MASSACHUSETTS CLEAN WATER TRUST

(formerly known as the Massachusetts Water Pollution Abatement Trust)

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements and
Required Supplementary Information

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

MASSACHUSETTS CLEAN WATER 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 Clean Water Trust:

Report on the Financial Statements

We have audited the accompanying financial statements of the Massachusetts Clean Water Trust (formerly known as 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, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Trust's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express our 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Massachusetts Clean Water Trust as of June 30, 2014 and 2013, 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.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 3-11 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 2014 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Trust's internal control over financial reporting and compliance.

KPMG LLP

October 24, 2014

Introduction

The Massachusetts Clean Water Trust, (formerly known as 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's program is leveraged by issuing bonds to provide construction proceeds for loans. Federal and state grants and other monies available to the Trust are pledged to secure the bonds by either financing reserve funds or pledged loans or a combination of both. Earnings on these pledged assets are used to pay a portion of debt service on the related bonds, thereby reducing the borrowers' loan repayment obligation. Since 2002, the Trust has provided loans to communities at 2% interest rate. As the effective market interest rate on bonds is higher than the 2% loan rate, the borrowers receive a subsidy equal to the difference between those rates.

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 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 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.

Financial Highlights – Fiscal Year 2014

- At the close of fiscal year 2014, assets and deferred outflows exceed liabilities by $2.13 billion compared to $2.07 billion for fiscal year 2013. Included in this number are total loans receivable, which decreased to $3.91 billion from $3.99 billion, total debt (bonds payable), which decreased to $3.39 billion from $3.77 billion was offset by a decrease in long-term investments (primarily reserve fund investments) to $1.03 billion from $1.26 billion.
- Total assets and deferred outflow of resources of $5.62 billion decreased $407 million from $6.02 billion the year before. Total liabilities of $3.49 billion decreased $463 million from $3.95 billion the year before.
- On June 12, 2014, the Trust issued $565,610,000 State Revolving Fund Refunding Bonds (at a true interest cost of 2.13%) to refund, $2,760,000 of the Trust's Pool Program Series 4 bonds; $12,050,000 of the Trust's Series 9 bonds; $33,540,000 of the Trust's Pool Program Series 10 bonds; $105,575,000 of the Trust's 2004B Refunding bonds; and $2,800,000 of the Trust's MWRA Loan Program 1998A bonds. These bonds also advance refunded $162,385,000 of the Trust's Pool Program Series 12 bonds; $283,220,000 of the Trust's Pool Program Series 13 bonds; and $137,595,000 of the Trust's Pool Program Series 14 bonds.
- On January 13, 2014, the Trust used $20,737,000 of proceeds received from terminating certain GIC investments with Portigon and program funds in the amount of $16,500,000 to pay off the Trust's Subordinate Revenue Refunding Bonds under the New Bedford Loan Program Series 1998A. The total debt defeased was $36,460,000.
- For FY 2014, the Trust recorded operating income of $3.2 million as compared to an operating loss of $11.7 million in FY 2013. The $14.9 million change in the Trust's operating income in FY 2014 was primarily attributed to the $15.3 million decrease in interest expense which exceeded the $8.6 million decrease in interest income and contract assistance by $6.7 million, primarily due to the Trust's recent refundings that replaced higher yielding bonds with bonds at all-time low interest rates. Also attributing to this increase in operating income was a $4.8 million decrease in principal forgiveness expense resulting from the final expenditures of the ARRA capitalization grants. Although the Trust's current capitalization grants continue to provide for principal forgiveness, it is not at the levels experienced with the ARRA grants.
- The statement of cash flows indicates and decrease in cash for the year of $86.8 million.
- In FY 2014, 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 $46.0 million from the Clean Water Program and received $16.0 million in the Drinking Water Program. The Commonwealth provided a match of $12.2 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 2013

- At the close of fiscal year 2013, assets and deferred outflows exceed liabilities by $2.07 billion compared to $2.00 billion for fiscal year 2012. Included in this number are total loans receivable, which increased to $3.99 billion from $3.92 billion, cash, which increased to $0.45 billion from $0.36 billion, offset by a decrease in investments (primarily reserve fund investments) to $1.39 billion from $1.43 billion and an increase in total debt (bonds payable), which increased to $3.77 billion from $3.72 billion.
- Total assets and deferred outflow of resources increased to $6.02 billion from $5.91 billion.
- On May 8, 2013, the Trust issued Series 17 bonds in the amount of $202,250,000 consisting of $185,605,000 State Revolving Fund Bonds, Subseries 17A and $16,645,000 State Revolving Fund Bonds, Subseries 17B. The monies were used to finance water pollution abatement and drinking water projects in 79 communities. The Trust pledged $70.7 million of direct loans for projects under the clean water SRF and $27.1 million of direct loans for projects under the drinking water SRF. The interest payments on the Series 17 pledged direct loans will be used to pay a portion of the debt service due on the Series 17 bonds.
- For FY 2013, the Trust recorded an operating loss of $11.7 million as compared to operating income of $22.4 million in FY 2012. The $34.1 million decrease in the Trust's operating income in FY 2013 was primarily attributed to FY 2012 operating income including a one-time $57.7 million gain realized on the termination of certain GICs offset by a $21.4 million decrease in principal forgiveness, ($33.7 million in FY 2012 to $12.3 million in FY 2013). The principal forgiveness is primarily associated with the disbursement of ARRA capitalization grant funds received in 2011. 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 statements of cash flows indicates an increase in cash for the year of $97.3 million.
- In FY 2013, 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 $48.0 million from the Clean Water Program and received $17.0 million in the Drinking Water Program. The Commonwealth provided a match of $13.0 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 a special purpose entity engaged solely in business-type activities. 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 position, statements of revenues, expenses, and changes in net position, 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 position present information on the total assets and deferred outflows of resources, and total liabilities and deferred inflows of resources of the Trust. The difference between the two totals is net position. Over time, increases and decreases in net position 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 position 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 position – then determines the net change in net position for the fiscal year. This change in net position added to last year's net position will reconcile to the total net position 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, vendors, and bondholders.

(Continued)

Condensed Financial Information and Financial Analysis

Massachusetts Clean Water Trust's Net Position
(In thousands)

		2014	2013	2012	Percentage change 2014–2013	Percentage change 2013–2012
Current assets	$	1,005,129	918,563	732,229	9.4%	25.4%
Loans receivable, long term		3,469,108	3,711,065	3,674,409	(6.5)	1.0
Investments, long term		1,029,899	1,262,224	1,336,254	(18.4)	(5.5)
Project fund investments		—	58,992	92,441	(100.0)	(36.2)
Deferred outflows		113,216	72,071	75,400	57.1	(4.4)
Other		42	1,469	2,264	(97.1)	(35.1)
Total assets and deferred outflows	$	5,617,394	6,024,384	5,912,997	(6.8)%	1.9%
Current liabilities	$	304,331	335,822	271,719	(9.4)%	23.6%
Loan commitments and project funds payable		—	58,979	92,415	(100.0)	(36.2)
Liability for derivative instruments		2,206	3,435	2,067	(35.8)	66.2
Long-term debt		3,183,470	3,555,255	3,542,898	(10.5)	0.3
Total liabilities		3,490,007	3,953,491	3,909,099	(11.7)%	1.1%
Net position:						
Restricted	$	1,718,052	1,658,888	1,600,042	3.6%	3.7%
Unrestricted		409,335	412,005	403,856	(0.6)	2.0
Total net position	$	2,127,387	2,070,893	2,003,898	2.7%	3.3%

Net position

The Trust's net position at June 30, 2014 and 2013 was $2.13 billion and $2.07 billion, respectively. Total assets and deferred outflow of $5.62 billion decreased $407 million from $6.02 billion at June 30. Total loans receivable, long term decreased $242 million to $3.47 billion as the Trust did not finance any loans in FY 2014 as part of a new bond financing, rather the Trust's interim loan portfolio and loan commitments increased $161 million and $122 million, respectively. The Trust's total long-term investments decreased $232 million to $1.03 billion. The decrease was primarily attributed to the termination of a $19.2 million GIC with Portigon and the liquidation of the $141.8 million Series 13 debt service reserve fund as part of the 2014 Refunding, in addition to scheduled maturities. Total liabilities decreased $463 million to $3.49 billion primarily due to the Series 2014 refunding bonds that refunded $739.9 million while issuing only $565.6 million of refunding bonds. In addition, the Trust did not finance new loans with a new bond issue in FY 2014, which results in a reduction of outstanding debt by scheduled maturities.

The Trust's net position at June 30, 2013 and 2012 was approximately $2.07 billion and $2.00 billion, respectively. Total assets and deferred outflows increased $111 million to $6.02 billion, while total liabilities remained relatively consistent at approximately $3.9 billion. Total loans receivable, long-term remained constant at $3.7 billion, similarly long-term investments remained relatively constant at $1.3 billion. Total liabilities remained relatively consistent year over year as the new bond issuances of $202.3 million for Series 17 were offset by scheduled maturities.

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, or a combination thereof, both of which are funded by the SRF program funds. 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, 2014, 2013 and 2012 (in thousands). More detailed information can be found in note 6 to the financial statements.

		2014	2013	2012
Water Pollution Abatement Revenue Bonds:				
MWRA Loan Program	$	11,365	16,410	22,370
South Essex Sewage District Loan Program		1,855	2,765	3,780
New Bedford Loan Program		785	1,515	2,405
Pool Loan Program		1,328,845	2,078,738	1,989,878
Subtotal revenue bonds		1,342,850	2,099,428	2,018,433
Subordinated Revenue Refunding Bonds:				
MWRA Loan Program		63,620	63,775	63,775
New Bedford Loan Program		—	36,460	40,850
Pool Loan Program		1,678,245	1,311,580	1,358,240
Subtotal revenue refunding bonds		1,741,865	1,411,815	1,462,865
Total bonds		3,084,715	3,511,243	3,481,298
Add: unamortized bond premium		304,295	259,765	233,905
Total bonds payable, net	$	3,389,010	3,771,008	3,715,203

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

Summary of Changes in Net Position
(In thousands)

	June 30			Percentage change	
	2014	**2013**	**2012**	**2014–2013**	**2013–2012**
Loan servicing fees	$ 5,137	5,288	5,270	(2.9)%	0.3%
Loan origination fees	19	1,698	2,243	(98.9)	(24.3)
Interest income	142,934	150,066	216,039	(4.8)	(30.5)
Contract assistance from Commonwealth of Massachusetts	32,388	33,895	36,700	(4.4)	(7.6)
Total operating revenues	180,478	190,947	260,252	(5.5)	(26.6)
Department of Environmental Protection programmatic support costs	$ 7,418	8,921	11,369	(16.8)	(21.5)
Principal forgiveness	7,567	12,335	33,693	(38.7)	(63.4)
General and administrative	7,860	5,046	8,440	55.8	(40.2)
Arbitrage rebate payments	166	6,725	10,487	(97.5)	(35.9)
Interest expense	154,316	169,595	173,869	(9.0)	(2.5)
Total operating expenses	177,327	202,622	237,858	(12.5)	(14.8)
Operating income (loss)	3,151	(11,675)	22,394	127.0	152.1
U.S. Environmental Protection Agency capitalization grants	61,950	65,671	74,181	(5.7)	(11.5)
Commonwealth of Massachusetts matching grants	12,205	12,999	8,896	(6.1)	46.1
Total nonoperating revenues	74,155	78,670	83,077	(5.7)	(5.3)
Return of Commonwealth initial investment	20,812	—	—	100.0	—
Total nonoperating expenses	20,812	—	—	100.0	—
Increase in net position	56,494	66,995	105,471	(15.7)	(36.5)
Net position, beginning of year	2,070,893	2,003,898	1,898,427	3.3	5.6
Net position, end of year	$ 2,127,387	2,070,893	2,003,898	2.7%	3.3%

Results of Operations

For FY 2014, the Trust recorded operating income of $3.2 million as compared to an operating loss of $11.7 million in FY 2013. The $14.9 million change in the Trust's operating income in FY 2014 was primarily attributed to the $15.3 million decrease in interest expense, which exceeded the $8.6 million decrease in interest income and contract assistance by $6.7 million, primarily due to the Trust's recent refundings that replaced higher yielding bonds with bonds at all-time low interest rates. Also attributing to this increase in operating income was a $4.8 million decrease in principal forgiveness expense resulting from the final expenditures of the ARRA capitalization grants. Although the Trust's current capitalization grants continue to provide for principal forgiveness, it is not at the levels experienced with the ARRA grants.

For FY 2013, the Trust recorded an operating loss of $11.7 million as compared to operating income of $22.4 million in FY 2012. The $34.1 million change in the Trust's operating income in FY 2013 was primarily attributed to FY 2012 operating income including a one-time $57.7 million gain realized on the terminations of certain GICs offset by the $21.4 million decrease in principal forgiveness, ($33.7 million in FY 2012 to $12.3 million in FY 2013). Excluding the $57.7 million gain realized on the termination of GICs, the Trust would have recorded a $35.3 million operating loss in FY 2012. The primary reason for the operating losses in both FY 2013 and FY 2012 was principal forgiveness, $12.3 million in FY 2013 and $33.7 million in FY 2012. The principal forgiveness was primarily associated with the disbursement of ARRA capitalization grant funds received in 2011. 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.

Contributing to the Trust's low operating income and or operating losses are the inclusion of expenses such as DEP programmatic support costs of $7.4 million, $8.9 million, and $11.4 million for FY 2014, FY 2013 and FY 2012, respectively, and principal forgiveness, which are funded by the capitalization grant revenue that is classified as nonoperating revenue.

The $4.5 million, or 5.7%, decrease in nonoperating revenue in FY 2014 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 $4.4 million, or 5.3%, decrease in nonoperating revenue in FY 2013 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.

FY 2014 includes nonoperating expense of $20.8 million, which represents the return to the Commonwealth of its investment in the Commonwealth Program that provided funding for eight projects that were ineligible for funding pursuant to the Clean Water Act when the SRF program was initially established.

Future Economic Factors

In August 2014, the Commonwealth enacted Chapter 286 of the Acts of 2014 of the Commonwealth, which provided for $57 million in matching capitalization funds to the Clean Water and Drinking Water programs. The Trust estimates this amount in addition to the amounts remaining from the authorization provided for in Chapter 312 of the Acts of 2008 of the Commonwealth, to be sufficient to meet its Clean Water and Drinking Water matching needs through FY 2019, assuming current federal funding levels are maintained.

Requests for Information

This financial report is intended to provide an overview of the financial picture of the Massachusetts Clean Water 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 CLEAN WATER TRUST
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Net Position

June 30, 2014 and 2013

(In thousands)

		2014	2013
Assets and deferred outflows:			
Current assets:			
Cash and cash equivalents (note 3)	$	367,669	454,452
Short-term investments (note 3)		43,576	43,248
Project fund investments (note 3)		16,540	23,747
Grants receivable:			
U.S. Environmental Protection Agency		81,507	61,408
Loans receivable, net (note 5)		437,317	274,421
Accrued interest receivable		58,520	61,287
Total current assets		1,005,129	918,563
Noncurrent assets:			
Project fund investments (note 3)		—	58,992
Loans receivable, long term (note 5)		3,469,108	3,711,065
Long-term investments (note 3)		1,029,899	1,262,224
Other assets		42	1,469
Total noncurrent assets		4,499,049	5,033,750
Deferred outflow of resources (note 10)		113,216	72,071
Total assets and deferred outflow of resources		5,617,394	6,024,384
Liabilities:			
Current liabilities:			
Accrued expenses and interest payable		54,326	68,061
Unearned revenue		28,065	28,385
Loan commitments and project funds payable		16,400	23,623
Long-term debt (note 6)		205,540	215,753
Total current liabilities		304,331	335,822
Noncurrent liabilities:			
Loan commitments and project funds payable		—	58,979
Liability for derivative instruments (note 9)		2,206	3,435
Long-term debt, net (note 6)		3,183,470	3,555,255
Total noncurrent liabilities		3,185,676	3,617,669
Total liabilities		3,490,007	3,953,491
Net position:			
Restricted for program purposes (note 7)		1,718,052	1,658,888
Unrestricted (note 7)		409,335	412,005
Total net position	$	2,127,387	2,070,893

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

(In thousands)

		2014	2013
Operating revenues:			
Loan servicing fees	$	5,137	5,288
Loan origination fees		19	1,698
Interest income		142,934	150,066
Contract assistance from Commonwealth of Massachusetts		32,388	33,895
Total operating revenues		180,478	190,947
Operating expenses:			
Commonwealth of Massachusetts:			
Department of Environmental Protection – programmatic support costs		7,418	8,921
Principal forgiveness		7,567	12,335
General and administrative		7,860	5,046
Arbitrage rebate payments		166	6,725
Interest expense		154,316	169,595
Total operating expenses		177,327	202,622
Operating income (loss)		3,151	(11,675)
Nonoperating revenue:			
Capitalization grant revenue:			
U.S. Environmental Protection Agency capitalization grants (note 4)		61,950	65,671
Commonwealth of Massachusetts matching grants (note 4)		12,205	12,999
Total nonoperating revenue		74,155	78,670
Nonoperating expense:			
Return of Commonwealth initial investment (note 2(f))		20,812	—
Total nonoperating expense		20,812	—
Increase in net position		56,494	66,995
Net position – beginning of year		2,070,893	2,003,898
Net position – end of year	$	2,127,387	2,070,893

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended June 30, 2014 and 2013

(In thousands)

		2014	2013
Cash flows from operating activities:			
Other cash received from borrowers	$	6,556	7,754
Cash paid to vendors		(14,906)	(21,958)
Net cash used in operating activities		(8,350)	(14,204)
Cash flows from noncapital financing activities:			
Bonds proceeds		—	242,657
Cash used in debt refunding		(197,738)	—
Repayment of bonds		(215,753)	(172,306)
Interest paid		(163,928)	(165,171)
Return of Commonwealth initial investment		(20,812)	—
Proceeds from U.S. Environmental Protection Agency capitalization grants		40,929	60,547
Proceeds from Commonwealth matching capitalization grants		12,809	14,574
Net cash used in noncapital financing activities		(544,493)	(19,699)
Cash flows from investing activities:			
Loans disbursed to recipients		(168,511)	(278,674)
Cash received from borrowers		210,697	177,917
Contract assistance received – principal		29,612	26,970
Interest received		121,834	127,208
Contract assistance received – interest		32,879	35,841
Purchases of investments		(13,726)	(60,790)
Cash received from termination of guaranteed investment contracts		160,102	—
Sales/maturities of investments		93,173	102,756
Net cash provided by investing activities		466,060	131,228
Net (decrease) increase in cash and cash equivalents		(86,783)	97,325
Cash and cash equivalents, beginning of year		454,452	357,127
Cash and cash equivalents, end of year	$	367,669	454,452
Reconciliation of operating income (loss) to net cash used in operating activities:			
Operating income (loss)	$	3,151	(11,675)
Adjustments to reconcile operating income (loss) to net cash used in operating activities:			
Reclassification of:			
Interest income		(142,934)	(150,066)
Contract assistance		(32,388)	(33,895)
Interest expense		154,316	169,595
Principal forgiveness		7,567	12,335
Changes in operating assets and liabilities:			
Other assets and liabilities, net		1,938	(498)
Net cash used in operating activities	$	(8,350)	(14,204)

During fiscal year 2014, the Trust issued bonds to partially refund various series of bonds. The $668,200 of bond proceeds combined with $160,500 of cash were deposited immediately into irrevocable trust funds for the defeasance of $739,900 of outstanding bond principal.

See accompanying notes to financial statements.

(1) General

(a) Organization

The Massachusetts Clean Water Trust (formerly known as 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.

(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.

(Continued)

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.

(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 a special purpose entity engaged solely in business-type activities. 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) 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 fair value. The investment in MMDT is valued at share price and the investment in U.S. Treasury securities are carried at amortized cost, which approximates fair value. The guaranteed investment contracts (GICs) are considered nonparticipating investment contracts and therefore are recorded at amortized 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 primarily 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. This origination fee revenue is recorded at the time of the bond closing which is when these fees are earned. Cost of issuance related to the bonds is recorded to general and administrative expenses when incurred.

The Trust previously reported bond issuance costs in other assets to the extent they were not offset by origination fees charged to the borrowers. These remaining costs were then amortized over the life of the bonds. The implementation of GASB Statement No. 65 resulted in the write-off of bond issuance costs as of July 1, 2011.

Prior to FY 2007, fees received and certain direct costs incurred, relating to the origination of loans, have been deferred and being paid by certain borrowers with their respective loans receivable.

(f) Nonoperating Expenses

FY 2014 includes nonoperating expense of $20,812, which represents the return to the Commonwealth of its investment in the Commonwealth Program that provided funding for eight projects that were ineligible for funding pursuant to the Clean Water Act when the SRF program was initially established.

(g) 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.

(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 position. Changes in fair value may be reported in the statement of revenues, expenses, and changes in net position, depending on whether the derivative instrument qualifies for hedge accounting.

(k) Deferred Inflows and Outflows of Resources

The Trust accounts for certain transactions that result in the consumption or acquisition in one period that are applicable to future periods as deferred outflows and deferred inflows of resources, respectively, to distinguish them from assets and liabilities. For fiscal years 2014 and 2013, the Trust has reported deferred outflows of resources pertaining to its hedging derivative instruments and to the deferred losses on its debt refunding transactions.

(l) Reclassifications

Certain reclassifications had been made to the FY 2013 balances to conform to the presentation used in FY 2014.

(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. The Office of the Treasurer and Receiver-General (Treasury) manages the Commonwealth's short-term external mixed investment pool, the Massachusetts Municipal Depository Trust (MMDT). MMDT is comprised of two portfolios, a Cash Portfolio and a Short Term Bond Portfolio. The Cash Portfolio is a money market like investment pool; its investments are carried at amortized cost, which approximates fair value. The fair value of the Trust's position in MMDT is at unit value. The Short Term Bond Portfolio investments are carried at fair value.

Investors in MMDT are not allowed to overdraw their shares. For a complete copy of MMDT's separately issued financial statements, please contact the Office of the State Treasurer's Cash Management Department, at (617) 367-9333 or download the statements from the Cash Management section of the Office of the State Treasurer's Web site at www.mass.gov/treasury. 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, 2014 and 2013.

(b) Investments

Custodial Credit Risk – 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. MMDT and the GICs are not rated.

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 Trust's U.S. Treasuries and Agencies investment portfolio was structured in its principal and interest return to support debt service on their related bonds.

(Dollars in thousands, unless noted)

The value and maturities of the Trust's investments are presented below:

Investment type		2014	Investment maturities (in years) Less than 1	1 to 5	6 to 10	More than 10
Debt securities:						
Guaranteed investment contracts	$	722,108	113,455	244,864	235,716	128,073
U.S. Treasuries – federally guaranteed		310,504	22,391	72,834	87,782	165,271
Cash equivalents:						
Massachusetts Municipal Depository Trust (MMDT)		425,072	425,072	—	—	—
Total investments	$	1,457,684	560,918	317,698	323,498	293,344

Investment type		2013	Investment maturities (in years) Less than 1	1 to 5	6 to 10	More than 10
Debt securities:						
Guaranteed investment contracts	$	801,849	102,502	253,291	269,949	176,107
U.S. Treasuries – federally guaranteed		463,260	28,540	121,252	141,345	252,538
Cash equivalents:						
Massachusetts Municipal Depository Trust (MMDT)		577,554	577,554	—	—	—
Total investments	$	1,842,663	708,596	374,543	411,294	428,645

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 2014	2013
Provider:		
Dexia Credit Local/FSA Capital Management Services, LLC	22%	19%
NATIXIS Funding Corp.	17	15
Trinity Funding Company, LLC	14	12
Citigroup	10	9

(Dollars in thousands, unless noted)

On December 4, 2013, the Trust terminated $19,200 of GICs with Portigon (WestLB). The Trust received $20,700 in cash proceeds from Portigon, which included a termination payment of $1,100 which has been recorded as interest income in the Statement of Revenues, Expenses and Changes in Net Position. The Trust used the cash proceeds to refund a portion of its outstanding bonds, refer to note 6.

On June 3, 2014, the Trust liquidated its U.S. Treasuries portfolio comprising the debt service reserve fund for Series 13 Bonds. The Trust received $140,800 in cash proceeds, which were used 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, 2014 and 2013 are as follows:

		Clean Water Program		Drinking Water Program	
		2014	2013	2014	2013
Federal capitalization	$	45,328	47,985	15,699	17,012
State match on federal funds		9,065	9,597	3,140	3,402
Total capitalization		54,393	57,582	18,839	20,414
Less administrative allowance and set asides		(2,176)	(2,303)	(4,866)	(5,187)
Project capitalization	$	52,217	55,279	13,973	15,227

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.

(Dollars in thousands, unless noted)

The following table depicts the Trust's capitalization grant revenue by grant:

		Clean Water		Drinking Water		Total Programs	
		2014	2013	2014	2013	2014	2013
Federal FY 2013 grant	$	33,996	—	11,775	—	45,771	—
Federal FY 2012 grant		11,996	35,988	4,183	12,549	16,179	48,537
Federal FY 2011 grant		—	12,534	—	4,600	—	17,134
Total grant revenue – EPA	$	45,992	48,522	15,958	17,149	61,950	65,671
State match – FY 2013 grant	$	9,065	—	3,140	—	12,205	—
State match – FY 2012 grant		—	9,597	—	3,346	—	12,943
State match – FY 2011 grant		—	—	—	56	—	56
Total grant revenue – state match	$	9,065	9,597	3,140	3,402	12,205	12,999

(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.

(Dollars in thousands, unless noted)

A summary of loan receivables as of June 30, 2014 and 2013 is as follows:

		2014	2013
Leveraged loans or bonds purchased	$	3,693,631	3,932,718
Direct loans		14,145	14,986
Interim loans		365,629	221,956
Principal forgiveness		(166,980)	(184,174)
Total loans receivable		3,906,425	3,985,486
Less current portion loans receivable		437,317	274,421
Long-term portion – loans receivable	$	3,469,108	3,711,065

The interim loan receivable balances were $365,629 and $221,956 as of June 30, 2014 and 2013, respectively. Additionally, the interim loan balances represent disbursements of construction funds of $166,980 and $184,174, 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 17 bond issue occurred in May 2013 and interim loans totaling $161,508 and direct loans totaling $64,321 were permanently financed as part of the Series 17 bond issue.

Aggregate principal maturities on leveraged loans receivable or bonds purchased are as follows:

Years ending June 30:		
2015	$	237,872
2016		234,856
2017		239,777
2018		231,351
2019		236,794
2020–2024		1,084,454
2025–2029		793,325
2030–2034		439,178
2035–2039		159,011
2038–2043		37,013
Total leveraged loans or bonds purchased	$	3,693,631

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

$496,000. 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.

(Dollars in thousands, unless noted)

The following is a summary of bonds payable at June 30, 2014 and 2013:

	Beginning balance, June 30, 2013	Additions	Reductions	Ending balance, June 30, 2014	Due within one year
Water Pollution Abatement Revenue Bonds:					
MWRA Loan Program:					
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	$ 615	—	300	315	315
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	70	—	70	—	—
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	3,660	—	3,660	—	—
Series 2002A, 3.0% to 5.25% issued October 15, 2002, due 2003 to 2032	12,065	—	1,015	11,050	990
South Essex Sewage District Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	755	—	365	390	390
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	2,010	—	545	1,465	575
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	1,515	—	730	785	515
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	23	—	23	—	—
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	295	—	190	105	105
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	85	—	85	—	—
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	3,785	—	3,785	—	—
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	20,190	—	1,675	18,515	1,440

(Dollars in thousands, unless noted)

	Beginning balance, June 30, 2013	Additions	Reductions	Ending balance, June 30, 2014	Due within one year
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2031	$ 8,630	—	560	8,070	470
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	21,040	—	2,065	18,975	1,935
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	72,260	—	24,420	47,840	12,825
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2034	59,315	—	46,215	13,100	13,100
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2035	78,995	—	11,975	67,020	12,340
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2036	311,260	—	179,145	132,115	17,195
Series 13, 3.75% to 5.0%, issued December 18, 2007, due 2008 to 2037	295,790	—	295,790	—	—
Series 14, 1.0% to 5.0%, issued March 18, 2009, due 2009 to 2038	348,570	—	153,225	195,345	15,965
Series 15, 2.0% to 5.192%, issued July 8, 2010, due 2012 to 2040	415,665	—	16,080	399,585	16,605
Series 16A and B, 2.0% to 5.0%, issued June 13, 2012, due 2013 to 2032	240,585	—	6,500	234,085	8,955
Series 17A and B, 0.25% to 5.0%, issued May 22, 2013, due 2014 to 2043	202,250	—	8,160	194,090	7,330
Subordinated Revenue Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	36,460	—	36,460	—	—
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	63,775	—	155	63,620	180

(Dollars in thousands, unless noted)

	Beginning balance, June 30, 2013	Additions	Reductions	Ending balance, June 30, 2014	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	$ 541,680	—	167,785	373,895	63,915
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	188,860	—	13,525	175,335	13,445
Series 2010A, 3.0% to 5.0%, issued July 8, 2010 due 2014 to 2026	41,990	—	4,560	37,430	4,905
Series 2012A and B, 3.0% to 5.0%, issued June 13, 2012 due 2013 to 2032	130,835	—	13,075	117,760	12,045
Series 2014, 2.0% to 5.0%, issued June 12, 2014 due 2015 to 2028	—	565,610	—	565,610	—
Subtotal	3,511,243	565,610	992,138	3,084,715	205,540
Add: Unamortized bond premiums	259,765	102,558	58,028	304,295	—
Total bonds payable	$ 3,771,008	668,168	1,050,166	3,389,010	205,540

(Continued)

(Dollars in thousands, unless noted)

The following is a summary of bonds payable at June 30, 2013 and 2012:

	Beginning balance, June 30, 2012	Additions	Reductions	Ending balance, June 30, 2013	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	$ 600	—	600	—	—
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	1,005	—	390	615	300
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	135	—	65	70	70
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	4,605	—	945	3,660	860
Series 2002A, 3.0% to 5.25% issued October 15, 2002, due 2003 to 2032	16,025	—	3,960	12,065	1,015
South Essex Sewage District Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	1,240	—	485	755	365
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	2,540	—	530	2,010	545
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	2,405	—	890	1,515	730
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	113	—	90	23	23
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	565	—	270	295	190
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	340	—	255	85	85

(Dollars in thousands, unless noted)

	Beginning balance, June 30, 2012	Additions	Reductions	Ending balance, June 30, 2013	Due within one year
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	$ 8,520	—	4,735	3,785	1,025
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	20,600	—	410	20,190	1,675
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2031	9,270	—	640	8,630	560
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	32,835	—	11,795	21,040	2,065
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	84,205	—	11,945	72,260	12,370
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2034	71,540	—	12,225	59,315	12,675
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2035	90,675	—	11,680	78,995	11,975
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2036	327,600	—	16,340	311,260	16,760
Series 13, 3.75% to 5.0%, issued December 18, 2007, due 2008 to 2037	308,000	—	12,210	295,790	12,570
Series 14, 1.0% to 5.0%, issued March 18, 2009, due 2009 to 2038	363,825	—	15,255	348,570	15,630
Series 15, 2.0% to 5.192%, issued July 8, 2010, due 2012 to 2040	431,205	—	15,540	415,665	16,080
Series 16A and B, 2.0% to 5.0%, issued June 13, 2012, due 2013 to 2032	240,585	—	—	240,585	6,500
Series 17A and B, 0.25% to 5.0%, issued May 22, 2013, due 2014 to 2043	—	202,250	—	202,250	8,160
Subordinated Revenue Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	40,850	—	4,390	36,460	—

(Dollars in thousands, unless noted)

	Beginning balance, June 30, 2012	Additions	Reductions	Ending balance, June 30, 2013	Due within one year
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	$ 63,775	—	—	63,775	155
Pool Program Refunding Bonds:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	575,375	—	33,695	541,680	62,210
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	201,825	—	12,965	188,860	13,525
Series 2010A, 3.0% to 5.0%, issued July 8, 2010 due 2014 to 2026	41,990	—	—	41,990	4,560
Series 2012A and B, 3.0% to 5.0%, issued June 13, 2012 due 2013 to 2032	130,835	—	—	130,835	13,075
Subtotal	3,481,298	202,250	172,305	3,511,243	215,753
Add unamortized bond premiums	233,905	40,407	14,547	259,765	—
Total bonds payable	$ 3,715,203	242,657	186,852	3,771,008	215,753

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 June 12, 2014, the Trust issued $565,610 State Revolving Fund Refunding Bonds (at a true interest cost of 2.13%) to refund, $2,760 of the Trust’s Pool Program Series 4 bonds; $12,050 of the Trust’s Series 9 bonds; $33,540 of the Trust’s Pool Program Series 10 bonds; $105,575 of the Trust’s 2004B Refunding bonds; and $2,800 of the Trust’s MWRA Loan Program 1998A bonds. These bonds also advance refunded $162,385 of the Trust’s Pool Program Series 12 bonds; $283,220 of the Trust’s Pool Program Series 13 bonds; and $137,595 of the Trust’s Pool Program Series 14 bonds.

(Dollars in thousands, unless noted)

The Trust used bond proceeds from the refunding bonds in addition to $140,839 of proceeds received from liquidating its Series 13 debt service reserve fund U.S. government securities. 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 $739,925, for a cash flow savings of $123,115, resulting in an economic gain (net present value) of $73,304. The reacquisition price exceeded the net carrying amount of the old debt by $52,427. This accounting loss is being reported as deferred outflows of resources on the Statement of Net Position.

On January 13, 2014, the Trust used $20,700 of proceeds received from terminating certain GIC investments with Portigon and program funds in the amount of $16,500 to refund the Trust's Subordinate Revenue Refunding Bonds under the New Bedford Loan Program Series 1998A. The total debt defeased was $36,460.

On May 8, 2013, the Trust issued Series 17 bonds in the amount of $202,250 consisting of $185,605 State Revolving Fund Bonds, Subseries 17A and $16,645 State Revolving Fund Bonds, Subseries 17B (Federally Taxable). These monies were used to finance water pollution abatement and drinking water projects in 79 communities. Proceeds in the amount of $158,700 were applied to fund loans for projects under the clean water SRF and $67,400 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. The Trust pledged $70,700 of direct loans for projects under the clean water SRF and $27,100 of Direct Loans for projects under the drinking water SRF. The interest payments on these Series 17 pledged direct loans will be used to pay a portion of the debt service due on the Series 17 bonds.

At June 30, 2014, debt service requirements to maturity for principal and interest are as follows:

		Total debt service	Principal	Interest
Year ending June 30:				
2015	$	339,999	205,540	134,459
2016		354,704	220,195	134,509
2017		337,290	212,250	125,040
2018		324,544	209,235	115,309
2019		311,909	207,045	104,864
2020–2024		1,316,306	938,985	377,321
2025–2029		819,333	638,890	180,443
2030–2034		383,659	317,745	65,914
2035–2039		125,029	106,775	18,254
2040–2043		30,448	28,055	2,393
Total debt service requirements	$	4,343,221	3,084,715	1,258,506

(Dollars in thousands, unless noted)

In the current year and in prior years, the Trust has deposited bond proceeds from refunding bonds with an escrow agent to provide resources for all future debt service payments on the refunded bonds. As a result, the bonds are considered to be defeased and the liability has been removed from the financial statements. The balances of bonds defeased "in substance" in the current year or prior years, and still outstanding as of June 30, 2014 are as follows:

Description	Redemption date	Outstanding principal amount 2014	Outstanding principal amount 2013
MWRA Loan Program:			
Series 1993B	November 3, 1999	$ 6,145	11,975
Series 1995A	November 3, 1999	12,230	17,795
Series 1998A	November 3, 1999	39,790	46,680
Series 1998A	June 12, 2014	2,800	—
Pool Loan Program:			
Pool 9	December 14, 2006	$ 139,560	139,560
Pool 9	June 12, 2014	12,050	—
Pool 10	December 14, 2006	168,620	168,620
Pool 10	June 12, 2014	33,540	—
Pool 11	December 14, 2006	87,735	87,735
Pool 11	June 13, 2012	50,780	50,780
Pool 12	August 11, 2009	31,430	31,430
Pool 12	June 12, 2014	162,385	—
Pool 13	June 12, 2014	283,220	—
Pool 14	June 12, 2014	137,595	—

When the Trust refunds or advance refunds it bonds, it calculates the difference between the reacquisition price and the net carrying amount of the old debt. The resulting accounting gain or loss is then amortized over the life of the refunding bonds. The net unamortized excess of acquisition price and the net carrying value of the defeased bonds are recorded in deferred outflows of resources on the Statement of Net Position.

Excess of reacquisition price over net carrying value of defeased bonds:

	2014	2013
Beginning balance	$ 68,636	73,333
Additions	52,427	—
Reductions	(10,053)	(4,697)
Ending balance	$ 111,010	68,636

(7) Net Position

As of June 30, 2014 and 2013, the Trust has a restricted net position in the amount of $1,718,052 and $1,658,888, respectively, and an unrestricted net position in the amount of $409,335 and $412,005, respectively. Restricted net position represents 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, 2014 and 2013, the Trust has agreed to provide loans to various local government units amounting to approximately $175,600 and $53,200, 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 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. The Series 2006 carry an interest rate indexed to the Municipal Consumer Price Index (Muni-CPI).

(Dollars in thousands, unless noted)

Terms – Under the terms of these swaps, the Trust agrees to receive a variable rate, based on the Muni-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	46,605
Fair value at June 30, 2014		(865)	(1,341)
Fair value at June 30, 2013		(1,346)	(2,089)
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, 2014 and 2013, which means on the August 1, 2014 debt service payment date the Trust will make a payment to the swap counterparty. At June 30, 2014 and 2013, the fair value of these swaps is reflected as a liability for derivative instruments and deferred outflows 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, 2014 and 2013, the Trust is not exposed to credit risk because the swaps had a negative 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.

(Dollars in thousands, unless noted)

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, 2014, the variable rate was calculated using the May 31, 2014 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:				
2015	$ —	2,388	618	3,006
2016	—	2,388	618	3,006
2017	—	2,388	618	3,006
2018	—	2,388	618	3,006
2019	—	2,388	618	3,006
2020	—	2,388	618	3,006
2021	—	2,388	618	3,006
2022	—	2,388	618	3,006
2023	30,650	1,914	497	33,061
2024	46,605	720	188	47,513

[1] Calculated rate uses May 31, 2014 Muni-CPI rate to reflect debt service payment for August 1, 2014.

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

(Dollars in thousands, unless noted)

(10) Deferred Outflows of Resources

The following is a summary of deferred outflows of resources at June 30, 2014 and 2013:

		2014	2013
Deferred outflows of resources:			
Derivative instruments (note 9)	$	2,206	3,435
Excess of reacquisition price over net carrying value of defeased bonds (note 6)		111,010	68,636
	$	113,216	72,071