KPMG

MASSACHUSETTS CLEAN WATER TRUST

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements and
Required Supplementary Information

June 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

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

Table of Contents

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 basic financial statements of the Massachusetts Clean Water Trust (the Trust), a component unit of the Commonwealth of Massachusetts, which comprise the statements of net position as of and for the years ended June 30, 2016 and 2015, and the statements of revenues, expenses and changes in net position, and cash flows for the years then ended and the related notes to the financial statements.

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 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 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, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended, in accordance 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 13, 2016 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

Boston, Massachusetts
October 13, 2016

Introduction

The Massachusetts Clean Water 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 establishing the Clean Water State Revolving Fund (Clean Water SRF). 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 (Drinking Water SRF).

The Trust's Clean Water SRF and the Drinking Water SRF 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 SRF programs utilize a "leveraged" financing model, under which federal grants and state matching grants, together with other monies available to the Trust are pledged as security for revenue bonds issued by the Trust. The proceeds of the bonds and other funds of the Trust are used to fund loans to local governmental units and other eligible borrowers for eligible project costs. In addition to loan repayments, 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. As the loans are repaid, the funds "revolve" and become available for new projects.

Since 2002, the Trust has provided loans to communities at 2% interest rate. As the effective market interest rate on the Trust's bonds is higher than the 2% loan rate, the borrowers receive a subsidy equal to the difference between those rates. The Clean Water SRF 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. 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 interest rate for loans from the Trust is typically 2%, as set by statute. However, clean water projects that address nutrient reduction, and projects approved prior to 2002, may receive a rate below 2%.

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 storm water 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; replacement of 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.

Financial Highlights – Fiscal Year 2016

- At the close of fiscal year (FY) 2016, assets and deferred outflows exceeded liabilities by $2.34 billion, as compared to $2.24 billion for FY 2015. Included in this calculation are total loans receivable, which increased $89.0 million to $4.05 billion which increase was offset by a $60.3 million decrease in long term investments, caused by scheduled maturities of debt service reserve fund investments. This reflects the change in assets that are pledged to the Trust's bonds away from debt service reserve funds (i.e., investments) to pledging direct loans.

- On February 11, 2016, the Trust issued Series 19 Green Bonds in the amount of $207.8 million. Proceeds of the Series 19 bonds were used to finance or refinance certain wastewater and drinking water projects in 47 communities. The Trust has designated the Series 19 bonds as "Green Bonds" based on the intended use of the proceeds of the Series 19 Bonds for the financing of projects that adhere to the federal Clean Water Act and Safe Drinking Water Act, as determined by the Environmental Protection Agency (EPA). Proceeds in the amount of $145.7 million were applied to fund loans for projects under the clean water SRF and $99.4 million of proceeds were applied to fund loans for projects under the drinking water SRF. The Trust anticipates expending all of the proceeds within three years. In connection with the issuance of the Series 19 bonds, the Trust made $58.4 million of direct loans for projects under the Clean Water SRF and $39.8 million of direct loans for projects under the Drinking Water SRF. The interest payments on these direct loans will be used to pay a portion of the debt service due on the Series 19 bonds.

- For FY 2016, the Trust recorded operating income of $20.6 million as compared to an operating income of $36.0 million in FY 2015. The $15.4 million change was primarily attributable to a $14.6 million decrease in interest income and contract assistance. Significant contributing factors of this decrease were the change in the fair market value year over year of $13.8 million, as well as a decrease in investment income as the debt service reserve fund investments matured. These decreases in income coupled with increased operating expenses contributed to the change. Operating expenses were notably impacted with the provision of $2.6 million for the programmatic support costs of DEP, including helping to fund the testing of lead in the water of public schools. Moreover, an increase of $1.3 million of principal forgiveness expense, due to the timing of disbursements on qualifying projects, further impacted the change.

- The statement of cash flows indicates an increase in cash for the year of $34.7 million.

- In FY 2016, the Trust continued to receive Capitalization Grants from the Environmental Protection Agency (EPA) for both the Clean Water SRF and Drinking Water SRF programs. The Trust received revenue of $47.4 million from the clean water program and received $16.4 million in the drinking water program. The Commonwealth provided a match of $12.7 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 Investors Service, Standard & Poor's, and Fitch Ratings 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 2015

- At the close of FY 2015, assets and deferred outflows exceed liabilities by $2.24 billion, as compared to $2.13 billion for FY 2014. Included in this calculation are total loans receivable, which increased to $3.96 billion from $3.91 billion, total debt (bonds payable), which decreased to $3.33 billion from $3.39 billion and was offset by a decrease in the total amount of long-term investments and long-term project fund investments (primarily reserve fund investments) to $1.00 billion from $1.03 billion.
- Total assets and deferred outflows of resources of $5.70 billion increased $77 million from $5.62 billion the year before. Total liabilities of $3.46 billion decreased $35 million from $3.49 billion the year before.
- On January 7, 2015, the Trust issued its Series 18 (Green Bonds) bonds in the amount of $228.1 million. Proceeds of the Series 18 bonds were used to finance water pollution abatement and drinking water projects in 68 communities. The Trust designated the Series 18 Bonds as "Green Bonds" based on the intended use of the proceeds for financing projects that adhere to the federal Clean Water Act and Safe Drinking Water Act, as determined by the Environmental Protection Agency (EPA). The purpose of labeling the Series 18 Bonds as Green Bonds was to allow investors to invest directly in bonds which finance environmentally beneficial projects. In connection with the issuance of the Series 18 bonds, the Trust made $81.7 million of direct loans for projects under the Clean Water SRF and $23.5 million of direct loans for projects under the Drinking Water SRF. The interest payments on these direct loans will be used to pay a portion of the debt service due on the Series 18 bonds. On October 30, 2014, the Trust used $40.5 million of its program equity cash to defease all or a portion of its Series 6, 7, 8, 9 and MWRA 99A bonds. All of the equity used for this transaction will be returned to the Trust in approximately 12 years, increasing program capacity by approximately $16.4 million. On March 31, 2015, the Trust used $59.6 million of its program equity cash to advance refund optimal current refunding candidates from Series 12. Equity used for this transaction will be returned in approximately 16 years, increasing program capacity by $43.6 million. The total debt defeased in FY 2015 was $100.1 million.
- For FY 2015, the Trust recorded operating income of $36.0 million as compared to operating income of $3.2 million in FY 2014. The $32.8 million change was primarily due to a $12.0 million decrease in operating expenses as principal forgiveness decreased $2.8 million due to timing of disbursements on qualifying projects and interest expense decreased $7.1 million due to higher interest rate bonds maturing or having been refunded with lower interest rate bonds. These decreases in expenses were coupled with a $20.5 million increase in interest income due to an increase in the fair market value of investments.
- The statement of cash flows indicates an increase in cash for the year of $84.2 million.
- In FY 2015, the Trust continued to receive Capitalization Grants from the Environmental Protection Agency (EPA) for both the Clean Water SRF and Drinking Water SRF programs. The Trust received revenue of $47.0 million from the clean water program and received $16.3 million in the drinking water program. The Commonwealth provided a match of $12.8 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 Investors Service, Standard & Poor's, 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.

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.

Condensed Financial Information and Financial Analysis

(In thousands)

	2016	2015	2014	Percentage change 2016–2015	Percentage change 2015–2014
Current assets	$ 1,085,068	990,101	1,005,129	9.6 %	(1.5) %
Loans receivable, long term	3,664,872	3,591,902	3,469,108	2.0	3.5
Investments, long term	916,829	977,104	1,029,899	(6.2)	(5.1)
Project fund investments	39,431	25,255	—	56.1	100.0
Deferred outflows	100,910	108,352	113,216	(6.9)	(4.3)
Other	1,895	1,928	42	(1.7)	4490.5
Total assets and deferred outflows	5,809,005	5,694,642	5,617,394	2.0 %	1.4
Current liabilities	324,309	318,424	304,331	1.8 %	4.6 %
Loan commitments and project funds payable	39,342	25,233	—	55.9	100.0
Liability for derivative instruments	6,461	5,642	2,206	14.5	155.8
Long-term debt	3,102,307	3,105,887	3,183,470	(0.1)	(2.4)
Total liabilities	3,472,419	3,455,186	3,490,007	0.5	(1.0)
Net position:					
Restricted	1,838,451	1,776,826	1,718,052	3.5 %	3.4 %
Unrestricted	498,135	462,630	409,335	7.7	13.0
Total net position	$ 2,336,586	2,239,456	2,127,387	4.3	5.3

Net position

The Trust's net position at June 30, 2016 and 2015 was $2.34 billion and $2.24 billion, respectively. Total assets and deferred outflows increased $114.4 million to $5.81 billion from $5.70 billion at June 30. This increase was driven primarily by an $89.0 million increase in loans receivable offset by a $60.3 million decrease in long term investments, caused by scheduled maturities of debt service reserve fund investments. This reflects the change in assets that are pledged to the Trust's bonds away from debt service reserve funds (i.e., investments) to direct loans.

The Trust's net position at June 30, 2015 and 2014 was $2.24 billion and $2.13 billion, respectively. Total assets and deferred outflows increased $77.2 million to $5.70 billion from $5.62 billion at June 30. This increase was driven primarily by a $53.7 million increase in loans receivable offset by a $39.4 million decrease in investments. This reflects the change in assets that are pledged to the Trust's bonds away from debt service reserve funds (i.e., investments) to direct loans. Total liabilities decreased $34.8 million to $3.46 billion primarily due to the defeasance of all or a portion of the Trust's Series 6, 7, 8, 9, MWRA 99A and 12 bonds, as described in note 6.

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, 2016, 2015 and 2014 (in thousands). More detailed information can be found in note 6 to the financial statements.

	2016	2015	2014
Water Pollution Abatement Revenue Bonds:			
MWRA Loan Program	$ 9,100	10,060	11,365
South Essex Sewage District Loan Program	285	890	1,855
New Bedford Loan Program	—	270	785
Pool Loan Program	1,466,700	1,362,395	1,328,845
Subtotal revenue bonds	1,476,085	1,373,615	1,342,850
Subordinated Revenue Refunding Bonds:			
MWRA Loan Program	54,040	54,040	63,620
Pool Loan Program	1,462,805	1,583,935	1,678,245
Subtotal revenue refunding bonds	1,516,845	1,637,975	1,741,865
Total bonds	2,992,930	3,011,590	3,084,715
Add: unamortized bond premium	335,272	320,762	304,295
Total bonds payable, net	$ 3,328,202	3,332,352	3,389,010

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	
	2016	2015	2014	2016–2015	2015–2014
Loan servicing fees	$ 5,515	5,315	5,137	3.8 %	3.5 %
Loan origination fees	1,926	2,150	19	(10.4)	11215.8
Interest income	133,905	147,069	126,577	(9.0)	16.2
Contract assistance from Commonwealth of Massachusetts	28,927	30,375	32,388	(4.8)	(6.2)
Total operating revenues	170,273	184,909	164,121	(7.9)	12.7
Department of Environmental Protection programmatic support costs	8,421	5,793	7,418	45.4	(21.9)
Principal forgiveness	6,117	4,797	7,567	27.5	(36.6)
General and administrative	4,092	5,923	7,860	(30.9)	(24.6)
Arbitrage rebate payments	3,785	1,538	166	146.1	826.5
Interest expense	127,247	130,888	137,959	(2.8)	(5.1)
Total operating expenses	149,662	148,939	160,970	0.5	(7.5)
Operating income	20,611	35,970	3,151	(42.7)	1041.5
U.S. Environmental Protection Agency capitalization grants	63,781	63,290	61,950	0.8	2.2
Commonwealth of Massachusetts matching grants	12,738	12,809	12,205	(0.6)	4.9
Total nonoperating revenues	76,519	76,099	74,155	0.6	2.6
Return of Commonwealth initial investment	—	—	20,812	0.0	(100.0)
Total nonoperating expenses	—	—	20,812	0.0	100.0
Increase in net position	97,130	112,069	56,494	(13.3)	98.4
Net position, beginning of year	2,239,456	2,127,387	2,070,893	5.3	2.7
Net position, end of year	$ 2,336,586	2,239,456	2,127,387	4.3 %	5.3 %

A summary of the Trust's interest income is as follows:

Summary of Interest Income
(In thousands)

	June 30			Percentage change	
	2016	**2015**	**2014**	**2016–2015**	**2015–2014**
BAB Subsidy Income	$ 4,266	4,395	4,254	(2.9)%	3.3%
Investment Income	40,234	41,596	53,211	(3.3)	(21.8)
Change in Fair Market Value	20,303	34,149	—	(40.5)	100.0
Loan Interest Income	69,102	66,929	69,112	3.2	(3.2)
Total interest income	$ 133,905	147,069	126,577	(9.0)	16.2

Results of Operations

For FY 2016, the Trust recorded operating income of $20.6 million as compared to operating income of $36.0 million in FY 2015. The $15.4 million change was primarily attributable to a $14.6 million decrease in interest income and contract assistance. Significant contributing factors of this decrease were the change in the fair market value year over year of $13.8 million, as well as a decrease in investment income as the debt service reserve fund investments matured. These decreases in income coupled with increased operating expenses contributed to the change. Operating expenses were notably impacted with the provision of $2.6 million for the programmatic support costs of DEP, including helping to fund the testing of lead in the water of public schools. Moreover, an increase of $1.3 million of principal forgiveness expense, due to the timing of disbursements on qualifying projects, further impacted the change.

For FY 2015, the Trust recorded operating income of $36.0 million as compared to an operating income of $3.2 million in FY 2014. The $32.8 million change was primarily due to a $12.0 million decrease in operating expenses as principal forgiveness decreased $2.8 million due to timing of disbursements on qualifying projects and bond interest expense decreased $7.1 million due to higher interest rate bonds maturing or having been refunded with lower interest rate bonds. These decreases in expenses were coupled with a $20.5 million increase in interest income due to an increase in the fair market value of investments.

The Trust's operating income is negatively impacted by the inclusion of expenses such as DEP programmatic support costs of $8.4 million, $5.8 million, and $7.4 million for FY 2016, FY 2015 and FY 2014, respectively, and principal forgiveness, which are funded by the capitalization grant revenue that is classified as nonoperating revenue.

For FY 2016, the Trust's nonoperating revenue of $76.5 million is consistent with FY 2015 reflecting 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 $1.9 million, or 2.6%, increase in nonoperating revenue in FY 2015 reflects an increase 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.

Future Economic Factors

In August 2014, the Commonwealth enacted Chapter 286 of the Acts of 2014 of the Commonwealth, which provided for $57.0 million in matching capitalization funds to the Clean Water SRF and Drinking Water SRF programs. As of June 30, 2016, matching capitalization funds available to the Clean Water SRF and Drinking Water SRF programs were $47.0 million. 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, 2016 and 2015

(In thousands)

		2016	2015
Assets and deferred outflows:			
Current assets:			
Cash and cash equivalents (note 3)	$	486,629	451,885
Short-term investments (note 3)		97,886	46,526
Project fund investments (note 3)		10,812	1,690
Grants receivable:			
U.S. Environmental Protection Agency		49,667	64,340
Loans receivable, net (note 5)		384,195	368,201
Accrued interest receivable		55,879	57,459
Total current assets		1,085,068	990,101
Noncurrent assets:			
Project fund investments (note 3)		39,431	25,255
Loans receivable, long term (note 5)		3,664,872	3,591,902
Long-term investments (note 3)		916,829	977,104
Other assets		1,895	1,928
Total noncurrent assets		4,623,027	4,596,189
Deferred outflows of resources (note 10)		100,910	108,352
Total assets and deferred outflows of resources		5,809,005	5,694,642
Liabilities:			
Current liabilities:			
Accrued expenses and interest payable		60,307	61,611
Unearned revenue		28,086	28,834
Loan commitments and project funds payable		10,021	1,514
Long-term debt (note 6)		225,895	226,465
Total current liabilities		324,309	318,424
Noncurrent liabilities:			
Loan commitments and project funds payable		39,342	25,233
Liability for derivative instruments (note 9)		6,461	5,642
Long-term debt, net (note 6)		3,102,307	3,105,887
Total noncurrent liabilities		3,148,110	3,136,762
Total liabilities		3,472,419	3,455,186
Net position:			
Restricted for program purposes (note 7)		1,838,451	1,776,826
Unrestricted (note 7)		498,135	462,630
Total net position	$	2,336,586	2,239,456

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, 2016 and 2015

(In thousands)

		2016	2015
Operating revenues:			
Loan servicing fees	$	5,515	5,315
Loan origination fees		1,926	2,150
Interest income		133,905	147,069
Contract assistance from Commonwealth of Massachusetts		28,927	30,375
Total operating revenues		170,273	184,909
Operating expenses:			
Commonwealth of Massachusetts:			
Department of Environmental Protection – programmatic support costs		8,421	5,793
Principal forgiveness		6,117	4,797
General and administrative		4,092	5,923
Arbitrage rebate payments		3,785	1,538
Interest expense		127,247	130,888
Total operating expenses		149,662	148,939
Operating income		20,611	35,970
Nonoperating revenue:			
Capitalization grant revenue:			
U.S. Environmental Protection Agency capitalization grants (note 4)		63,781	63,290
Commonwealth of Massachusetts matching grants (note 4)		12,738	12,809
Total nonoperating revenue		76,519	76,099
Increase in net position		97,130	112,069
Net position – beginning of year		2,239,456	2,127,387
Net position – end of year	$	2,336,586	2,239,456

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, 2016 and 2015

(In thousands)

		2016	2015
Cash flows from operating activities:			
Other cash received from borrowers	$	7,466	5,558
Cash paid to vendors		(16,611)	(10,827)
Net cash used in operating activities		(9,145)	(5,269)
Cash flows from noncapital financing activities:			
Bonds proceeds		245,140	268,686
Cash used in debt refunding		—	(99,633)
Repayment of bonds		(226,465)	(205,540)
Interest paid		(141,504)	(134,400)
Proceeds from U.S. Environmental Protection Agency capitalization grants		78,367	81,210
Proceeds from Commonwealth matching capitalization grants		12,078	12,823
Net cash used in noncapital financing activities		(32,384)	(76,854)
Cash flows from investing activities:			
Loans disbursed to recipients		(346,507)	(300,344)
Cash received from borrowers		222,577	209,803
Contract assistance received – principal		27,056	29,905
Interest received		112,296	108,277
Contract assistance received – interest		30,323	31,897
Purchases of investments		(61,858)	(7,192)
Sales/maturities of investments, net		92,386	93,993
Net cash provided by investing activities		76,273	166,339
Net increase in cash and cash equivalents		34,744	84,216
Cash and cash equivalents, beginning of year		451,885	367,669
Cash and cash equivalents, end of year	$	486,629	451,885
Reconciliation of operating income to net cash used in operating activities:			
Operating income	$	20,611	35,970
Adjustments to reconcile operating income to net cash used in operating activities:			
Reclassification of:			
Interest income		(133,905)	(147,069)
Contract assistance		(28,927)	(30,375)
Interest expense		127,247	130,888
Principal forgiveness		6,117	4,797
Changes in operating assets and liabilities:			
Other assets and liabilities, net		(288)	520
Net cash used in operating activities	$	(9,145)	(5,269)

See accompanying notes to financial statements.

(1) General

(a) Organization

The Massachusetts Clean Water 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 State Revolving Fund (Clean Water SRF) and Drinking Water State Revolving Fund (Drinking Water 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.

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.

In 2016 the Trust implemented GASB 72, *Fair Value Measurement and Application*. Investments are generally carried at fair value. The investment in MMDT is valued at the share value of $1.00 and carried at fair value. The guaranteed investment contracts (GICs) are considered nonparticipating investment contracts and therefore are recorded at contract value.

(e) Allowance for Uncollectible Amounts and Principal Forgiveness

The allowance for uncollectible accounts receivables is determined principally on the basis of past collection experience as well as consideration of current economic conditions. Receivables are reported at the gross amount and an allowance for doubtful accounts would be recognized for that portion of receivables that is deemed uncollectible, based upon a review of outstanding receivables, historical collection information, and existing economic conditions and trends. Because of the absence of any delinquent loans, there is no provision for uncollectible amounts.

Loans are reported net of principal forgiveness expected to be provided upon project completion. The amount of principal forgiveness is determined by the Trust's board and is recorded on a first-in, first-out basis as disbursements are processed, up to the total amount of the principal forgiveness awarded to the individual loans.

(f) 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.

(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.

(Dollars in thousands, unless noted)

(j) Derivatives

Derivative instruments are reported as assets or liabilities at fair value on the statement of net position. Changes in fair value are either deferred or 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 2016 and 2015, the Trust has reported deferred outflows of resources pertaining to its hedging derivative instruments and to the losses on its debt refunding transactions.

(l) Reclassifications

Certain reclassifications have been made to the FY 2015 balances to conform to the presentation used in FY 2016.

(3) Deposits and Investments

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

		Investment maturities (in years)			
Investment type	**2016**	**Less than 1**	**1 to 5**	**6 to 10**	**More than 10**
Guaranteed investment contracts	$ 602,926	$ 119,926	$ 226,720	$ 181,703	$ 74,577
U.S. Treasuries and Agencies	319,023	13,432	76,224	77,004	152,363
MMDT cash portfolio	536,873	497,442	39,431	—	—
MMDT short term bond portfolio	92,765	92,765	—	—	—
Total investments and cash equivalents	$ 1,551,587	723,565	342,375	258,707	226,940

		Investment maturities (in years)			
Investment type	**2015**	**Less than 1**	**1 to 5**	**6 to 10**	**More than 10**
Guaranteed investment contracts	$ 659,912	$ 113,063	$ 239,663	$ 210,802	$ 96,384
U.S. Treasuries and Agencies	322,262	23,550	67,838	79,465	151,409
MMDT cash portfolio	478,830	453,575	25,255	—	—
MMDT short term bond portfolio	41,456	41,456	—	—	—
Total investments and cash equivalents	$ 1,502,460	631,644	332,756	290,267	247,793

(a) Cash and Cash Equivalents

The Trust's cash and cash equivalents primarily consist of the SRF program equity accounts. Use of these funds are governed by the Clean Water Act and Safe Drinking Water Act, and are required to be kept in perpetuity in support of the State Revolving Fund. 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 Bond Resolutions. 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 Massachusetts Municipal Depository Trust (MMDT). The Office of the Treasurer and Receiver-General (Treasury) manages the Commonwealth's short-term external mixed investment pool, 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 investment in MMDT is valued at the share value of $1.00 and carried at fair 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.

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, 2016 and 2015.

(b) Project Fund Investments

The project fund investments are held by the Trustees and disbursed in accordance with executed loan agreements. The project fund investment accounts disburse bond proceeds to borrowers as needed. These funds are restricted and are to be disbursed solely for the applicable project costs associated with the applicable loan financing agreement. When all costs have been paid, any amounts remaining unexpended in the project fund investment accounts will normally be applied to the repayment of the applicable borrower's principal. Project fund investment accounts are invested as part of the MMDT Cash Portfolio.

(c) Investments

Investments primarily consist of debt service reserve accounts established as security for 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 SRF equity accounts. Interest earnings on the debt service reserve accounts are used for debt service payments. The Trust's debt service reserve accounts are invested in either Guaranteed Investment Contracts (GICs) or U.S. Treasuries and Agencies.

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 GICs or in U.S. Treasuries and Agencies. The U.S. Treasuries and Agencies 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 take 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 an 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.

Fair Value Disclosure – Investments

The Trust categorizes its fair value investments within the fair value hierarchy established by generally accepted accounting principles. GASB defines a certain hierarchy of inputs to valuation techniques used to measure fair value. All of the Trusts' investments in U.S. Treasuries and Agencies are categorized as Level 2.

(Dollars in thousands, unless noted)

Inputs within Level 2 of the fair value hierarchy include inputs that are directly observable, these inputs are derived principally from or corroborated by observable market data through correlation or by other means. Investments in debt securities classified as Level 2 of the fair value hierarchy are valued using matrix pricing techniques, in accordance with market quotations or valuation methodologies from reliable financial industry services.

Under existing standards, several types of investments are not required to be reported at fair value. The investment in MMDT is valued at the share value of $1.00 and carried at fair value. For purposes of risk categorization, MMDT shares are not categorized. The GICs are considered nonparticipating investment contracts and are also excluded from the Statement on fair value measurement. These investment values will continue to be measured in accordance with existing accounting standards, and are recorded at contract value.

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	
	2016	**2015**
Provider:		
Dexia Credit Local/FSA Capital Manangement Services, LLC	20%	21%
NATIXIS Funding Corp.	16	17
Trinity Funding Company, LLC	16	15
Citigroup	10	10

(4) Capitalization Grants

The Trust is awarded clean water and drinking water grants from the U.S. EPA. 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.

(Dollars in thousands, unless noted)

The total grants awarded for the Trust's fiscal years ended June 30, 2016 and 2015 are as follows:

		Clean Water Program		Drinking Water Program	
		2016	**2015**	**2016**	**2015**
Federal capitalization	$	47,360	47,603	16,333	16,441
State match on federal funds		9,472	9,520	3,267	3,288
Total capitalization		56,832	57,123	19,600	19,729
Less administrative allowance and set asides		(2,273)	(2,285)	(5,063)	(5,096)
Project capitalization	$	54,559	54,838	14,537	14,633

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:

		Clean Water		Drinking Water		Total Programs	
		2016	**2015**	**2016**	**2015**	**2016**	**2015**
Federal FY 2015 grant	$	35,520	—	12,250	—	47,770	—
Federal FY 2014 grant		11,901	35,702	4,110	12,331	16,011	48,033
Federal FY 2013 grant		—	11,332		3,925	—	15,257
Total grant revenue – EPA	$	47,421	47,034	16,360	16,256	63,781	63,290
State match – FY 2015 grant	$	9,472	—	3,266	—	12,738	—
State match – FY 2014 grant		—	9,521	—	3,288	—	12,809
Total grant revenue – State Match	$	9,472	9,521	3,266	3,288	12,738	12,809

(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 SRF, Drinking Water SRF, and Title V – Community Septic Management Programs.

Each loan to a borrower is in the form of either a loan or a bond purchase agreement, and is pursuant to a financing agreement between the Trust and the borrower. Pursuant to an agreement made with the EPA, projects financed for greater than 20 years are financed through a bond purchase agreement. 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 may provide loans under its Clean Water SRF and Drinking Water SRF programs with terms up to 30 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’s loans to borrowers are funded either through SRF bond proceeds (leveraged loans), or funded with SRF program equity funds (direct loans).

(Dollars in thousands, unless noted)

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 or direct loan.

A summary of loan receivables as of June 30, 2016 and 2015 is as follows:

		2016	2015
Leveraged loans or bonds purchased	$	3,527,080	3,519,380
Direct loans used for bond debt service		394,770	309,871
Other direct loans		9,909	10,574
Interim loans		172,334	266,500
Principal forgiveness		(55,026)	(146,222)
Total loans receivable		4,049,067	3,960,103
Less current portion loans receivable		384,195	368,201
Long-term portion – loans receivable	$	3,664,872	3,591,902

The interim loan receivable balances were $172,334 and $266,500 as of June 30, 2016 and 2015, respectively. Additionally, the interim loan balances represent disbursements of construction funds of $55,026 and $146,222, respectively, to borrowers for which a subsidy was provided in the form of principal forgiveness. The subsidized interim loan amounts will be legally forgiven as the applicable projects are completed.

Principal forgiveness is offered to borrowers, based on eligibility criteria defined by the Trust’s board, to comply with a requirement included in the grant agreement. The Trust provides principal forgiveness on some of its loans, assisting borrowers more in their efforts to comply with water quality standards by making projects even more affordable. Loans funded by principal forgiveness grants are advanced to local agencies on a cost reimbursement basis up to the amount of the awarded principal forgiveness. Loan agreements require repayment of the forgiven loan if all program requirements are not met.

The Series 19 bond issuance occurred in February 2016 and interim loans totaling $201,533 were permanently financed. In connection with the issuance of the Series 19 bonds, the Trust applied a portion of its SRF Program Funds to make direct loans, the interest on which will be applied to pay a portion of the debt service on the Series 19 bonds, thereby supplementing the loan repayment obligations of the local borrowers. Principal payments on the direct loans are pledged as further security for the Trust's bonds. The Series 19 bonds are the fourth series of Trust SRF Bonds to use this approach. As of June 30, 2016, the Trust has $394.8 million in direct loans made for the purpose of paying debt service on Trust bonds.

(Dollars in thousands, unless noted)

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

Years ending June 30:	Leveraged loans	Direct loans used for bond debt service
2017	$ 249,613	$ 16,601
2018	244,375	16,960
2019	249,957	17,327
2020	244,350	17,683
2021	237,803	18,059
2022–2026	1,063,535	94,456
2027–2031	719,060	97,033
2032–2036	375,058	70,107
2037–2041	112,565	25,990
2042–2046	30,764	20,554
	$ 3,527,080	$ 394,770

The Trust's loans to its borrowers are subsidized by interest earnings on its pledged assets which include Debt Service Reserve Funds, direct loans and contract assistance provided to the Trust by the Commonwealth. Although borrowers are obligated to the Trust to make scheduled payments, these subsidies are expected to be available for the lives of the loan financing agreements. The Commonwealth has committed to provide contract assistance in the amount of $323.2 million over 30 years. 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.

(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 Series 19 Bonds issued on February 11, 2016, were the second series of the Trust's bonds to be issued under and secured by the Master Trust Agreement ("MTA"). MTA Bonds are payable solely from the funds pledged to the MTA which include repayments on all loans financed through the MTA Program, together with contract assistance payments, and earnings on certain funds held under the MTA. All other series of Trust bonds are payable from amounts pledged pursuant to the individual Water Pollution Abatement and Drinking Water Project Bond Resolutions, which include payments by local governmental units of principal and interest on the loans, contract assistance, and earnings on amounts on deposit in the Debt Service Reserve Funds or interest received on certain direct loans made by the Trust.

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 pledged as security for the bonds; and contract assistance payments, when received by the Trust are pledged as security for the bonds.

(Dollars in thousands, unless noted)

The following is a summary of bonds payable at June 30, 2016 and 2015:

	Beginning balance June 30, 2015	Additions	Reductions	Ending balance June 30, 2016	Due within one year
Water Pollution Abatement Revenue Bonds:					
MWRA Loan Program:					
Series 2002A, 3.0% to 5.25% issued October 15, 2002, due 2003 to 2032	$ 10,060	—	960	9,100	930
South Essex Sewage District Loan Program:					
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	890	—	605	285	285
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	270	—	270	—	—
Pool Loan Program:					
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	4,085	—	920	3,165	—
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2031	1,530	—	—	1,530	—
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	12,150	—	1,790	10,360	1,630
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	28,905	—	13,255	15,650	1,700
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2035	54,680	—	12,720	41,960	235
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2036	58,640	—	17,660	40,980	18,150
Series 14, 1.0% to 5.0%, issued March 18, 2009, due 2009 to 2038	179,380	—	16,260	163,120	16,625
Series 15, 2.0% to 5.192%, issued July 8, 2010, due 2012 to 2040	382,980	—	17,120	365,860	17,635
Series 16A and B, 2.0% to 5.0%, issued June 13, 2012, due 2013 to 2042	225,130	—	9,170	215,960	9,415

(Continued)

(Dollars in thousands, unless noted)

	Beginning balance June 30, 2015	Additions	Reductions	Ending balance June 30, 2016	Due within one year
Series 17A and B, 0.25% to 5.0%, issued May 22, 2013, due 2014 to 2043	$ 186,760	—	7,365	179,395	7,400
Series 18, 1.5% to 5.0%, issued January 7, 2015, due 2016 to 2045	228,155	—	7,240	220,915	7,775
Series 19, 4.0% to 5.0%, issued February 11, 2016 due 2017 to 2046	—	207,805	—	207,805	7,545
Subordinated Revenue Refunding Bonds:					
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	54,040	—	—	54,040	—
Pool Program Refunding Bonds:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	309,980	—	48,870	261,110	50,990
Series 2006, 3.0% to 5.25%, issued December 14, 2006 due 2007 to 2034	408,215	—	—	408,215	10,685
Series 2009A, 2.0% to 5.0%, issued July 30, 2009 due 2010 to 2029	161,890	—	13,560	148,330	13,305
Series 2010A, 3.0% to 5.0%, issued July 8, 2010 due 2014 to 2026	32,525	—	5,270	27,255	2,180
Series 2012A and B, 3.0% to 5.0%, issued June 13, 2012 due 2013 to 2032	105,715	—	12,695	93,020	16,520
Series 2014, 2.0% to 5.0%, issued June 12, 2014 due 2015 to 2028	565,610	—	40,735	524,875	42,890
Subtotal	3,011,590	207,805	226,465	2,992,930	225,895
Add: Unamortized bond premiums	320,762	37,335	22,825	335,272	—
Total bonds payable	$ 3,332,352	245,140	249,290	3,328,202	225,895

(Continued)

(Dollars in thousands, unless noted)

The following is a summary of bonds payable at June 30, 2015 and 2014:

	Beginning balance June 30, 2014	Additions	Reductions	Ending balance June 30, 2015	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	$ 315	—	315	—	—
Series 2002A, 3.0% to 5.25% issued October 15, 2002, due 2003 to 2032	11,050	—	990	10,060	960
South Essex Sewage District Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	390	—	390	—	—
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	1,465	—	575	890	605
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	785	—	515	270	270
Pool Loan Program:					
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	105	—	105	—	—
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	18,515	—	14,430	4,085	920
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2031	8,070	—	6,540	1,530	—
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	18,975	—	6,825	12,150	1,790
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	47,840	—	18,935	28,905	13,255
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2034	13,100	—	13,100	—	—
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2035	67,020	—	12,340	54,680	12,720
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2036	132,115	—	73,475	58,640	17,660

(Dollars in thousands, unless noted)

	Beginning balance June 30, 2014	Additions	Reductions	Ending balance June 30, 2015	Due within one year
Series 14, 1.0% to 5.0%, issued March 18, 2009, due 2009 to 2038	$ 195,345	—	15,965	179,380	16,260
Series 15, 2.0% to 5.192%, issued July 8, 2010, due 2012 to 2040	399,585	—	16,605	382,980	17,120
Series 16A and B, 2.0% to 5.0%, issued June 13, 2012, due 2013 to 2042	234,085	—	8,955	225,130	9,170
Series 17A and B, 0.25% to 5.0%, issued May 22, 2013, due 2014 to 2043	194,090	—	7,330	186,760	7,365
Series 18, 1.5% to 5.0%, issued January 7, 2015, due 2016 to 2045	—	228,155	—	228,155	7,240
Subordinated Revenue Refunding Bonds:					
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	63,620	—	9,580	54,040	—
Pool Program Refunding Bonds:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	373,895	—	63,915	309,980	48,870
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	175,335	—	13,445	161,890	13,560
Series 2010A, 3.0% to 5.0%, issued July 8, 2010 due 2014 to 2026	37,430	—	4,905	32,525	5,270
Series 2012A and B, 3.0% to 5.0%, issued June 13, 2012 due 2013 to 2032	117,760	—	12,045	105,715	12,695
Series 2014, 2.0% to 5.0%, issued June 12, 2014 due 2015 to 2028	565,610	—	—	565,610	40,735
Subtotal	3,084,715	228,155	301,280	3,011,590	226,465
Add: Unamortized bond premiums	304,295	40,531	24,064	320,762	—
Total bonds payable	$ 3,389,010	268,686	325,344	3,332,352	226,465

On February 11, 2016, the Trust issued its Series 19 Bonds in the amount of $207.8 million. The proceeds of the Series 19 Bonds were used to finance or refinance certain wastewater and drinking water projects in 47 communities. The Trust designated the Series 19 bonds as “Green Bonds” based on the intended use of the proceeds of the Series 19 Bonds for the financing of projects that adhere to the federal Clean Water Act and Safe Drinking Water Act, as determined by the EPA. Proceeds in the amount of $145.7 million were applied to fund loans for projects under the Clean Water SRF and $99.4 million of proceeds were applied to fund loans for projects under the Drinking Water SRF. The Trust anticipates expending all of the proceeds within three years. In connection with the issuance of the Series 19 Bonds, the Trust made $58.4 million of direct loans for projects under the Clean Water SRF and $39.8 million of direct loans for projects under the Drinking Water SRF. The interest payments on these direct loans will be used to pay a portion of the debt service due on the Series 19 bonds.

On January 7, 2015 the Trust issued its Series 18 Green Bonds in the amount of $228.2 million. The proceeds of the Series 18 Bonds were used to finance or refinance certain wastewater and drinking water projects in 68 communities. The Trust designated the Series 18 bonds as “Green Bonds” based on the intended use of the proceeds of the Series 18 Bonds for the financing of projects that adhere to the federal Clean Water Act and Safe Drinking Water Act, as determined by the EPA. Proceeds in the amount of $203.5 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 three years. In connection with the issuance of the Series 18 Bonds, the Trust made $81.7 million of direct loans for projects under the Clean Water SRF and $26.3 million of direct loans for projects under the Drinking Water SRF. The interest payments on these direct loans will be used to pay a portion of the debt service due on the Series 18 bonds.

On October 30, 2014, the Trust used $40.5 million of its program equity cash todefease all or a portion of its Series 6, 7, 8, 9 and MWRA 99A bonds. All of the equity used for this transaction will be returned to the Trust in approximately 12 years, increasing program capacity by approximately $16.4 million. On March 31, 2015, the Trust used $59.6 million of its program equity cash to defease its Series 12 bonds. Equity used for this transaction will be returned to the Trust in approximately 16 years, increasing capacity by $43.6 million. The total debt defeased was $100.1 million.

(Dollars in thousands, unless noted)

At June 30, 2016, debt service requirements to maturity for principal and interest are as follows:

		Total debt service	Principal	Interest
Year ending June 30:				
2017	$	366,596	225,895	140,701
2018		355,040	224,445	130,595
2019		342,756	223,310	119,446
2020		327,606	219,220	108,386
2021		309,574	211,955	97,619
2022–2026		1,267,396	924,445	342,951
2027–2031		740,576	582,230	158,346
2032–2036		321,561	264,770	56,791
2037–2041		103,372	86,585	16,787
2042–2046		33,079	30,075	3,004
Total debt service requirements	$	4,167,556	2,992,930	1,174,626

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, 2016 are as follows:

			Outstanding principal amount	
Description	Redemption date		2016	2015
MWRA Loan Program:				
Series 1995A	November 3, 1999	$	—	6,270
Series 1998A	November 3, 1999		24,660	32,565
Series 1998A	June 12, 2014		—	2,035
Pool Loan Program:				
Pool 9	December 14, 2006		—	139,560
Pool 9	June 12, 2014		—	12,050
Pool 10	December 14, 2006		—	168,620
Pool 10	June 12, 2014		—	33,540
Pool 11	December 14, 2006		—	87,735
Pool 11	June 13, 2012		—	50,780
Pool 12	August 11, 2009		31,430	31,430
Pool 12	June 12, 2014		162,385	162,385
Pool 12	March 31, 2015		56,280	56,280
Pool 13	June 12, 2014		256,965	270,280
Pool 14	June 12, 2014		137,595	137,595

(Dollars in thousands, unless noted)

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 generally 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 (deferred outflows of resources – see note 10):

		2016	2015
Beginning balance	$	102,710	111,010
Additions		—	—
Reductions		(8,261)	(8,300)
Ending balance	$	94,449	102,710

(7) Net Position

As of June 30, 2016 and 2015, the Trust has a restricted net position in the amount of $1,838,451 and $1,776,826, respectively, and an unrestricted net position in the amount of $498,135 and $462,630, respectively. Restricted net position represents capitalization grants received cumulative to date from the EPA and corresponding matching amounts received from the Commonwealth, required to revolve back to the program. 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, 2016 and 2015, the Trust has agreed to provide loans to various local government units amounting to approximately $163,748 and $111,586, respectively, excluding loan 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).

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:

(Dollars in thousands, unless noted)

		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, 2016		(2,361)	(4,100)
Fair value at June 30, 2015		(2,169)	(3,473)
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, 2016 and 2015, which means on the August 1, 2016 debt service payment date the Trust will make a payment to the swap counterparty. At June 30, 2016 and 2015, the fair value of these swaps is reflected as a liability for derivative instruments and deferred outflows in the accompanying financial statements. GASB defines certain hierarchy of inputs to valuation techniques used to measure fair value. Derivative instruments are classified as Level 2 of the fair value hierarchy 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, 2016 and 2015, 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 Swaps and Derivatives 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, 2016, the variable rate was calculated using the May 31, 2016 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:				
2017	$ —	1,546	1,461	3,007
2018	—	1,546	1,461	3,007
2019	—	1,546	1,461	3,007
2020	—	1,546	1,461	3,007
2021	—	1,546	1,461	3,007
2022	—	1,546	1,461	3,007
2023	—	1,546	1,461	3,007
2024	30,650	1,239	1,173	33,062
2025	46,605	466	443	47,514

[1] Calculated rate uses May 31, 2016 Muni-CPI rate to reflect debt service payment for August 1, 2016.

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

(Continued)

(Dollars in thousands, unless noted)

(10) Deferred Outflows of Resources

The following is a summary of deferred outflows of resources at June 30, 2016 and 2015:

		2016	2015
Deferred outflows of resources:			
Derivative instruments (note 9)	$	6,461	5,642
Excess of reacquisition price over net carrying value of defeased bonds (note 6)		94,449	102,710
	$	100,910	108,352