# FY 2023 Comments and Recommendations

on the MWRA's Proposed
Capital Improvement Program & Current Expense Budget

MWRA
Advisory Board

JUNE 2022

# Executive Committee



# The MWRA Advisory Board...

was established by the State Legislature to represent 60 communities in the MWRA service area. Through annual comments and recommendations on the Authority's proposed capital and current expense budgets and rates, the Advisory Board provides a ratepayer perspective on the MWRA's plans and policies to improve the region's water and sewer systems.

# Introduction

The world has changed. As the world, the nation, and the Commonwealth attempt to move toward the still uncertain "new normal" following the global pandemic, many uncertainties remain.

The future of work remains unclear. The Great Resignation has shaken the foundations of the previously predictable workforce and hiring process for many industries, and the water/wastewater industry is no exception. The Authority is grappling with significant challenges brought on by the pressure of an increase in retirements due to the age of its current workforce, as well as the challenges of hiring new employees, particularly many operations positions that require specific professional licenses.

The MWRA's pension system is on track to be fully funded by 2030; however, the costs to meet this deadline are projected to increase steeply due to the pressure of the decreasing amount of time to achieve full funding.

The MWRA has also been affected by unprecedented inflation on key expenses including utilities and chemicals, causing additional pressure on its Current Expense Budget (CEB), and calling into question the timing of capital projects within the Capital Improvement Program (CIP) as well.

On top of these direct challenges, the many uncertainties facing the nation and the world – the current conflict in Ukraine, the reaction of the stock market as the Fed begins to raise interest rates, and more -could have far-ranging impacts upon the Authority's operations and finances moving forward.

These are many of the challenges and pressures facing the Authority, and these provide the context within which we undertake this year's review of the MWRA's Proposed FY23 CIP and CEB.

Our recommendation for FY23 is for a combined 2.85% increase – a 16.7% reduction from the MWRA's proposed 3.42% increase. Areas we identified for reduction include:

- Receipt of Debt Service Assistance of about $1.18 million, which we thank the House and Senate for making possible
- Increasing the assumed vacancy rate for the MWRA to more closely match current trends

The Advisory Board remains committed both to its approach to achieve sustainable and predictable rate revenue requirement increases for its communities, as well as to push the Authority toward its "2.4% by '24" goal. One change you will see in this year's Comments & Recommendations is an enhanced focus on the water/sewer utility split for both expenses as well as rate revenue requirement increases. In particular, the waterworks utility is projected to have significant capital financing costs within the next several years, putting pressure on the water assessments' rate of increase. While the stated goal of the Advisory Board is to achieve a 2.4% combined rate revenue requirement increase in FY24, the Advisory Board also recognizes the need to address the separate utilities' challenges as part of a rates management strategy moving forward.

One theme you will find throughout our review is the recognition that there are three timeframes to address the various challenges facing the MWRA: short-term, mid-term, and long-term. There are the short-term issues we previously identified as impacting the Authority now and in the next few years; the mid-term issues that provide significant rates management challenges; and long-term impacts dealing with the unfolding of the "new normal" and the continued pressure of the MWRA's remaining unfunded benefits liability and capital financing obligations.

We present this year's Comments & Recommendations not as a one-year snapshot, but rather as a potential roadmap to consider in managing the Authority's expenses and the resulting impacts on communities and ratepayers into the future.

# FY 2023 CEB OVERVIEW

| MWRA Current Expense Budget ($ millions) | FY22 Budget | FY23 Proposed | $ Change | % Change |
|---|---|---|---|---|
| *Expenses* | | | | |
| Direct Expenses | 259.8 | 267.7 | 7.8 | 3.02% |
| Indirect Expenses | 56.7 | 58.6 | 2.0 | 3.47% |
| Capital Financing | 496.5 | 514.0 | 17.4 | 3.51% |
| ***Subtotal Expenses*** | ***$813.0*** | ***$840.2*** | ***$27.2*** | ***3.35%*** |
| *Offsets* | | | | |
| Bond Redemption | 0.0 | 0.0 | 0.0 | - |
| Debt Service Assistance | (0.9) | 0.0 | 0.9 | -100.0% |
| ***Subtotal Offsets*** | ***-$0.9*** | ***$0.0*** | ***$0.9*** | ***-100.0%*** |
| **Net Expenses** | **$812.1** | **$840.2** | **$28.1** | **3.5%** |
| *Revenues* | | | | |
| Other User Charges | 2.8 | 9.9 | 7.1 | 250.3% |
| Other Revenue | 9.3 | 16.0 | 6.7 | 71.9% |
| Rate Stabilization | 1.3 | 1.0 | -0.3 | -21.6% |
| Investment Income | 4.0 | 4.1 | 0.2 | 4.5% |
| ***Subtotal Non-Rate Revenue*** | ***$17.3*** | ***$31.0*** | ***$13.6*** | ***78.7%*** |
| ***Rate Revenue*** | ***$792.1*** | ***$819.1*** | ***$27.1*** | ***3.42%*** |
| **Total Revenue and Income** | **$809.4** | **$850.1** | **$40.7** | **5.0%** |

$7.92 million ≈ 1% of FY22 rate revenue

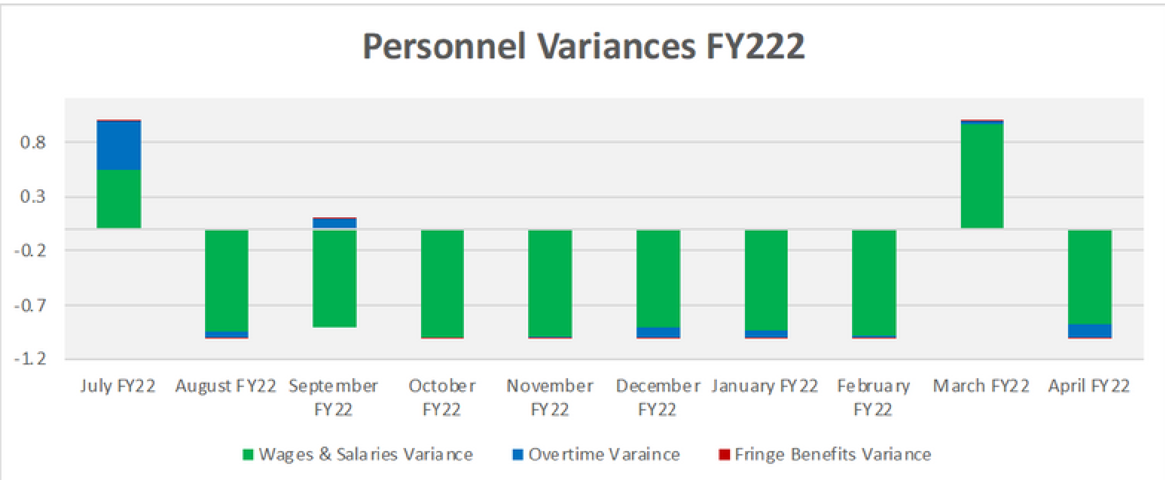
**Recommendation: The Advisory Board recommends reducing the FY23 Rate Revenue Requirement by $4,503,320 resulting in a combined wholesale assessment increase of 2.85%**

# Personnel

| Proposed Fiscal Year 2023 Personnel Expenses Summary ($s) | | | | |
|---|---|---|---|---|
| *Line Item/Description* | *Final FY22* | *Proposed FY23* | *Δ ($s)* | *Δ (%)* |
| *Regular Pay* | $114,904,106 | $115,813,644 | $909,538 | 0.8% |
| Regular wages and salaries for full- and part-time employees. | | | | |
| *Other Pay* | 1,776,235 | 1,923,422 | 147,187 | 8.3% |
| Includes shift differential, holiday pay, temporary employees, interns/co-ops, and stand by pay. | | | | |
| **Wages and Salaries Subtotal** | 116,680,341 | 119,281,491 | 2,601,150 | 2.2% |
| **Fringe Benefits** | 23,253,137 | 24,287,374 | 1,034,237 | 4.4% |
| Includes health insurance, dental insurance, Medicare, and all other fringe benefits. | | | | |
| **Overtime** | 5,156,681 | 5,337,898 | 181,217 | 3.5% |
| For planned maintenance, emergency, and coverage. | | | | |
| **Workers' Compensation** | 2,614,159 | 2,519,751 | -94,408 | -3.6% |
| Includes compensation payments, medical payments, and other related costs. | | | | |
| **TOTAL PERSONNEL EXPENSES** | **$147,704,318** | **$151,426,514** | **$3,722,196** | **2.5%** |

During each budget review process, the Advisory Board carefully monitors the Authority FTE levels and recommends adjustments to Personnel spending if needed. Often, the MWRA is not forecasted to fill all budgeted positions and the Advisory Board recommends a reduction in spending. This reduction is always attached with an assurance that the Advisory Board does not want to eliminate any Authority positions but acknowledges that it takes time to fill a position with the best candidate. The Advisory Board is fully supportive of the MWRA striving to reach its goal of 1,167 FTE as recommended in its last staffing study from 2012.

Staffing trends in this year's budget review, however, are showing very different trends. Through March, there were 56 fewer average FTEs making the total 1,111. There have already been 112 employment changes (resignations/retirements/terminations) so far in FY22. There were only 77 employment changes in FY21. As of March 2022, Wages and Salaries are under budget by $8.6 million or 10.3%.



# Personnel

The Advisory Board believes that the MWRA staffing shifts warrant more than a spending adjustment recommendation. The Authority could find itself overstretched if trends continue. It is pertinent that the source the staffing shifts is determined and analyzed to successfully retain current employees and recruit future employees. During the 2012 staffing study, the adequate staffing levels were analyzed but not the workplace environment and compensation. The Advisory Board believes it is time to analyze these factors in an updated staffing study.

**Recommendation: The Advisory Board Recommends that the Authority have a staffing study conducted by a third party to determine adequate staffing and compensation levels.**

**Recommendation: For FY23, the Advisory Board also recommends adjusting the proposed vacancy rate of 21 FTE to 27 FTE for a total Personnel expense reduction of $2,700,000.**

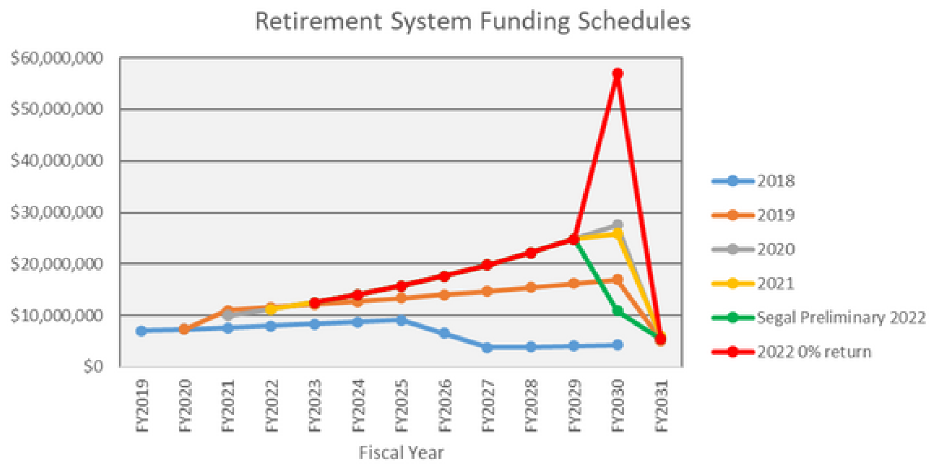
**Water: $-1,100,000 Sewer: $-1,600,000**

| Proposed Fiscal Year 2023<br>Indirect Expenses Summary<br>($s) | | | | |
|---|---|---|---|---|
| ***Line Item/Description*** | ***Final FY22*** | ***Proposed FY23*** | ***Δ ($s)*** | ***Δ (%)*** |
| **Pension** | $11,205,000 | $12,555,203 | $1,350,203 | 12.1% |
| Scheduled updated contribution to retirement fund. | | | | |
| **Post-Employment Benefits/Additional Pension Deposit** | 4,673,624 | 4,754,061 | 80,437 | 1.7% |
| All other benefits for retirees (e.g. health insurance). | | | | |
| **Insurance** | 3,943,600 | 3,916,002 | -27,598 | -0.7% |
| Insurance and payments/claims. | | | | |
| **Mitigation Payments** | 1,693,360 | 1,735,694 | 42,334 | 2.5% |
| Mitigation payments to Quincy and Winthrop. | | | | |
| **HEEC Payments** | 6,991,953 | 6,225,566 | -766,387 | -11.0% |
| Cross harbor cable to Deer Island (includes both debt service and O&M components). | | | | |
| **Watershed Reimbursements** | 26,731,490 | 28,023,798 | 1,292,308 | 4.8% |
| Supports the operations and related costs of the state's Department of Conservation and Recreation, Office of Watershed Management. | | | | |
| **Additions to Reserves** | 1,412,647 | 1,406,800 | -5,847 | -0.4% |
| 1/6th of all planned Operating Expenses. | | | | |
| **TOTAL INDIRECT EXPENSES** | **$56,651,674** | **$58,617,124** | **$1,965,450** | **3.5%** |

# Pension

The MWRA is at the vanguard with regard to its approach on fully funding its pension obligation. The retirement fund CY 2020 actuarial study (dated January 2021) showed its funding level at 88.23%, and it has one of the more aggressive funding schedules in the Commonwealth, with full funding scheduled to be achieved by 2030, rather than the 2040 deadline adopted by many public pension systems.

However, being ahead of the pack sometimes comes with unforeseen consequences. For one, because the pension's deadline for full funding is only seven years away means the entire remaining liability needs to be addressed within that timeframe, regardless of the performance of investments within the retirement fund. The fact that current state law makes no mention of anything other than a date-certain for full funding means that each subsequent year, the MWRA retirement fund has one year less to meet its funding deadline regardless of investment performance. For example, imagine if in 2029 the retirement fund broke even and did not meet its estimated rate of return on its investments. That would mean that the MWRA must make a contribution of not only the amount originally planned for the 2030 contribution, but also the amount of investment income the retirement fund failed to achieve the prior year. All within one year as demonstrated in this chart:



This chart shows the recent funding schedules according to the recent years' actuarial valuations including the preliminary CY 2022 valuation recently provided to the MWRA by Segal. The red line models the example discussed above, where in the last year prior to the funding deadline the MWRA experiences an investment income return of 0%. Using the retirement system's actuarial value of assets (AVA) from the CY 2022 preliminary actuarial valuation with the assumed rate of return on investments of 6.9%, the assumed amount of investment income on the MWRA's AVA is $46 million in 2022. Add that to the amount the MWRA is scheduled to contribute according to the preliminary 2022 schedule, and it would increase the MWRA's contribution in 2030 to $56.9 million – more than double the amount included in the Proposed FY23 CEB planning projections. It's also important to note that this calculation is based on 2022 numbers. Presumably, the AVA will be much higher by 2029 after additional contributions are made and investment income realized over the next seven years, meaning the amount could actually be far greater. However, this provides an order of magnitude this challenge would present.

The yellow line in the chart shows the CY 2021 valuation that the Proposed FY23 CEB was based upon, with pension expenses for the MWRA continuing to climb until 2030, reaching nearly $26 million in 2029 – more than double the $12.6 million included in the FY23 proposed CEB pension expense line item. As projected in the proposed FY23 CEB, pension expense will total $170 million between FY22 and FY30. These increasing levels of pension expense are unsustainable from a rates management perspective.

The Advisory Board sees this current 2030 deadline to fully fund the pension and the projected amount of spending to do so as one of the largest challenges facing the MWRA. However, the Advisory Board would also like to reframe the challenges of funding the MWRA's pension system into three timeframes to be addressed: the short-term, the mid-term, and the long-term. Toward that end, the Advisory Board is recommending a "Pillars of Pension" plan to address the three facets of this challenge.

## "Retiring the Pension"

### Pillars of Pension Plan

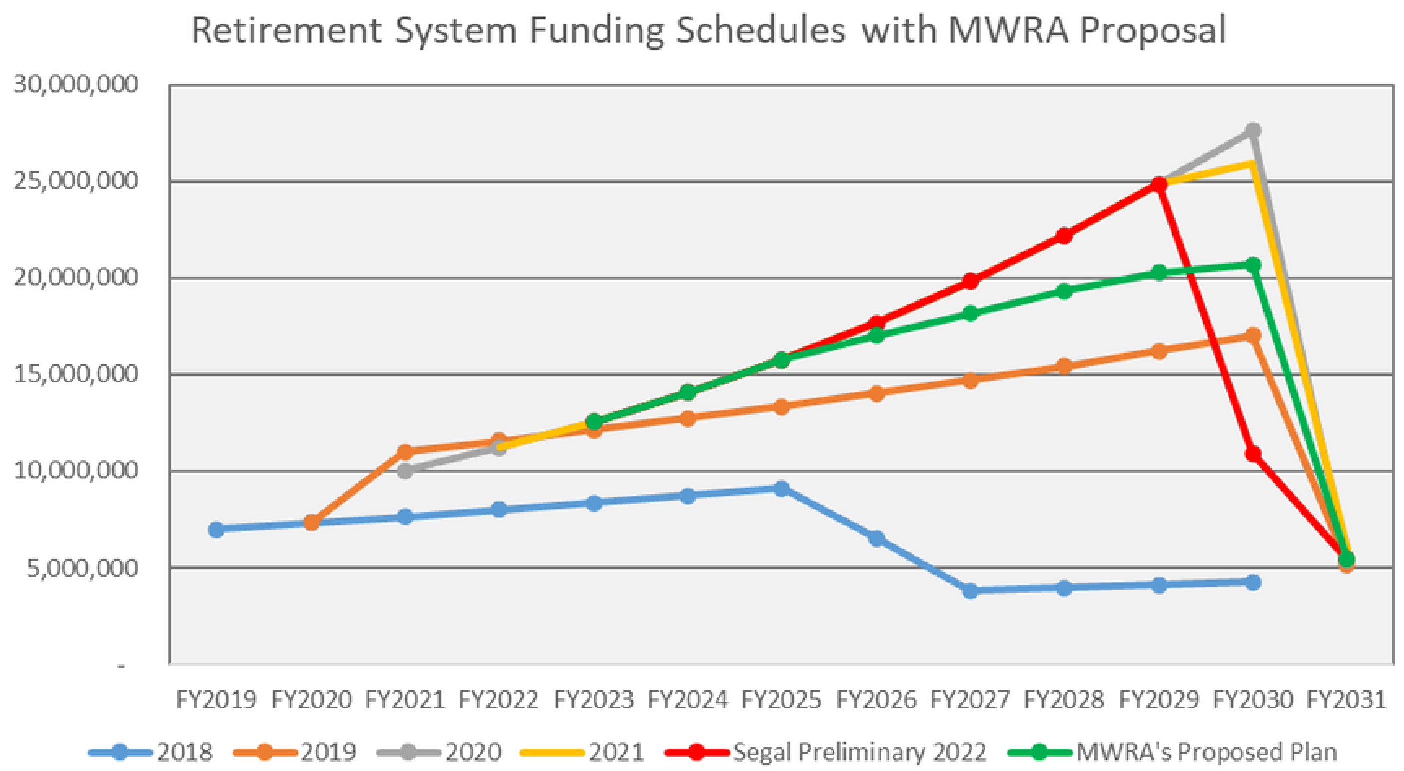
1. **If the 2021 actuarial study numbers are favorable, MWRA should use the updated numbers to recalculate the projected future pension contribution costs in the final FY23 CEB and accompanying planning projections.**
2. **Consistent with the "two sides of the same coin" approach endorsed by the MWRA Board of Directors, MWRA should shift the OPEB contribution in the water utility FY23 CEB to the pension line item and continue to do so until "virtual full funding" level is achieved (95%-105%).**
3. **The MWRA should shift optional debt prepayments in the sewer utility FY23 CEB into the pension line item and continue to do so until full funding (not virtual) is achieved.**
4. **The MWRA should propose to the Retirement Board a one-time use of water rate stabilization funds to the pension calculated to achieve no less than 90% funding on the overall pension unfunded liability, keeping this deposit in either cash or a stable capital preservation vehicle to isolate it from potential negative market impacts. This one-time deposit will be contingent upon:**
5. **A vote of the Retirement Bboard to extend the date for full funding of the retirement fund to 2033, and to delegate authority to the Executive Director of the Retirement Board to request that PERAC approve a one-year extension in future if certain criteria are met to simulate a rolling 10-year funding schedule up through 2040.[1]**
6. **MWRA should work with the Advisory Board, and other retirement system stakeholders to secure legislation to amend Chapter 32 to authorize the state actuary to develop a plan that addresses well-funded, short-to-full amortization systems like the MWRA, with the goal of shifting to a rolling date for full funding if certain criteria are met (e.g. the system must be 90%+ funded)**

[1] Note: the criteria still need to be determined. Possibilities include not meeting the MWRA's anticipated actuarial rate of return.

### 2021 Actuarial Study

As of this writing, the updated actuarial study of the MWRA's retirement fund has been received and the numbers are favorable, as anticipated. The funding ratio shifts from 88.23% to 89.71% funded, reducing the total unfunded liability by $83.9 million to $76.4 million to be funded by 2030. The MWRA already plans to incorporate these updated numbers in the FY23 planning projections.

In its preliminary valuation, Segal proposed realizing this actuarial savings by reducing the 2030 pension expense line item, as is shown on the red line in the chart below. However, this leaves the prior years with significant contributions to be made.




The Advisory Board understands that the MWRA proposed to the Retirement Board that the actuarial benefit of the updated CY 2021 actuarial study (dated January 2022) be spread over the final five years to assist with the dramatic increases seen in prior valuation projected expenses rather than realizing the benefit solely in FY30. This can be seen plotted on the green line in the above chart. Unfortunately, this recommendation has not been adopted by the Retirement Board as of yet.

The proposal would have targeted the most benefit at the years that had the most need, helping to lower the amount of rate revenue requirement projected for pension expense. This seems like a commonsense win-win-win for the MWRA, the pension system, and thereby the employees.

*Comment: The Advisory Board recommends that the Authority reduce the FY22 proposed budget request by $1,162,500 for Capital Financing through the tools available to the Treasurer, including defeasance, refunding or a reduction in the optional debt payment.*

### OPEB Contribution - Water

Years ago, when GASB45 required public pension systems to begin accounting for and reporting the balance of their unfunded other post-employment benefits (OPEB) liability on their balance sheet, the MWRA began to explore options to begin addressing this unfunded liability. MWRA staff made the argument that both liabilities were "two sides of the same coin," meaning that they each reflected one part of an overall total liability that needed to be addressed. Because there was a date-certain funding deadline for the pension system, but not one for the OPEB liability, the decision was made to "aggressively pay down" the pension liability until "virtual full funding" was achieved. Virtual full funding was defined as the pension's funding ratio to be within the 95-105% range. MWRA met this goal and began to make payments toward its OPEB liability in 2015. As noted in the beginning of this section, using the preliminary CY 2022 valuation the pension currently sits at 89.71% funded, well below the minimum 95% to trigger the OPEB contributions.

The Advisory Board recognizes the importance of addressing the OPEB liability; however, because the funding level is so far below the 95% threshold, we are recommending an adjustment to the OPEB funding strategy.
To help aggressively target the pension's unfunded liability, the Advisory Board is recommending that the MWRA redirect water utility funds currently budgeted for OPEB to the pension line item and continue to do so until "virtual full funding" level is achieved (95%-105%).

**<u>Recommendation</u>: The Advisory Board recommends that the MWRA redirect water utility funds currently budgeted for OPEB to the pension line item and continue to do so until "virtual full funding" level is achieved (95%-105%).**

### Optional Debt Prepayment - Sewer

To ensure that the sewer utility doesn't fall behind on its portion of the pension obligation, the Advisory Board further recommends that the MWRA redirect optional debt prepayments in the sewer utility FY23 CEB into the pension line item and continue to do so until full funding (not virtual) is achieved.[2]

The Advisory Board believes that this is a solution that will assist the challenges the MWRA faces in fully funding the pension by 2030 both in the short-term as well as the mid-term.

**<u>Recommendation</u>: The Advisory Board recommends that the MWRA redirect optional debt prepayments in the sewer utility FY23 CEB into the pension line item and continue to do so until full funding (not virtual) is achieved.[2]**

[2] It should be noted that adjustments may need to be made to the amount deposited into the pension to account for the operating reserve requirement necessitated by the pension expense, which is not required for optional prepayment of debt service

## One-Time Use of Rate Stabilization Funds

The water utility has a combined balance of $54.8 million in bond redemption and rate stabilization funds. For comparison, the sewer combined balance totals $11.4 million. The Advisory Board feels it important to reiterate what rate stabilization funds **are** and are not. [3]

Rate stabilization funds are funds that were raised by the ratepayers in prior years that have been placed in dedicated accounts for the express purpose of rates management. Rate stabilization funds are not a reserve, such as the operating reserve. As such, the Advisory Board feels strongly that these funds should be used to help manage MWRA's rate revenue requirement.

That said, a quick analysis indicates that using rate stabilization as a one-time revenue source in one year generates a rate spike in the following year, requiring even more use of rate stabilization. This problem compounds over time until rate stabilization is depleted and the year after its last use will register a significant projected rate increase. This indicates that a more creative use of rate stabilization is warranted.

The Advisory Board believes fully funding the pension is critical and remains fully committed to doing so. Moreover, the Advisory Board has flagged the impending deadline and the dramatically increasing amounts of pension expense as a significant rates management challenge.

To help address this liability and to utilize rate stabilization funds – funds that were paid by communities and ratepayers – in a creative manner, the Advisory Board recommends that the MWRA propose to the Retirement Board a one-time use of water rate stabilization funds to the pension calculated to achieve no less than 90% funding on the overall pension unfunded liability, keeping this deposit in either cash or a stable capital preservation vehicle to isolate it from potential negative market impacts.

**Recommendation: The Advisory Board recommends that the MWRA propose to the Retirement Board a one-time use of water rate stabilization funds to the pension calculated to achieve no less than 90% funding on the overall pension unfunded liability, keeping this deposit in either cash or a stable capital preservation vehicle to isolate it from potential negative market impacts.**

This one time infusion of funds will not directly benefit the rate revenue requirement in FY23, because it would be an "over and above" contribution to the pension designed to quickly advance the funding level closer to 100%. However, it should decrease some of the pension expense in the remaining seven years of the payment schedule to some degree. Combined with the previous recommendations, this one-time infusion of capital should help address pension funding concerns in the short-term and the mid-term.

That said, there remains the long-term problem, for which there is currently no good solution. Namely, the existing legislation governing publicly funded pensions note a date-certain funding date. Currently, public systems are allowed to schedule this full funding date out to 2040 but, as previously noted, the Authority is currently on a 2030 funding schedule.

[3] For the purpose of brevity, this narrative will refer to both the combined total of rate stabilization funds and/or bond redemption funds as "rate stabilization funds" or "rate stabilization."

We have demonstrated the challenges of an ever-shrinking window of time to pay off the remaining unfunded liability and the susceptibility it has to negative market conditions. The 2030 deadline severely limits the MWRA's options moving forward and runs the risk of significantly impacting rates as the deadline grows ever nearer.

Previous discussions to extend the payment schedule at the Retirement Board have been contentious, and with good reason. The unfunded liability needs to be addressed and moving the funding schedule out appears to be "kicking the can down" the road, which is not the Advisory Board's goal or intention. Instead, the Advisory Board merely wants to provide the Authority with the flexibility it needs to address the liability while still keeping year-to-year pension expense reasonable from a rates management perspective.

As such, the Advisory Board's previous recommendation is contingent upon the next Pillar of Pension.

## Simulate a Rolling Funding Deadline

The Advisory Board asked MWRA staff what could be a solution to the issue of a date-certain deadline, since this issue clearly affects MWRA now, but will inevitably affect all publicly funded pensions as 2040 approaches. The response offered suggestions being discussed in the industry including the creation of a "rolling funding deadline." In essence, a system that is on target to fully fund its pension liability on schedule should be close to full funding as it approaches the deadline, so rather than arbitrarily extending the deadline, each year the deadline would advance one year ahead to reduce any negative impacts of the markets on retirement fund investments, and eliminate the possibility that the years immediately preceding the deadline will be suddenly tasked with absorbing an additional expense. Because the MWRA has an aggressive deadline of 2030, it still has the option to request an extension of its funding schedule from the Public Employee Retirement Administration Commission (PERAC). The Advisory Board believes there is a way to simulate such a rolling deadline with a well-balanced and strategic approach to extending the MWRA's current funding schedule.
Therefore, the Advisory Board's prior recommendation for a one-time use of water rate stabilization funds to immediately reduce the pension's unfunded liability is contingent upon:

**A vote of the Retirement Board to extend the date for full funding of the retirement fund to 2033, and to delegate authority to the Executive Director of the Retirement Board to request that PERAC approve a one-year extension in future if certain criteria are met to simulate a rolling 10-year funding schedule up through 2040.[4]**

Extension of the funding deadline to 2033 would bring the funding schedule back to ten years to provide some short-term relief on the accelerating pension expense, particularly in the last years leading up to the deadline. The second component is the critical piece, however. Delegating Authority to the Executive Director of the Retirement Board to request one-year extensions as needed would allow the MWRA the flexibility to react to market conditions in a way that minimizes unforeseen immediate increases to the pension expense line item. The Advisory Board recognizes that there should only be requests for extending the payment schedule should certain criteria be met; however, those criteria would need to be established and agreed upon by the MWRA and the Retirement Board. An example would be in the event the retirement fund's investments fell below its anticipated actuarial return for the year.

[4] Note: the criteria still need to be determined. Possibilities include not meeting the MWRA's anticipated actuarial rate of return.

## Secure a Continuous Rolling Deadline

As noted, the proposed solution above would only mimic the rolling deadline that would be helpful for well-funded, short-to-full amortization systems like the MWRA. The long-term solution is to secure such a rolling deadline in place of a date-certain deadline as currently exists. This, however, would require a change in legislation.

MGL Chapter 32 is the governing legislation for publicly funded pension systems. In both sections where funding schedules are discussed the language states that systems "may establish a revised retirement system funding schedule… which reduces the unfunded actuarial liability of the system to zero not later than June 30" of either 2030 or 2040, whichever the system has chosen.[5]

The language is unambiguous and sets a date certain for the system to reach zero unfunded liability, which could cause the potential problems we describe as the MWRA approaches its funding deadline. Moreover, this is a problem that will impact every publicly funded pension system unless it is resolved. The trouble is that two-thirds of the systems are on the 2040 funding schedule, meaning the impacts are distant from their perspective. For the MWRA and the remaining one-third on the 2030 funding schedule, the impacts are much nearer.

Because securing legislation would be a lengthy process, caution dictates that the efforts should begin now. As such, the Advisory Board recommends that MWRA work with the Advisory Board and other retirement system stakeholders to secure legislation to amend Chapter 32 to authorize the state actuary to develop a plan that addresses well-funded, short-to-full amortization systems like the MWRA, with the goal of shifting to a rolling date for full funding if certain criteria are met (e.g. the system must be 90%+ funded).

**Recommendation: The Advisory Board recommends that MWRA work with the Advisory Board and other retirement system stakeholders to secure legislation to amend Chapter 32 to authorize the state actuary to develop a plan that addresses well-funded, short-to-full amortization systems like the MWRA, with the goal of shifting to a rolling date for full funding if certain criteria are met (e.g. the system must be 90%+ funded).**

[5] § 22D and 22F

# Rates Management

The MWRA's overall goal related to rates management is the mantra "sustainable and predictable." They have used many tools over the years to help achieve this goal, while also working hard to meet the Advisory Board's challenges each year to reduce community assessments. The largest component of the MWRA's CEB is capital financing, so managing this line item is the most effective way to manage rates.

Recently, the MWRA has developed a new tool to assist with achieving sustainable and predictable rates that they refer to as "utility smoothing." This topic gained some attention at the Advisory Board's Finance Committee meeting, which introduced the tool to our member communities. Given the larger implications and the need to involve communities in the discussion of how this tool might be used, the Advisory Board will be holding another Finance Committee meeting in fall 2022 to review the MWRA's capital financing structure and discuss the various tools the MWRA has available to help manage capital financing expense, including "utility smoothing."

**Recommendation: The Advisory Board recommends that MWRA provide a detailed overview of its current capital financing plans, future strategies, and various tools or options available to the MWRA Advisory Board's Finance Committee.**

As it relates to proposed FY23 capital financing, the MWRA anticipates making some reductions to this line item. While the exact levels are uncertain, the Advisory Board is including some estimated reductions for this line item.

*Comment: The Advisory Board anticipates a lower than proposed capital financing cost. Differences should be adjusted in RRR.*

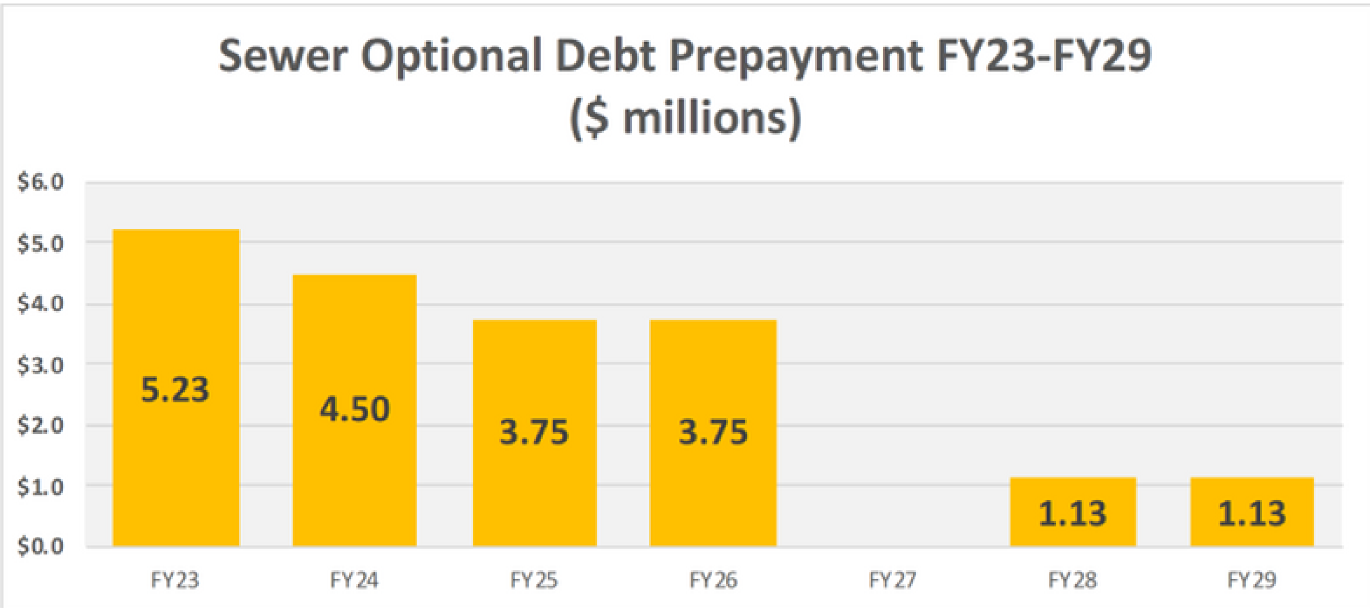
*Water: $-500,000 Sewer: $-1,000,000*

# Optional Debt Prepayment

Debt prepayment is a concept the Advisory Board continues to assess each fiscal year. In FY22, The Advisory Board recommended a reduction in spending this line-item while keeping it funded higher than it had been over the previous 2 years.

The Advisory Board maintains that it can only be supportive of debt prepayment if it helps lower the long-term costs that are to be paid for by communities. While the Advisory Board generally supports increasing levels of defeasance, it has grown concerned over another long-term cost. In FY23, the increasing liability of the nearing pension full funding date is an area that the Advisory Board believes needs to be addressed thoroughly.

Accordingly, The Advisory Board sees protentional in shifting the projected sewer optional debt payments towards the sewer pension liability. The amount of sewer debt prepayment in the proposed FY23 planning projections can be seen in this chart:




**<u>Recommendation</u>: The Advisory Board further recommends that the MWRA redirect optional debt prepayments in the sewer utility FY23 CEB into the pension line item and continue to do so until full funding (not virtual) is achieved.**

# Spring Revisits

As has been practice in recent years, the Advisory Board has incorporated updated information from the MWRA related to the proposed FY23 CEB into our Comments and Recommendations. The budget process begins early in the fiscal year, and by the time our Comments and Recommendations are submitted, much has changed. Not only is this year no different, but the changes are far more dramatic than in prior years, as is seen in the tables below.

| Water | | |
|---|---|---|
| **Direct & Indirect Cost Changes** | | |
| Wages & Salaries | $ | 129,231 |
| Fringe Benefits | $ | (121,568) |
| Chemicals | $ | 110,233 |
| Energy & Utilities | $ | 1,431,520 |
| Maintenance | $ | 164,313 |
| Professional Services | $ | (33,733) |
| Other Materials | $ | 27,868 |
| Other Services | $ | 84,841 |
| Watershed/Pilot | $ | 866,964 |
| Additions to Reserves | $ | 300,975 |
| Defeasance Impact | $ | (625,914) |
| **Subtotal of Changes to Operating Costs** | **$** | **2,334,730** |
| **Revenue & Income** | | |
| Investment Income | $ | (1,668,377) |
| **Subtotal of Rate & Revenue** | **$** | **(1,668,377)** |

| Sewer | | |
|---|---|---|
| **Direct & Indirect Cost Changes** | | |
| Wages & Salaries | $ | (330,033) |
| Fringe Benefits | $ | (204,166) |
| Chemicals | $ | 295,480 |
| Energy & Utilities | $ | 2,538,233 |
| Maintenance | $ | 346,023 |
| Professional Services | $ | (23,407) |
| Other Materials | $ | (1,903) |
| Other Services | $ | 166,474 |
| Additions to Reserves | $ | 462,260 |
| Defeasance Impact | $ | (308,286) |
| **Subtotal of Changes to Operating Costs** | **$** | **2,940,675** |
| **Revenue & Income** | | |
| Investment Income | $ | (2,779,791) |
| **Subtotal of Rate & Revenue** | **$** | **(2,779,791)** |

Unsurprisingly, current market conditions including inflation, supply chain issues, and ongoing global uncertainty related to the lingering COVID-19 pandemic and the conflict in Ukraine have all contributed to staggering increases, particularly for energy and utilities.

These increases – totaling nearly $5.3 million – only make achieving our recommended rate revenue requirement increase that much more difficult. We look forward to the MWRA's responses to our Comments and Recommendations, as well as any further updated information in their final FY23 CEB recommendation.

# CIP Spending Cap & Master Plan

FY23 will be the final year in the current CIP five-year spending cap. When this cap period began in July 2018, it was a completely different environment. The MWRA had to redefine many operations to maintain in the height of the pandemic and it will now have to redesign many dynamics as it moves into endemic.

The pandemic was a catalyst for underspending in FY20 and FY21, which the Authority hopes to overcome through FY22 and FY23. The halftime reshuffle brought on by the pandemic, however, has prompted the Advisory Board as ask if the parameters that go into setting the CIP spending cap need to be redefined. For FY23, the Advisory Board does not have a specific recommendation for the Capital Improvement Program but begins to lay the groundwork for reevaluating the spending cap and overall program as the current cap period comes to a close.

Similarly, the MWRA has commenced planning for its next iteration of its Master Plan. The Advisory will be active in this planning process and the MWRA plans beyond the current cap and beyond the impacts of the COVID-19 pandemic.

# Inflow/Infiltration Community Assistance

The Advisory Board's Operations Committee met on April 12, 2022 to receive an update on and discuss the community assistance programs in the CIP. Out of that discussion came the following recommendations that were subsequently approved by both the Executive Committee and the full Advisory Board:

1. **The Advisory Board recommends that the MWRA authorize and fund Phase 14 of the Inflow/Infiltration Community Assistance Program at the same level and with the same criteria and guidelines as Phase 12 of the Inflow/Infiltration Community Assistance Program.**
2. **The Advisory Board recommends that the MWRA designate that the loan-only Phase 13 of the Inflow/Infiltration Community Assistance Program is optional for communities and does not need to be used before accessing funding from future phases of the I/I program.**
3. **The Advisory Board recommends that the MWRA extend Phase 2 of the Local Water System Assistance Program two years from FY23 to FY25.**

# Looking to the Future

As noted in many of our recommendations, the MWRA faces many challenges in the short-term - inflation and supply chain issues as well as staffing challenges - the mid-term - the looming pension liability deadline of 2030, and the long-term - the continuing challenge to manage rates beyond 2032.

FY23 marks the third year in a row that the Advisory Board has recommended a combined rate revenue requirement increase below 3%, teeing up the challenge of meeting the Advisory Board's most recent mantra: "2.4% by '24."

The Advisory Board staff would like to thank MWRA staff for all of their time and assistance in conducting our annual budget review. The process continues to work due in large part to the MWRA's willingness to fully engage with the Advisory Board in its statutory role.

Please continue to stay safe .

**Joseph E. Favaloro**
Executive Director

# List of Comments & Recommendations

1. Continuation of the Advisory Board's "Pay it Forward" Principle, applying FY22 Debt Service Assistance towards FY23 Budget. (Water: $-105,309 Sewer: $-1,077,185)

2. Consultation via a compensation and staffing study to review the new MWRA staffing trends to retain current personnel and hire new personnel from pandemic into endemic.

3. For FY23, the Advisory Board also recommends adjusting the proposed vacancy rate of 21 FTE to 27 FTE for a total Personnel expense reduction of $2,700,000. (Water: $-1,100,000 Sewer: $-1,600,000)

4. Retiring the Pension: Advisory Board's Pillars of Pension

    - If the 2021 actuarial study numbers are favorable, MWRA should use the updated numbers to recalculate the projected future pension contribution costs in the final FY23 CEB and accompanying planning projections.
    - Consistent with the "two sides of the same coin" approach endorsed by the MWRA Board of Directors, MWRA should shift the OPEB contribution in the water utility FY23 CEB to the pension line item and continue to do so until "virtual full funding" level is achieved (95%-105%).
    - The MWRA should shift optional debt prepayments in the sewer utility FY23 CEB into the pension line item and continue to do so until full funding (not virtual) is achieved.
    - The MWRA should propose to the Retirement Board a one-time use of water rate stabilization funds to the pension calculated to achieve no less than 90% funding on the overall pension unfunded liability, keeping this deposit in either cash or a stable capital preservation vehicle to isolate it from potential negative market impacts. This one-time deposit will be contingent upon:
    - A vote of the Retirement Board to extend the date for full funding of the retirement fund to 2033, and to delegate authority to the Executive Director of the Retirement Board to request that PERAC approve a one-year extension in future years if certain criteria are met to simulate a rolling 10-year funding schedule up through 2040.
    - MWRA should work with the Advisory Board, and other retirement system stakeholders to secure legislation to amend MGL Chapter 32 to authorize the state actuary to develop a plan that addresses well-funded, short-to-full amortization systems like the MWRA, with the goal of shifting to a rolling date for full funding if certain criteria are met (e.g. the system must be 90%+ funded).

5. The MWRA should shift optional debt prepayments in the sewer utility FY23 CEB into the pension line item, and continue to do so until full funding (not virtual) is achieved. (see Retirement section)

6. MWRA anticipates a lower than proposed capital financing cost. Differences should be adjusted in RRR. (Water: $-500,000 Sewer: $-1,000,000)

# The Dunphy Sheet - FY2023

**Executive Committee: May 13, 2022**
**Advisory Board: May 19, 2022**

| **IMPACTS ON RATE REVENUE REQUIREMENT** | | **Amount** |
|---|---|---|
| Final FY2022 RRR | $ | 792,084,000 |
| Proposed FY2023 RRR | $ | 819,138,000 |
| **MWRA Proposed FY23 RRR Increase** | | **3.42%** |
| | | |
| AB Recommendations | $ | (4,503,320) |
| FY2023 RRR, less changes | $ | 814,634,680 |
| **Advisory Board Recommended FY23 RRR Increase** | | **2.85%** |

| **IMPACTS ON EXPENDITURES** | | **Amount** | **Description** |
|---|---|---|---|
| **MWRA ADVISORY BOARD RECOMMENDATIONS FOR FY23 CEB** | | | |
| Water Utility Adjustments | $ | (1,600,000) | |
| Sewer Utility Adjustments | $ | (2,600,000) | |
| Debt Service Assistance | $ | (1,182,494) | |
| **Subtotal AB Recommendations** | **$** | **(5,382,494)** | |
| | | | |
| **ANTICIPATED ADJUSTMENTS TO PROPOSED FY23 CEB** | | | |
| **Direct & Indirect Cost Changes** | | | |
| Water Spring Revisits | $ | 2,334,730 | |
| Sewer Spring Revisits | $ | 2,940,675 | |
| **Subtotal of Changes to Operating Costs** | **$** | **5,275,405** | |
| **Revenue & Income** | | | |
| Water Spring Revisits | $ | (1,668,377) | |
| Sewer Spring Revisits | $ | (2,779,791) | |
| **Subtotal of Rate & Revenue** | **$** | **(4,448,168)** | |
| **OPERATING RESERVE REQUIREMENT ADJUSTMENT** | | | |
| Operating Reserve Requirement | $ | 51,937 | |
| **NET CHANGES TO PROPOSED FY23 CEB** | **$** | **(4,503,320)** | |