MASSACHUSETTS WATER POLLUTION ABATEMENT TRUST

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements and
Required Supplementary Information

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST
(A Component Unit of the Commonwealth of Massachusetts)

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KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

Independent Auditors' Report

The Board of Trustees
Massachusetts Water Pollution Abatement Trust:

We have audited the accompanying basic financial statements of the Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Massachusetts Water Pollution Abatement Trust as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 3–10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 26, 2012, on our consideration of the Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

KPMG LLP

October 26, 2012

Introduction

The Massachusetts Water Pollution Abatement Trust (the Trust) is a public instrumentality of the Commonwealth of Massachusetts (the Commonwealth). It was established in 1989 to administer the Massachusetts Water Pollution Abatement Revolving Fund pursuant to Title VI of the Federal Clean Water Act. Its enabling statute, Chapter 29C of the Massachusetts General Laws, was amended in 1998 to provide that the Trust would also administer the provisions of Title XIV of the Federal Safe Drinking Water Act establishing the Drinking Water State Revolving Fund.

The Trust's Clean Water State Revolving Fund (SRF) and the Drinking Water State Revolving Fund programs were established to accept federal grants and required Commonwealth matching funds in an amount equal to approximately 20% of the federal grants. The Trust applies for such grants and state matching funds and other monies available to the Trust to reduce financing costs for its borrowers by establishing reserve funds to secure the Trust's bonds issued to fund such projects, and by applying investment earnings on such reserve funds to pay a portion of the debt service on the related bonds, thereby reducing the borrowers' loan repayment obligations.

Subsidized financing has been an important incentive for many communities to undertake water and sewer infrastructure improvement projects. Since the enactment of Chapter 95 of the Acts of 1995 of the Commonwealth, the Trust has been the Commonwealth's primary program to finance such improvements. The Trust provides funding to communities through low-interest loan programs. The rate for Trust loans is set by statute at 2%, although projects approved prior to 2002 may qualify for a lower rate.

The Clean Water SRF provides low cost financing to eligible borrowers for projects that reduce, eliminate, or prevent water pollution. Examples of Clean Water SRF projects include construction of new wastewater treatment facilities, upgrades to existing facilities, infiltration/inflow correction, wastewater collection systems, and nonpoint source pollution abatement projects such as landfill capping, community programs for upgrading septic systems (Title 5), brownfield remediation, pollution prevention, and stormwater remediation.

The Drinking Water SRF provides low cost financing to publicly and privately owned community water system projects that provide safe, affordable drinking water. Examples of Drinking Water SRF projects include new and upgraded drinking water treatment facilities; projects to replace contaminated sources, new water treatment, or storage facilities; consolidation or restructuring of water systems; projects and system activities that provide treatment, or effective alternatives to treatment for compliance with regulated health standards such as the Surface Water Treatment Rule; and installation or replacement of transmission or distribution systems.

The Clean Water and Drinking Water SRF programs are administered by the Trust in partnership with the Massachusetts Department of Environmental Protection (DEP). DEP manages project development and approval while the Trust manages the flow of funds to the communities. As the loans are repaid, the funds "revolve" and become available for new projects.

The Trust issues revenue bonds (SRF Bonds) in order to fund communities' construction projects under the Clean Water and Drinking Water programs. The SRF Bonds are secured by either reserve funds or loans to borrowers that are pledged as a source of payment and security both of which are funded by the SRF program funds, or a combination thereof. The SRF Bonds are payable from borrower loan repayments, reserve fund earnings and payments made by the Commonwealth to the Trust on behalf of the borrowers.

(Continued)

Financial Highlights – Fiscal Year 2012

- At the close of fiscal year 2012, assets exceed liabilities by $2.0 billion compared to $1.9 billion for fiscal year 2011. Included in this number are total loans receivable, which increased to $3.9 billion from $3.8 billion, total debt (bonds payable), which decreased to $3.6 billion from $3.7 billion offset by a decrease in investments (primarily reserve fund investments) to $1.3 billion from $1.5 billion.
- Total assets and deferred outflow of resources remained consistent with last year at $5.8 billion.
- On June 13, 2012, the Trust issued Series 16 bonds in the amount of $240,585,000 consisting of $80,185,000 State Revolving Fund Bonds, Subseries 16A and $160,400,000 State Revolving Fund Bonds, Subseries B. These monies were used to finance water pollution abatement and drinking water projects in 58 communities. Concurrently with the issuance of the Series 16 bonds, the Trust financed $121.2 million of Series 16 Direct Loans. The interest payments on the Series 16 Direct Loans will be used to pay a portion of the debt service due on the Series 16 bonds.
- The Trust issued $130,835,000 State Revolving Fund Refunding Bonds (at a true interest cost of 2.61%) to refund $261.8 million of the Trust's bonds. The Trust used bond proceeds from the refunding bonds in addition to $120.6 million of proceeds received from terminating certain guaranteed investment contracts (GICs) with Trinity, for a savings of $21.6 million, resulting in an economic gain (net present value) of $17.3 million.
- For FY 2012, the Trust recorded operating income of $24.6 million as compared to an operating loss of $65.6 million in FY 2011. The $90.2 million increase in the Trust's operating income in FY 2012 was primarily attributed to the $57.7 million in gains realized on the terminations of certain GICs combined with a $37.3 million decrease in principal forgiveness, from $71.0 million in FY2011 to $33.7 million in FY 2012. The principal forgiveness is primarily associated with the disbursement of ARRA capitalization grant funds received in 2010. These ARRA grants required that no less than 50% of the funds be provided as additional subsidization in the form of principal forgiveness, grants or negative interest loans. The Trust committed all of its ARRA project funds to additional subsidization in the form of principal forgiveness.
- The statement of cash flows indicates an increase in cash for the year of $108.5 million.
- In FY 2012, the Trust continued to receive Capitalization Grants from the Environmental Protection Agency (EPA) for both the Clean Water and Drinking Water programs. The Trust received $50.1 million from the Clean Water Program and received $17.3 million in the Drinking Water Program. The Commonwealth provided a match of $13.5 million for these federally funded programs. The continued capitalization of the Trust, combined with the Trust's access to the bond market, has allowed the Trust to provide funding to all qualified borrowers.
- The Trust maintains the highest ratings of "Aaa," "AAA," and "AAA" from Moody's S&P, and Fitch rating agencies, respectively, on its recently issued bonds, allowing the Trust to continue to provide low cost funding to communities in the Commonwealth.

Financial Highlights – Fiscal Year 2011

- At the close of fiscal year 2011, assets exceed liabilities by $1.9 billion consistent with fiscal year 2010. Included in this number are long-term loans receivable, which increased to $3.4 billion from $3.1 billion, long-term investments (primarily reserve fund investments), which increased to $1.5 billion from $1.4 billion, offsetting long-term debt, which increased to $3.5 billion from $3.2 billion.
- Total assets and deferred outflow of resources increased $373.7 million from last year to $5.8 billion, an increase of 6.9%.
- In July 2010 the Trust issued Series 15 bonds in the amount of $444.5 million consisting of $191.9 million State Revolving Fund Bonds, Subseries 15A and $252.6 million State Revolving Fund Bonds, Subseries 15B. These monies were used to finance water pollution abatement and drinking water projects in 85 communities. The Subseries 15B bonds are federally taxable as they are part of the Build America Bonds (BABs) program that is part of the American Recovery and Reinvestment Act of 2009 (ARRA). As part of the program, the Trust will receive a cash subsidy of 35% for interest from the federal government instead of tax credits accruing to purchasers of the bonds.
- The Trust refunded $46.2 million of New Bedford 1998A revenue bonds by issuing its 2010A Refunding Bonds in July 2010.
- For FY 2011, the Trust recorded an operating loss of $65.6 million as compared to an operating loss of $102.5 million in FY 2010. The primary reason for the operating losses in each year was the establishment of reserves for anticipated future principal forgiveness associated with the disbursement of ARRA funds, in the amounts of $71.0 million and $89.6 million, respectively. In fiscal year 2009, the Trust received ARRA capitalization grants of $133.1 million and $52.2 million for the Clean Water and Drinking Water SRF programs, respectively. These ARRA grants required that no less than 50% of the funds be provided as additional subsidization in the form of principal forgiveness, grants or negative interest loans. The Trust committed all of its ARRA project funds to additional subsidization in the form of principal forgiveness.
- The statement of cash flows indicates an increase in cash for the year of $43.8 million.
- In FY 2011, the Trust continued to receive Capitalization Grants from the Environmental Protection Agency (EPA) for both the Clean Water and Drinking Water programs. The Trust received $69.2 million from the Clean Water Program and received $25.3 million in the Drinking Water Program. The Commonwealth provided a match of $18.9 million for these federally funded programs. The continued capitalization of the Trust, combined with the Trust's access to the bond market, has allowed the Trust to provide funding to all qualified borrowers.

Overview of Financial Statements

The financial section of this report consists of the following parts: management's discussion and analysis (this section), the basic financial statements, and the notes to the financial statements.

The Trust's financial statements are prepared in conformity with U.S. generally accepted accounting principles as applied to government enterprise funds. Under this method of accounting, an economic resources measurement focus and an accrual basis of accounting are used. Revenue is recorded when earned, and expenses are recorded when incurred. The basic financial statements include statements of net assets, statements of revenues, expenses, and changes in net assets, and statements of cash flows. This report also includes notes accompanying the financial statements to fully explain the activities reported in them.

The statements of net assets present information on the assets and liabilities of the Trust. The difference between the two is net assets. Over time, increases and decreases in net assets may be an indicator of the strength or deterioration of the financial health of the Trust.

The statements of revenues, expenses, and changes in net assets report the operating revenues and expenses and the nonoperating revenues and expenses of the Trust for the fiscal year. The difference – increase or decrease in net assets – then determines the net change in assets for the fiscal year. This change in net assets added to last year's net assets will reconcile to the total net assets for this fiscal year.

The statements of cash flows report activity of cash and cash equivalents during the fiscal year resulting from operating activities, noncapital financing activities, and investing activities. The net result of these activities is reconciled to the cash and cash equivalent balances reported at the end of the fiscal year. These statements are prepared using the direct method of presentation, which allows the reader to easily discern the amount of cash received from grantors, borrowers, and financial institutions, and how much cash was disbursed to borrowers, suppliers, and bondholders.

Condensed Financial Information and Financial Analysis

Massachusetts Water Pollution Abatement Trust's Net Assets

(In thousands)

	2012	2011	2010	Percentage change 2012 – 2011	Percentage change 2011 – 2010
Current assets	$ 732,229	740,656	800,269	(1.1)%	(7.4)%
Loans receivable, long term	3,674,409	3,449,256	3,148,462	6.5	9.6
Investments, long-term	1,336,254	1,504,028	1,429,286	(11.2)	5.2
Project fund investments	92,441	56,721	—	63.0	100.0
Deferred outflow of resources from derivative instruments	2,067	—	1,259	100.0	(100.0)
Other	9,766	9,309	7,008	4.9	32.8
Total assets and deferred outflow	$ 5,847,166	5,759,970	5,386,284	1.5%	6.9%
Current liabilities	271,719	287,449	273,203	(5.5)	5.2
Loan commitments and project funds payable	92,415	56,249	—	64.3	100.0
Liability for derivative instruments	2,067	—	1,259	100.0	(100.0)
Long-term debt	3,468,098	3,504,907	3,225,726	(1.1)	8.7
Deferred inflow of resources from derivative instruments	—	2,456	—	(100.0)	100.0
Other	—	3,751	3,366	(100.0)	11.4
Total liabilities and deferred inflow	$ 3,834,299	3,854,812	3,503,554	(0.5)%	10.0%
Net assets:					
Restricted	$ 1,746,043	1,692,073	1,662,106	3.2%	1.8%
Unrestricted	266,824	213,085	220,624	25.2	(3.4)
Total net assets	$ 2,012,867	1,905,158	1,882,730	5.7%	1.2%

Net Assets

The Trust's net assets at June 30, 2012 and 2011 were approximately $2.0 billion and $1.9 billion, respectively. Total assets and deferred outflow remained consistent at $5.8 billion, and total liabilities and deferred inflow also remained consistent at $3.8 billion. Total loans receivable, long-term increased $225.2 million to $3.7 billion while investments decreased $167.8 million to $1.3 billion. This reflects the Trust's use of direct loans to provide additional security for its Series 16 bond issuance rather than its traditional use of an investment reserve fund; as well as the termination of $119.1 million of GICs. Total liabilities and deferred inflow remained consistent year over year as the new bond issuances of $240.6 million for Series 16 and $130.8 million for Series 2012 Refunding bonds were offset by scheduled maturities and bonds refunded with cash proceeds from the GIC termination.

The Trust's net assets at June 30, 2011 and 2010 were approximately $1.9 billion. Total assets and deferred outflow increased 6.9% to $5.8 billion, and total liabilities and deferred inflow increased 10.0% to $3.9 billion. The increases in both assets and liabilities are principally attributed to the Trust issuing in July 2010, its Series 15 bonds and related loans from the bond proceeds and 2010 refunding bonds.

Bonds Payable

The Trust issues revenue bonds (SRF Bonds) in order to fund communities' construction projects under the Clean Water and Drinking Water programs. The SRF Bonds are secured by either reserve funds or loans to borrowers that are pledged as a source of payment and security, both of which are funded by the SRF program funds, or a combination thereof. The SRF Bonds are payable from borrower loan repayments, reserve fund earnings and payments made by the Commonwealth to the Trust on behalf of the borrowers.

The following is a summary of bonds payable at June 30, 2012, 2011 and 2010 (in thousands). More detailed information can be found in note 6 to the financial statements.

		2012	2011	2010
Water Pollution Abatement Revenue Bonds:				
MWRA Loan Program	$	22,370	48,200	54,545
South Essex Sewage District Loan Program		3,780	5,015	6,440
New Bedford Loan Program		2,405	3,440	4,605
Pool Loan Program		1,989,878	2,125,200	1,812,331
Subtotal revenue bonds		2,018,433	2,181,855	1,877,921
Subordinated Revenue Refunding Bonds:				
MWRA Loan Program		63,775	63,775	63,775
New Bedford Loan Program		40,850	44,935	94,935
Pool Loan Program		1,358,240	1,264,190	1,246,130
Subtotal revenue refunding bonds		1,462,865	1,372,900	1,404,840
Total bonds		3,481,298	3,554,755	3,282,761
Add (deduct) unamortized amounts:				
Bond premium		233,906	211,862	194,122
Net unamortized excess of reacquisition price over net carrying value of defeased bonds		(74,801)	(78,608)	(82,837)
Total bonds payable, net	$	3,640,403	3,688,009	3,394,046

A summary of the Trust's statements of revenues, expenses, and changes in net assets is as follows:

Summary of Changes in Net Assets

(In thousands)

	June 30			Percentage change	
	2012	2011	2010	2012 – 2011	2011 – 2010
Loan servicing fees	$ 5,270	5,209	5,092	1.2%	2.3%
Loan origination fees	75	129	89	(41.9)	44.9
Interest income	216,039	159,922	130,955	35.1	22.1
Contract assistance from Commonwealth of Massachusetts	36,700	35,886	39,584	2.3	(9.3)
Total operating revenues	258,084	201,146	175,720	28.3	14.5
Department of Environmental Protection programmatic support costs	11,369	10,482	12,168	8.5	(13.9)
Principal forgiveness	33,693	71,018	89,581	(52.6)	(20.7)
General and administrative	3,560	2,111	4,754	68.6	(55.6)
Arbitrage rebate payments	10,488	1,122	972	834.8	15.4
Interest expense	174,342	182,035	170,724	(4.2)	6.6
Total operating expenses	233,452	266,768	278,199	(12.5)	(4.1)
Operating income (loss)	24,632	(65,622)	(102,479)	137.5	36.0
U.S. Environmental Protection Agency capitalization grants	74,181	82,089	178,096	(9.6)	(53.9)
Commonwealth of Massachusetts matching grants	8,896	5,961	—	49.2	100.0
Total nonoperating revenues	83,077	88,050	178,096	(5.6)	(50.6)
Increase in net assets	107,709	22,428	75,617	380.2	(70.3)
Net assets, beginning of year	1,905,158	1,882,730	1,807,113	1.2	4.2
Net assets, end of year	$ 2,012,867	1,905,158	1,882,730	5.7%	1.2%

Results of Operations

For FY 2012, the Trust recorded operating income of $24.6 million as compared to an operating loss of $65.6 million in FY 2011. The $90.2 million increase in the Trust's operating income in FY 2012 was primarily attributed to the $57.7 million in gains realized on the terminations of certain GICs combined with a $37.3 million decrease in principal forgiveness, from $71.0 million in FY 2011 to $33.7 million in FY 2012. The principal forgiveness is primarily associated with the disbursement of ARRA capitalization grant funds received in 2010. These ARRA grants required that no less than 50% of the funds be provided as additional subsidization in the form of principal forgiveness, grants or negative interest loans. The Trust committed all of its ARRA project funds to additional subsidization in the form of principal forgiveness.

Excluding the $57.7 million gain realized on the termination of GICs, the Trust would have recorded a $33.1 million operating loss in FY 2012 compared to an operating loss of $65.6 million in FY 2011. The operating losses are primarily the result of principal forgiveness of $33.7 million and $71.0 million in FY 2012 and FY 2011, respectively. Other significant factors contributing to the operating losses are DEP programmatic support costs of $11.4 million and $10.5 million, respectively, which are program administrative costs funded by 4.0% of the capitalization grant. The capitalization grant revenues funding both the principal forgiveness and the programmatic support costs are classified as nonoperating revenue.

The $5.0 million, or 5.6%, decrease in nonoperating revenue in FY 2012 reflects a decrease in the annual Clean Water and Drinking Water federal capitalization grants revenue and the related state matching grant. Revenue is recognized based on the funding availability schedule contained in the grant. For more information on grant revenue, refer to note 4.

The $90.0 million, or 50.6% decrease in nonoperating revenue in FY2011 reflects the nonrecurring ARRA capitalization grant revenue of $139.0 million in FY2010 offset by a $48.9 million increase in the annual Clean Water and Drinking Water federal capitalization grants revenue and the related state matching grant.

Future Economic Factors

In August 2008, the Commonwealth enacted Chapter 312 of the Acts of 2008 of the Commonwealth, which provided for $75 million in matching capitalization funds to the Clean Water (CW) and Drinking Water (DW) programs. The Trust estimates this amount to be sufficient to meet its Clean Water matching needs through FY2015 and Drinking Water matching needs through FY2014, assuming current federal funding levels are maintained. The Trust will submit a request to the Legislature for an additional appropriation of $25.8 million which would allow the Trust to continue to receive Federal Clean Water and Drinking Water grants through FY2017. The Trust expects the request to be submitted and acted upon during the 2013 legislative session.

Requests for Information

This financial report is intended to provide an overview of the financial picture of the Massachusetts Water Pollution Abatement Trust. Any further questions regarding any of the information contained within this report may be directed to the Executive Director or the Controller at 3 Center Plaza, Suite 430, Boston, MA 02108.

MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Net Assets

June 30, 2012 and 2011

(In thousands)

		2012	2011
Assets and deferred outflows:			
Current assets:			
Cash and cash equivalents (note 3)	$	357,127	248,602
Short-term investments (note 3)		3,039	3,477
Project fund investments (note 3)		545	—
Grants receivable:			
U.S. Environmental Protection Agency		56,960	100,536
Commonwealth of Massachusetts		2,313	2,313
Loans receivable, net (note 5)		249,177	317,317
Accrued interest receivable		63,068	68,411
Total current assets		732,229	740,656
Noncurrent assets:			
Project fund investments (note 3)		92,441	56,721
Loans receivable, long-term (note 5)		3,674,409	3,449,256
Long-term investments (note 3)		1,336,254	1,504,028
Other assets		9,766	9,309
Total noncurrent assets		5,112,870	5,019,314
Deferred outflow of resources from derivative instruments (note 9)		2,067	—
Total assets and deferred outflows		5,847,166	5,759,970
Liabilities:			
Current liabilities:			
Accrued expenses and interest payable		69,617	71,831
Deferred revenue		29,797	32,516
Long-term debt (note 6)		172,305	183,102
Total current liabilities		271,719	287,449
Noncurrent liabilities:			
Loan commitments and project funds payable		92,415	56,249
Accrued interest on capital appreciation bonds		—	3,751
Liability for derivative instruments (note 9)		2,067	—
Long-term debt, net (note 6)		3,468,098	3,504,907
Total noncurrent liabilities		3,562,580	3,564,907
Deferred inflow of resources from derivative instruments (note 9)		—	2,456
Total liabilities and deferred inflows		3,834,299	3,854,812
Net assets:			
Restricted for program purposes (note 7)		1,746,043	1,692,073
Unrestricted (note 7)		266,824	213,085
Total net assets	$	2,012,867	1,905,158

See accompanying notes to financial statements.

MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

		2012	2011
Operating revenues:			
Loan servicing fees	$	5,270	5,209
Loan origination fees		75	129
Interest income		216,039	159,922
Contract assistance from Commonwealth of Massachusetts		36,700	35,886
Total operating revenues		258,084	201,146
Operating expenses:			
Commonwealth of Massachusetts:			
Department of Environmental Protection – programmatic support costs		11,369	10,482
Principal forgiveness		33,693	71,018
General and administrative		3,560	2,111
Arbitrage rebate payments		10,488	1,122
Interest expense		174,342	182,035
Total operating expenses		233,452	266,768
Operating income/(loss)		24,632	(65,622)
Nonoperating revenue:			
Capitalization grant revenue:			
U.S. Environmental Protection Agency capitalization grants (note 4)		74,181	82,089
Commonwealth of Massachusetts matching grants (note 4)		8,896	5,961
Total nonoperating revenue		83,077	88,050
Increase in net assets		107,709	22,428
Net assets – beginning of year		1,905,158	1,882,730
Net assets – end of year	$	2,012,867	1,905,158

See accompanying notes to financial statements.

MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

		2012	2011
Cash flows from operating activities:			
Other cash received from borrowers	$	5,345	5,338
Cash paid to vendors		(24,256)	(13,619)
Net cash used in operating activities		(18,911)	(8,281)
Cash flows from noncapital financing activities:			
Bonds proceeds		268,422	463,391
Repayment of bonds		(303,668)	(168,319)
Interest paid		(172,561)	(171,296)
Proceeds from U.S. Environmental Protection Agency capitalization grants		110,991	119,542
Proceeds from Commonwealth matching capitalization grants		12,943	10,396
Net cash provided by (used in) noncapital financing activities		(83,873)	253,714
Cash flows from investing activities:			
Loans disbursed to recipients		(398,004)	(493,597)
Cash received from borrowers		173,739	154,789
Contract assistance received – principal		29,722	28,975
Interest received		164,434	141,514
Contract assistance received – interest		35,264	37,118
Purchases of investments		(171,793)	(180,897)
Cash received from termination of guaranteed investment contracts		150,437	—
Sales/maturities of investments		227,510	110,420
Net cash provided by (used in) investing activities		211,309	(201,678)
Net increase in cash and cash equivalents		108,525	43,755
Cash and cash equivalents, beginning of year		248,602	204,847
Cash and cash equivalents, end of year	$	357,127	248,602
Reconciliation of operating income (loss) to net cash used in operating activities:			
Operating income/(loss)	$	24,632	(65,622)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Reclassification of:			
Interest income		(216,039)	(159,922)
Contract assistance		(36,700)	(35,886)
Interest expense		174,342	182,035
Principal forgiveness		33,693	71,018
Changes in operating assets and liabilities:			
Other assets and liabilities, net		1,161	96
Net cash used in operating activities	$	(18,911)	(8,281)

During fiscal year 2012, the Trust issued bonds to partially refund various series of bonds. The $154,832 bond proceeds combined with $120,566 of cash were deposited immediately into irrevocable trust funds for the defeasance of $261,775 of outstanding bond principal.

During fiscal year 2011, the Trust issued bonds to refund New Bedford 1998A debt. The $41,990 bond proceeds were deposited immediately into irrevocable trust funds for the defeasance of $46,195 of outstanding bond principal.

See accompanying notes to financial statements.

(1) General

(a) Organization

The Massachusetts Water Pollution Abatement Trust (the Trust), is a component unit of the Commonwealth of Massachusetts (the Commonwealth). The Trust was created by Chapter 275 of the Acts of 1989, and is governed by Chapter 29C of the Massachusetts General Laws. Pursuant to an Operating Agreement between the United States Environmental Protection Agency (EPA), the Massachusetts Department of Environmental Protection (DEP), and the Trust, executed in 1993 and subsequently amended, the Trust administers the Commonwealth's Clean Water and Drinking Water State Revolving Fund (SRF) programs.

Financial and management activities of the Trust are administered by employees of the Trust who fall under the Office of the State Treasurer. Project evaluation, selection, and oversight are provided by DEP employees.

The Trust is governed by a three-member board of trustees chaired by the State Treasurer and composed of the Secretary for Administration and Finance and the Commissioner of DEP. The Trust is reported as a component unit of the Commonwealth of Massachusetts.

(b) Description of Business

The SRF programs, which were authorized by federal legislation – the Water Quality Act of 1987 for the Clean Water SRF and the Safe Drinking Water Act of 1996 for the Drinking Water SRF – provide low-cost financing to cities, towns, and other eligible borrowers primarily for the construction and improvement of drinking water and wastewater infrastructure. The Trust's SRF program's primary activities include providing low-cost financing for eligible projects funded by the issuance of debt in the capital markets, providing low cost interim financing for its borrowers, the investment of program funds, and the management and coordination of the programs.

SRF program capitalization grants are issued from the EPA to the Trust, for which the Commonwealth is required to provide 20% in matching funds. The Trust applies such grants and state matching funds and other monies available to the Trust to reduce financing costs by establishing reserve funds to secure the Trust's bonds issued to fund such projects, and by applying investment earnings on such reserve funds to pay a portion of the debt service on the related bonds.

The SRF programs are called the State Revolving Fund programs because as borrowers pay down the principal balances of their loans and as the Trust pays principal on its SRF bonds, proportional amounts are released from the reserves and/or loans pledged to secure the related SRF bonds. These funds come back to the Trust and "revolve" or are used to establish new reserve funds or loans to borrowers that are pledged as a source of payment and security, for new SRF bonds or for other eligible purposes.

Funds pertaining to the SRF programs are limited to specific uses by laws and regulations as well as Grant and Operating Agreements entered into between EPA and the Commonwealth. As a result of these limitations on uses, these funds are classified as restricted on the statements of net assets.

(Continued)

(2) Summary of Significant Accounting Policies

The accounting policies of the Trust conform to U.S. generally accepted accounting principles (GAAP) as applicable to government enterprises. The following is a summary of the Trust's significant accounting policies:

(a) Basis of Presentation

The Trust's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting as specified by the Governmental Accounting Standards Board's (GASB) requirements for an enterprise fund. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Trust has elected to solely apply all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements. The more significant account policies are described below.

(b) Revenue Recognition

Operating revenues, including interest income, and expenses are generated through the issuance of loans to local government units within the Commonwealth. All other revenues and expenses are reported as nonoperating revenues and expenses.

Funding from federal capitalization grants and state matching grants are recorded as nonoperating revenue. Federal capitalization revenue is recognized in accordance with funding availability schedules contained within the individual grant agreements. Revenue recognition associated with these grants is based on the standard principles of eligibility, including timing requirements.

The Trust's recent federal capitalization grants beginning with the American Recovery and Reinvestment Act of 2009 (ARRA) grant received in 2009, required that a portion of the grant funds be provided as additional subsidization in the form of principal forgiveness, grants, or negative interest loans. The Trust provides the additional subsidization in the form of principal forgiveness, which has been recorded as an operating expense.

(c) Cash and Cash Equivalents

The Trust's policy is to treat all highly liquid investments with original maturities of three months or less as cash and cash equivalents.

(d) Investments

The Trust's investment guidelines permit investment of funds in obligations of, or guaranteed by, the United States of America or the short-term external investment pool, the Massachusetts Municipal Depository Trust (MMDT), managed by the Commonwealth, as well as in time-deposits, guaranteed investment contracts, repurchase agreements, and other permitted investments such as qualified municipal obligations.

Investments are generally carried at amortized cost which approximates fair value. The guaranteed investment contracts (GICs) are considered nonparticipating investment contracts and therefore are recorded at cost.

Under the Massachusetts Water Pollution Abatement Trust Program Resolutions and bond resolutions entered into in connection with the issuance of bonds by the Trust (the Resolutions), the Trust must maintain certain investment funds in the SRF programs. The types of funds held by the Trustees are in the following accounts:

Equity Accounts – The equity accounts consist of cash and cash equivalents that are currently invested in MMDT. The equity accounts comprise both a federal program account and a state account and can be used for programmatic costs and operating expenses within the SRF programs. These funds are derived from: (1) funds drawn by the Trust from federal capitalization grants and Commonwealth matching funds; (2) other amounts paid to the Trust representing financial assistance provided pursuant to the Act for purposes of deposit in the SRF programs; (3) other amounts appropriated to the Trust by the Commonwealth for purposes of the SRF programs; (4) direct loan repayments; (5) interest earnings on investments or deposits of amounts held in the equity accounts; and (6) amounts transferred from the Debt Service Reserve Fund as a result of loan repayments in accordance with the provisions specified in the Resolutions.

Interim Loan Accounts – The interim loan accounts have been established to fund temporary loans in anticipation of permanent leveraged borrowings. The source of funds is the equity accounts.

Project Accounts – The project accounts disburse bond proceeds to borrowers as needed. These funds are restricted by the bond resolutions and are to be applied solely to the payment or refinancing of costs associated with the applicable project. When all costs have been paid, any amounts remaining unexpended in the project accounts will normally be applied to the repayment of the applicable borrower's principal.

Debt Service Reserve Accounts – Debt service reserve accounts consist of reserves established as security to bonds issued by the Trust. The amount deposited in each debt service reserve account is determined at the time of the issuance of the bonds, and has varied from 33% to 50% of the par amount of the bonds issued. Debt Service Reserve Funds are funded from cash, and deposits are transferred from the equity accounts. Interest earnings on the debt service reserve accounts are used for debt service payments.

Debt Service Accounts – Debt service accounts are used as a pass-through of principal and interest to the bondholders. The debt service accounts are also used to hold accrued interest on the bonds to be applied to pay a portion of the interest due on the bonds.

(Continued)

(e) Loan Origination Fees and Costs of Issuance

The Trust requires payment of loan origination fees at the time of the first debt service payment. Costs of issuance related to the bonds are then offset against the amount of loan origination fees charged to borrowers. Remaining costs of issuance, if any, are recorded in other assets in the accompanying statements of net assets and are amortized over the life of the bonds.

Costs of issuance relating to the issuance of refunding bonds are amortized over the life of the bonds.

Prior to FY 2007, fees received and certain direct costs incurred, relating to the origination of loans, have been deferred and are included with loans receivable in the accompanying statements of net assets and are amortized over the life of the loans.

(f) Risk Financing

The Trust is not insured for casualty, theft, tort claims, or other losses. No amounts have been accrued for such losses as they are not considered material. As discussed in note 1, all financial, management, and project oversight activities are provided by employees of the State Treasurer's Office, DEP, and the Executive Office for Administration and Finance. These employees are covered under the Commonwealth's existing employee benefit programs. The cost of these programs is allocated to the Trust, through a fringe benefit allocation. Costs in excess of this amount are borne by the Commonwealth. As a result, no liabilities for employee-related activities have been recorded by the Trust.

(g) Other Assets and Other Liabilities

Other assets consist principally of the unamortized portion of bond issue costs, which are amortized using the straight-line method over the life of the bonds.

(h) Bond Premium

Bond premium, included in long-term debt, is amortized on a straight-line basis, which approximates the effective interest basis, over the life of the associated bond issue.

(i) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(j) Derivatives

The Trust complies with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement requires that derivative instruments be reported as assets or liabilities at fair value on the statement of net assets. Changes in fair value may be reported in the statement of revenues, expenses, and changes in net assets, or as deferred inflows or outflows in the statement of net assets in accordance with GASB Concepts Statement No. 4, *Elements of Financial Statements*, depending on whether the derivative instrument qualifies for hedge accounting.

(k) Reclassifications

Certain reclassifications have been made to the FY 2011 balances to conform to the presentation used in FY 2012.

(3) Deposits and Investments

The Trust complies with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. Cash, cash equivalents, and investments are separately held by several of the Trust's funds.

(a) Cash and Cash Equivalents

The Trust's cash and cash equivalents consist of the equity accounts previously discussed in note 2 as well as project funds that have not yet been disbursed. The project funds are held by the Trustees and disbursed in accordance with executed loan agreements. A small portion of the cash and cash equivalents is held to pay the administrative costs of the Trust.

Cash and cash equivalents include investments in the MMDT. For purposes of risk categorization, MMDT shares are not categorized. The fair value of the Trust's position in MMDT is at unit value.

Custodial Credit Risk – Custodial credit risk is the risk that, in the event of a bank failure, the Trust's deposits may not be returned to it. Cash balances represent amounts held in bank depository accounts that may be subject to custodial credit risk. The Trust had no significant amount of cash on deposit with banks at June 30, 2012 and 2011.

(b) Investments

Custodial Credit Risk – Investments – Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Trust will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Trust requires that all investment agreements be collateralized either upon execution of such agreement or upon the happening of certain events, and at all times thereafter, by securities or other obligations issued or guaranteed by the United States, by certain federal agencies or corporations or, in some cases, by corporate or municipal issuers rated "AAA" by Standard & Poor's and "Aaa" by Moody's, having a market value of not less than 102% of the amount currently on deposit or in accordance with their respective agreement.

Credit Risk – The majority of the Trust's investments are in Guaranteed Investment Contracts (GICs) or in Treasury or agency securities. The Treasury and agency securities are all backed by the federal government. The GICs either have collateral requirements in place upon execution of the investment agreement, or have triggered collateral requirements under which, upon a rating downgrade below a specified level, the counterparty is typically required to do one of three actions: 1) post collateral to a level sufficient to maintain an AA rating, 2) assign the investment contract to a new counterparty that has at least a AA rating, or 3) provide credit enhancement to maintain a rating on the investment contract of at least AA.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the Trust's investments. The Trust limits its exposure to interest rate risk by entering into guaranteed investment contracts and federally guaranteed fixed income securities for all of its long-term investments upon which the Trust relies to meet its obligations.

The value and maturities of the Trust's investments are presented below (in thousands):

		Investment maturities (in years)			
Investment type	**2012**	**Less than 1**	**1 to 5**	**6 to 10**	**More than 10**
Debt securities:					
Guaranteed investment contracts	$ 856,386	94,795	315,535	269,949	176,107
U.S. Treasuries – federally guaranteed	482,907	27,791	137,425	138,696	267,553
Cash equivalents:					
Massachusetts Municipal Depository Trust (MMDT)	450,113	450,113	—	—	—
Total investments	$ 1,789,406	572,699	452,960	408,645	443,660

		Investment maturities (in years)			
Investment type	**2011**	**Less than 1**	**1 to 5**	**6 to 10**	**More than 10**
Debt securities:					
Guaranteed investment contracts	$ 1,174,074	109,089	368,173	344,599	352,212
U.S. Treasuries – federally guaranteed	333,431	14,663	79,897	81,778	208,975
Cash equivalents:					
Massachusetts Municipal Depository Trust (MMDT)	305,323	305,323	—	—	—
Total investments	$ 1,812,828	429,075	448,070	426,377	561,187

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The issuers where investments exceeded 5% of the Trust's total investments are as follows:

	Percentage of total investments	
	2012	**2011**
Provider:		
Dexia Credit Local/FSA Capital Management Services, LLC	19%	27%
NATIXIS Funding Corp.	16	15
Trinity Funding Company, LLC	11	18
Citigroup	9	8

On December 14, 2011, the Trust terminated $130.4 million of GICs with Dexia Credit Local/FSA Capital Managements related to the Series 13 Pool Program Bonds. The Trust received a replacement portfolio comprised of Treasuries and Agency Securities with a par value of $203.9 million and amortized cost value of $160.7 million. The difference between the amortized cost value of the replacement portfolio and the par value plus accrued interest through the date of termination of the GIC totaled $27.9 million and has been recorded as interest income in the Statement of Revenue, Expenses and Changes in Net Assets.

On April 30, 2012, the Trust terminated $119.1 million of GICs with Trinity Funding Company, LLC (Trinity). The Trust received $150.4 million in cash proceeds from Trinity which included a make-whole payment of $29.9 million which has been recorded as interest income in the Statement of Revenues, Expenses and Changes in Net Assets. The Trust used the cash proceeds to refund a portion of its outstanding bonds, refer to note 6.

(4) Capitalization Grants

The Trust is awarded Clean Water and Drinking Water grants from the U.S. Environmental Protection Agency. These grants require that the Trust enter into binding commitments with local government units within one year of the receipt of each federal grant payment to provide assistance in an amount equal to 120% (including 20% state matching grants) of each grant award. Each federal capitalization grant contains federally mandated set-asides, including a 4% administrative allowance, that result in total grant funding actually being 83.3% federal and 16.7% state.

The total grants awarded for the Trust's fiscal years ended June 30, 2012 and 2011 are as follows (in thousands):

	Clean Water Program		Drinking Water Program	
	2012	2011	2012	2011
Federal capitalization	$ 50,136	69,177	17,278	25,303
State match on federal funds	10,027	13,835	3,456	5,061
Total capitalization	60,163	83,012	20,734	30,364
Less administrative allowance and set asides	(2,406)	(3,320)	(5,356)	(7,843)
Project capitalization	$ 57,757	79,692	15,378	22,521

The periodic cash draws by the Trust on federal grants are based on the amount of incurred costs for certain eligible projects or activities. Federal capitalization revenue is recognized in accordance with funding availability schedules contained within the individual grant agreements.

The following table depicts the Trust's capitalization grant revenue by grant (in thousands):

	Clean Water		Drinking Water		Total Programs	
	2012	2011	2012	2011	2012	2011
Federal FY 2011 grant	$ 37,602	—	12,959	—	50,561	—
Federal FY 2010 grant	17,294	51,883	6,326	18,977	23,620	70,860
Federal FY 2009 grant	—	5,776	—	5,453	—	11,229
Total grant revenue – EPA	$ 54,896	57,659	19,285	24,430	74,181	82,089
State match – FY 2011 grant	$ 5,440	—	3,456	—	8,896	—
State match – FY 2010 grant	—	901	—	5,060	—	5,961
Total grant revenue – state match	$ 5,440	901	3,456	5,060	8,896	5,961

(5) Loans Receivable and Bonds Purchased

The Trust provides low-cost financing to cities, towns, and other eligible borrowers primarily for the construction and improvement of drinking water and wastewater infrastructure. These loans are provided under the Trust's Clean Water, Drinking Water, and Title V – Community Septic Management Programs.

Each loan to a borrower made with the proceeds of the Trust's SRF bonds is in the form of either a loan or the bond purchase agreement. Pursuant to an agreement with the EPA, projects financed for greater than 20 years are financed through a bond purchase agreement. Both forms of assistance are referred to as "leveraged loans" and are made pursuant to a financing agreement between the Trust and the borrower. Pursuant to the financing agreements, each borrower delivers its own general or special obligation bond to the Trust referred to as a "local bond," in order to secure its loan repayment obligations. The Trust makes loans under its Clean Water SRF program with terms up to 30 years from project completion and under its Drinking Water SRF program up to 20 years from project completion, but in no event does the Trust make a loan longer than the expected useful life of the project financed or refinanced by such loan.

The Trust recognizes the need for construction funds to be available to borrowers throughout the year, not simply at the time of an annual Trust bond issue. This need is addressed by making funds available to eligible projects through the interim loan program. Interim loans are temporary loans provided by the Trust to local governmental units or other eligible borrowers in accordance with a financing agreement for all or any part of the cost of a project in anticipation of a leveraged loan.

In addition, the Trust will from time to time provide direct loans. Direct loans are loans subject to repayment, provided to local governmental units or other eligible borrowers with SRF equity funds rather than bond proceeds.

A summary of loan receivables as of June 30, 2012 and 2011 is as follows (in thousands):

		2012	2011
Leveraged loans or bonds purchased	$	3,796,500	3,610,479
Direct loans		79,977	40,301
Interim loans		241,174	276,165
Principal forgiveness		(194,065)	(160,372)
Total loans receivable		3,923,586	3,766,573
Less current portion loans receivable		249,177	317,317
Long-term portion – loans receivable	$	3,674,409	3,449,256

The interim loan receivable balances were $241,174 and $276,165 as of June 30, 2012 and 2011, respectively. Additionally, the interim loan balances represent disbursements of construction funds of $194,065 and $160,372, respectively, to borrowers for which a subsidy was provided in the form of principal forgiveness. The interim loan amounts will be legally forgiven as the applicable projects are completed.

The Series 16 bond issue occurred in June 2012 and interim loans totaling $221,865 and direct loans totaling $23,463 were permanently financed as part of the Series 16 bond issue. An additional $52,038 of interim loans were financed as direct loans in June 2012.

The Series 15 bond issue occurred in July 2010 and interim loans totaling $156,778 were permanently financed as part of the Series 15 bond issue. An additional $21,464 of interim loans were financed as direct loans in July 2010.

(Continued)

Aggregate principal maturities on leveraged loans receivable or bonds purchased are as follows (in thousands):

Years ending June 30:		
2013	$	201,377
2014		225,297
2015		227,438
2016		220,908
2017		225,549
2018 – 2022		1,058,296
2023 – 2027		856,201
2028 – 2032		500,022
2033 – 2037		216,402
2038 – 2042		65,010
Total leveraged loans or bonds purchased	$	3,796,500

The Trust's loans to its borrowers are subsidized by interest earnings on Debt Service Reserve Funds and contract assistance provided to the Trust by the Commonwealth. Although borrowers are obligated to the Trust to make scheduled payments, both of these subsidies are expected to be available for the lives of the financing agreements. The Commonwealth has committed to provide contract assistance in the amount of $496 million. This obligation of the Commonwealth to the Trust is a general obligation of the Commonwealth, for which its full faith and credit are pledged. Annual appropriations are made each year by the Commonwealth to fund the current year's obligation.

For the leveraged bond purchase program, pursuant to an agreement with the Commonwealth, contract assistance is drawn in an amount as if the financing was for a 20-year period. The amount that is not currently needed is invested at the applicable bond yield and used to fund the subsidy in years 21 to 30.

(6) Bonds Payable

The Trust issues special obligation bonds under its SRF programs to provide financial assistance to eligible borrowers. The financial assistance is provided pursuant to leveraged loans and bond purchase agreements between the Trust and each borrower as described in note 5.

The following is a summary of bonds payable at June 30, 2012 and 2011 (in thousands):

	Beginning balance, June 30, 2011	Additions	Reductions	Ending balance, June 30, 2012	Due within one year
Water Pollution Abatement Revenue Bonds:					
MWRA Loan Program:					
Series 1993A, 4.5% to 5.45%, issued March 18, 1993, due 2000 to 2013	$ 1,165	—	565	600	600
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	1,470	—	465	1,005	390
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	390	—	255	135	65
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	5,635	—	1,030	4,605	945
Series 2002A, 3.0% to 5.25% issued October 15, 2002, due 2003 to 2032	39,540	—	23,515	16,025	3,960
South Essex Sewage District Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	1,850	—	610	1,240	485
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	3,165	—	625	2,540	530
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	3,440	—	1,035	2,405	890

	Beginning balance, June 30, 2011	Additions	Reductions	Ending balance, June 30, 2012	Due within one year
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	$ 260	—	147	113	90
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	905	—	340	565	270
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	770	—	430	340	255
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	16,935	—	8,415	8,520	4,735
Series 5, 4.25% to 5.75%, issued October 6, 1999, due 2000 to 2029	32,695	—	32,695	—	—
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	46,080	—	25,480	20,600	410
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2031	127,955	—	118,685	9,270	640
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	80,765	—	47,930	32,835	11,795
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	95,765	—	11,560	84,205	11,945
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2034	83,450	—	11,910	71,540	12,225
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2035	152,910	—	62,235	90,675	11,680
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2036	343,540	—	15,940	327,600	16,340

	Beginning balance, June 30, 2011	Additions	Reductions	Ending balance, June 30, 2012	Due within one year
Series 13, 3.75% to 5.0%, issued December 18, 2007, due 2008 to 2037	$ 319,890	—	11,890	308,000	12,210
Series 14, 1.0% to 5.0%, issued March 18, 2009, due 2009 to 2038	378,760	—	14,935	363,825	15,255
Series 15, 2.0% to 5.192%, issued July 8, 2010, due 2012 to 2040	444,520	—	13,315	431,205	15,540
Series 16A and B, 2.0% to 5.0%, issued June 13, 2012, due 2013 to 2032	—	240,585	—	240,585	—
Subordinated Revenue Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	44,935	—	4,085	40,850	4,390
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	63,775	—	—	63,775	—
Pool Program Refunding Bonds:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	610,680	—	35,305	575,375	33,695
Series 2006, 3.0% to 5.25%, issued December 14, 2006 due 2007 to 2034	408,215	—	—	408,215	—
Series 2009A, 2.0% to 5.0%, issued July 30, 2009 due 2010 to 2029	203,305	—	1,480	201,825	12,965
Series 2010A, 3.0% to 5.0%, issued July 8, 2010 due 2014 to 2026	41,990	—	—	41,990	—
Series 2012A and B, 3.0% to 5.0%, issued June 13, 2012 due 2013 to 2032	—	130,835	—	130,835	—
Subtotal	3,554,755	371,420	444,877	3,481,298	172,305
Add (deduct) unamortized amounts:					
Bond premium	211,862	51,834	29,790	233,906	—
Net unamortized excess of reacquisition price over net carrying value of defeased bonds	(78,608)	(7,810)	(11,617)	(74,801)	—
Total bonds payable	$ 3,688,009	415,444	463,050	3,640,403	172,305

(Continued)

The following is a summary of bonds payable at June 30, 2011 and 2010 (in thousands):

	Beginning balance, June 30, 2010	Additions	Reductions	Ending balance, June 30, 2011	Due within one year
Water Pollution Abatement Revenue Bonds:					
MWRA Loan Program:					
Series 1993A, 4.5% to 5.45%, issued March 18, 1993, due 2000 to 2013	$ 1,735	—	570	1,165	565
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	2,000	—	530	1,470	465
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	750	—	360	390	255
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	6,740	—	1,105	5,635	1,030
Series 2002A, 3.0% to 5.25% issued October 15, 2002, due 2003 to 2032	43,320	—	3,780	39,540	3,855
South Essex Sewage District Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	2,570	—	720	1,850	610
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	3,870	—	705	3,165	625
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	4,605	—	1,165	3,440	1,035
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	456	—	196	260	147
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	1,310	—	405	905	340
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	1,360	—	590	770	430

(Continued)

	Beginning balance, June 30, 2010	Additions	Reductions	Ending balance, June 30, 2011	Due within one year
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	$ 17,980	—	1,045	16,935	910
Series 5, 4.25% to 5.75%, issued October 6, 1999, due 2000 to 2029	34,620	—	1,925	32,695	1,755
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	61,980	—	15,900	46,080	2,090
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2031	152,270	—	24,315	127,955	25,630
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	91,860	—	11,095	80,765	11,485
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	107,055	—	11,290	95,765	11,560
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2034	95,085	—	11,635	83,450	11,910
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2035	164,260	—	11,350	152,910	11,455
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2036	359,125	—	15,585	343,540	15,940
Series 13, 3.75% to 5.0%, issued December 18, 2007, due 2008 to 2037	331,430	—	11,540	319,890	11,890
Series 14, 1.0% to 5.0%, issued March 18, 2009, due 2009 to 2038	393,540	—	14,780	378,760	14,935
Series 15, 2.0% to 5.192%, issued July 8, 2010, due 2011 to 2040	—	444,520	—	444,520	13,315
Subordinated Revenue Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	94,935	—	50,000	44,935	4,085
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	63,775	—	—	63,775	—

	Beginning balance, June 30, 2010	Additions	Reductions	Ending balance, June 30, 2011	Due within one year
Pool Program Refunding Bonds:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	$ 632,910	—	22,230	610,680	35,305
Series 2006, 3.0% to 5.25%, issued December 14, 2006 due 2007 to 2034	408,215	—	—	408,215	—
Series 2009A, 2.0% to 5.0%, issued July 30, 2009 due 2010 to 2029	205,005	—	1,700	203,305	1,480
Series 2010A, 3.0% to 5.0%, issued July 8, 2010 due 2014 to 2026	—	41,990	—	41,990	—
Subtotal	3,282,761	486,510	214,516	3,554,755	183,102
Add (deduct) unamortized amounts:					
Bond premium	194,122	28,374	10,634	211,862	—
Net unamortized excess of reacquisition price over net carrying value of defeased bonds	(82,837)	(50)	(4,279)	(78,608)	—
Total bonds payable	$ 3,394,046	514,834	220,871	3,688,009	183,102

All bonds are payable from amounts pledged pursuant to the Water Pollution Abatement Project Bond Resolutions, which include payments by local governmental units of principal and interest on the loans and amounts on deposit in the Debt Service Reserve Funds. Pursuant to the Commonwealth Assistance Contract (the Contract), the Commonwealth has agreed to provide Contract Assistance payments to the Trust to reduce the payments by local government units. The Contract is not pledged as security for the bonds; however, the Contract Assistance payments, when received by the Trust, are pledged as security for the bonds.

On March 1, 2012, the Trust issued $100,000,000 State Revolving Fund Bond Anticipation Notes, Series 16. The Notes were issued by the Trust to finance water pollution abatement and drinking water projects. The Notes were scheduled to mature March 1, 2013; however, they were repaid with the proceeds from the Series 16 bonds.

On June 13, 2012, the Trust issued Series 16 bonds in the amount of $240,585,000 consisting of $80,185,000 State Revolving Fund Bonds, Subseries 16A and $160,400,000 State Revolving Fund Bonds, Subseries B. These monies were used to finance water pollution abatement and drinking water projects in 58 communities. Proceeds in the amount of $202.1 million were applied to fund loans for projects under the clean water SRF and $65.2 million of proceeds were applied to fund loans for projects under the drinking water SRF. The Trust anticipates expending all of the proceeds within two years. Concurrently with the issuance of the Series 16 bonds, the Trust financed $121.2 million of Series 16 Direct Loans. The interest payments on the Series 16 Direct Loans will be used to pay a portion of the debt service due on the Series 16 bonds.

On June 13, 2012, the Trust issued $130,835,000 State Revolving Fund Refunding Bonds (at a true interest cost of 2.61%) to refund, $7.5 million of the Trust's Pool Program Series 4 bonds; $30.9 million of the Trust's Series 5 bonds; $23.4 million of the Trust's Pool Program Series 6 bonds; $93.1 million of the Trust's Pool Program Series 7 bonds; $36.4 million of the Trust's Pool Program Series 8 bonds; and $19.7 million of the Trust's MWRA Loan Program 2002A bonds. These bonds also advance refunded $50.8 million of the Trust's Pool Program Series 11 bonds.

The Trust used bond proceeds from the refunding bonds in addition to $120.6 million of proceeds received from terminating certain GIC investments with Trinity, refer to note 3(b). These proceeds were deposited with an escrow agent to provide resources for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. The total debt defeased through this new issue was $261.8 million, for a savings of $21.6 million, resulting in an economic gain (net present value) of $17.3 million. The reacquisition price exceeded the net carrying amount of the old debt by $7.8 million. This accounting loss is being netted against the new debt issued.

On July 8, 2010, the Trust issued Series 15 bonds in the amount of $444,520,000 consisting of $191,925,000 State Revolving Fund Bonds, SubSeries 15A, and $252,595,000 State Revolving Fund Bonds, SubSeries 15B. These monies were used to finance water pollution abatement and drinking water projects in 85 communities. Proceeds in the amount of $317.6 million are expected to be applied to fund loans for projects under the clean water SRF and $150.8 million of proceeds are expected to be applied to fund loans for projects under the drinking water SRF. The Trust anticipates expending all of the proceeds within two years.

The SubSeries 15B bonds are federally taxable as they are part of the Build America Bonds (BABs) program that is part of the American Recovery and Reinvestment Act of 2009. As part of the program, the Trust will receive a cash subsidy for interest from the federal government instead of tax credits accruing to purchasers of the bonds. The Trust will be entitled to 35% of all interest payable on the bonds, based on required filings to the U.S. Treasury from the Trust. The Trust is obligated to pay debt service on these bonds, regardless of whether subsidy payments are received or not.

On July 8, 2010, the Trust issued $41,990,000 State Revolving Fund Refunding Bonds to refund a portion of the Trust's Subordinate Revenue Refunding Bonds under the New Bedford Loan Program Series 1998A. The total debt defeased through this new issue was $46,195,000. The proceeds of the refunded debt were deposited with an escrow agent to provide resources for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. The reacquisition price was immaterially different to the net carrying amount; this difference was recorded as interest expense in the statements of revenues, expenses and changes in net assets.

At June 30, 2012, debt service requirements to maturity for principal and interest are as follows (amounts in thousands):

		Total debt service	Principal	Interest
Year ending June 30:				
2013	$	334,266	172,305	161,961
2014		362,796	207,593	155,203
2015		358,450	212,785	145,665
2016		352,510	216,790	135,720
2017		338,085	212,560	125,525
2018 – 2022		1,480,137	1,008,690	471,447
2023 – 2027		1,033,033	786,030	247,003
2028 – 2032		524,659	420,985	103,674
2033 – 2037		218,778	185,370	33,408
2038 – 2043		63,144	58,190	4,954
Total debt service requirements	$	5,065,858	3,481,298	1,584,560

The balances of bonds defeased "in substance" in prior years and still outstanding as of June 30 are as follows (in thousands):

Description	Redemption date		Outstanding principal amount 2012	2011
MWRA Loan Program:				
Series 1993A	November 3, 1999	$	5,360	16,060
Series 1993B	November 3, 1999		17,405	22,460
Series 1995A	November 3, 1999		23,060	27,855
Series 1998A	November 3, 1999		53,260	59,735
Series 1999A	August 25, 2004		51,410	54,670
Series 1999A	August 11, 2009		164,680	164,680
Series 2002A	August 25, 2004		26,980	26,980
Series 2002A	December 14, 2006		30,875	30,875
Series 2002A	June 13, 2012		19,660	—
New Bedford Loan Program:				
Series 1996A	December 23, 1998		35,945	43,805
Series 1998A	July 8, 2010		46,195	46,195
South Essex Sewage District Loan Program:				
Series 1994A	July 15, 2001		17,110	21,875
Series 1996A	July 15, 2001		23,275	27,400

Description	Redemption date		Outstanding principal amount 2012	2011
Pool Loan Program:				
Pool 1	July 15, 2001	$	3,675	5,885
Pool 2	July 15, 2001		10,385	13,310
Pool 3	July 15, 2001		33,510	39,900
Pool 4	August 25, 2004		41,685	49,420
Pool 4	June 13, 2012		7,505	—
Pool 5	August 25, 2004		106,700	116,205
Pool 5	June 13, 2012		30,940	—
Pool 6	August 25, 2004		143,960	154,850
Pool 6	June 13, 2012		23,390	—
Pool 7	August 25, 2004		59,330	59,330
Pool 7	June 13, 2012		93,055	—
Pool 8	August 25, 2004		105,045	105,045
Pool 8	June 13, 2012		36,445	—
Pool 9	December 14, 2006		139,560	139,560
Pool 10	December 14, 2006		168,620	168,620
Pool 11	December 14, 2006		87,735	87,735
Pool 11	June 13, 2012		50,780	—
Pool 12	August 11, 2009		31,430	31,430

(7) Net Assets

As of June 30, 2012 and 2011, the Trust has restricted net assets in the amount of $1.7 billion and $1.7 billion, respectively, and unrestricted net assets in the amount of $266.8 million and $213.1 million, respectively. Restricted net assets represent capitalization grants received cumulative to date from the EPA and corresponding matching amounts received from the Commonwealth. The capitalization grants are restricted to provide financial assistance, but not grants, to local communities and interstate agencies for the construction of wastewater treatment works, drinking water infrastructure improvements, and other related projects as described in note 1.

(8) Commitment

As of June 30, 2012 and 2011, the Trust has agreed to provide loans to various local government units amounting to approximately $90.9 million and $122.0 million, respectively, excluding loans amounts already disbursed, which will be funded or collateralized with grant awards received by the Trust.

(9) Derivative Transactions

Interest Rate Swap Agreements – $77,255,000 dated November 21, 2006

Objective of the Interest Rate Swap – As a means to lower its borrowings costs, when compared with fixed-rate bonds at the time of their issuance in November 2006, the Trust entered into two interest rate swap agreements in connection with its Pool Program Refunding Bonds, Series 2006 bonds. The intention of the swaps was to hedge the Trust's exposure to interest rate risk by effectively changing the Trust's variable rate bonds maturing in 2022 and 2023 to a synthetic fixed rate of 3.88% and 3.90%, respectively.

Terms – Under the terms of these swaps, the Trust agrees to receive a variable rate, based on the Consumer Price Index (CPI), equal to the amounts due on variable rate bonds issued by the Trust concurrently with the execution of the swap agreement. The Trust agrees to pay a fixed rate to the counterparty. Payments are made semiannually, due August 1 and February 1 of each year, on the same schedule as the fixed rate bonds issued in December 2006. The counterparty is JP Morgan Chase & Co. JP Morgan Chase Bank, N.A. The terms of each swap agreement are summarized below:

		2022 Termination	2023 Termination
Trade date		November 21, 2006	November 21, 2006
Effective date		December 14, 2006	December 14, 2006
Termination date		August 1, 2022	August 1, 2023
Notional amount	$	30,650,000	46,605,000
Fair value at June 30, 2012		(805,070)	(1,261,527)
Fair value at June 30, 2011		911,084	1,544,791
Variable rate bond coupon payments		Muni-CPI* rate + 0.99%	Muni-CPI* rate + 0.99%
Variable rate payment from counterparty		Muni-CPI* rate + 0.99%	Muni-CPI* rate + 0.99%
Fixed rate payment to counterparty		3.88%	3.90%
Synthetic fixed rate on bonds		3.88	3.90

* Muni-CPI rate is equal to the quotient of (1) the Reference CPI-U for the current debt service payment date minus the prior Reference CPI-U divided by (2) the prior Reference CPI-U. Reference refers to 3 months preceding the debt service payment date. Prior Reference period refers to 15 months preceding the debt service payment date.

Fair Value – The swaps had an aggregate negative fair value as of June 30, 2012, which means on the August 1, 2012 debt service payment date the Trust will make a payment to the swap counterparty. Because the Muni-CPI rate increased in excess of the synthetic fixed rate, the swaps had positive fair values as of June 30, 2011, meaning that on the next debt service payment date, August 1, 2011, the Trust received a payment from its swap counterparty. Because the coupons on the Trust's variable rate bonds adjust to the changing Muni-CPI rates, the bonds do not have a corresponding fair value increase or decrease. At June 30, 2012, the fair value of these swaps is reflected as a liability for derivative instruments and deferred outflows in the accompanying financial statements. At June 30, 2011, the fair value of these swaps is reflected as an asset from derivative instruments, a component of other assets, and deferred inflow from derivative instruments in the accompanying financial statements. The fair value of the derivative was estimated using the zero-coupon method. This method calculates the future net settlement payments/receipts required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Credit Risk – As of June 30, 2012, the Trust is not exposed to credit risk because the swaps had a negative fair value. As of June 30, 2011, the Trust is exposed to credit risk equal to the amount of the derivative's fair value. Prior to January 5, 2009, the swap counterparty was Bear Stearns Capital Markets, Inc. As of January 5, 2009, the counterparty is JP Morgan Chase & Co. JP Morgan Chase Bank, N.A. and is rated AA-/Aa1/AA-by Standard & Poor's, Moody's Investors Service, and Fitch Ratings, respectively. To mitigate credit risk, the Trust has the right to terminate the swap upon a ratings downgrade by the counterparty's credit support provider below BBB-/Baa3 by Standard & Poor's, and Moody's Investors Service, respectively.

Termination Risk – The swap contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. In addition, the Trust may terminate upon a ratings downgrade by the counterparty, as described above. The Trust and the counterparty may terminate if either party fails to perform under the terms of the Contract. If at the time of termination, the swap has a negative fair value, the Trust would be liable to the counterparty for a payment equal to the swap's fair value. The source of funds for this payment is from "legally available funds." Legally available funds is defined as, "funds held in the Trust's Federal Clean Water State Revolving Fund or Drinking Water State Revolving Fund…only to the extent that Congress passes a law or EPA adopts a regulation or issues an opinion or other notice…making such amounts legally available to pay settlement amounts."

Swap Payments and Hedged Debt – In accordance with the swap agreement, the variable rate is calculated using the preceding 3 months' Muni-CPI rate with settlement payments made on the debt service payment dates of February 1 and August 1. As of June 30, 2012, the variable rate was calculated using the May 31, 2012 Muni-CPI rate. Assuming this rate remains the same, the debt service requirements of the variable rate debt and the net swap payments are presented in the table below. As the Muni-CPI rate varies, the variable rate payments on the bonds and the variable rate receipts from the swap are equal, the net debt service will remain fixed.

	Variable rate bonds[1]		Net swap	Total
	Principal	**Interest**	**payments[2]**	**debt service**
Fiscal year ending June 30:				
2013	$ —	2,069,877	936,938	3,006,815
2014	—	2,069,877	936,938	3,006,815
2015	—	2,069,877	936,938	3,006,815
2016	—	2,069,877	936,938	3,006,815
2017	—	2,069,877	936,938	3,006,815
2018	—	2,069,877	936,938	3,006,815
2019	—	2,069,877	936,938	3,006,815
2020	—	2,069,877	936,938	3,006,815
2021	—	2,069,877	936,938	3,006,815
2022	—	2,069,877	936,938	3,006,815
2023	30,650,000	1,659,277	752,928	33,062,205
2024	46,605,000	624,339	284,459	47,513,798

[1] Calculated rate uses May 31, 2012 Muni-CPI rate to reflect debt service payment for August 1, 2012.

[2] A positive net swap payment requires a payment from the Trust to the counterparty.