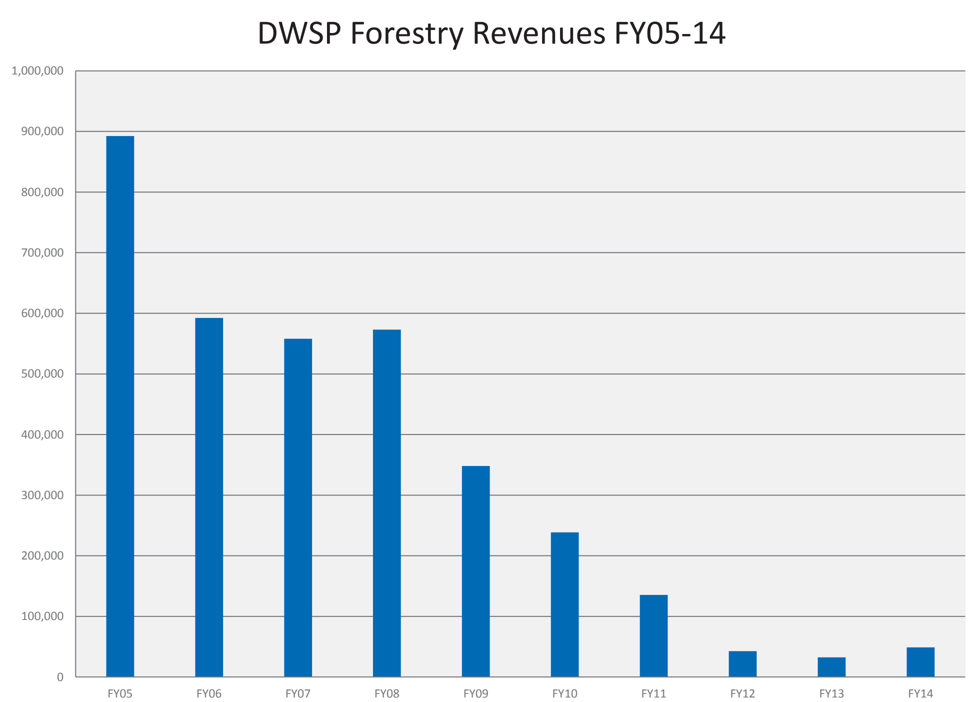

Figure 25

In response, the decision was made to reconvene the Quabbin Science and Technical Advisory Committee (STAC) to conduct an audit of the watershed forestry management program. Thirty months later, much to the chagrin of the Advisory Board, the STAC report was released in December 2012 with a comment period through January 2013.

The Advisory Board's comments were to immediately implement the findings of the STAC report and to begin its forestry program according to the recommendations of the STAC report. As seen in Figure 25, forestry revenues were in the $500 thousand-plus range until the forestry program was halted for STAC's review. Since then, there has been very little growth in revenue from the forestry program.

The Advisory Board recognizes that the watershed is crucial for the protection of the water supply. Indeed, the Advisory Board has even bought into the concept of an actively managed forestry program to assist in the natural filtration of the water supply.

Furthermore, the Advisory Board reiterates its recommendation from the *Integrated Comments* on the Proposed FY14 CEB: **DCR should pursue a "green" recertification of DWSP lands through the Forest Stewardship Council.**

Beyond "green" recertification, **the Advisory Board remains concerned about the results of the forestry program since it has been restarted, and recommends that DWSP make a formal presentation to the MWRA Board of Directors comparing the current status of the forestry program with the recommendations of the STAC report to see what progress has been made.**