DISTRICT OF COLUMBIA
WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance & Budget Committee

Thursday, October 26, 2006

9:00 a.m.

MEETING MINUTES

COMMITTEE MEMBERS	**WASA STAFF**
Glenn Gerstell, Chairman	Jerry Johnson, General Manager
Dr. Jacqueline Brown	Olu Adebo, Acting Chief Financial Officer
Anthony Griffin	Avis M. Russell, General Counsel
Paul Folkers	Linda Manley, Board Secretary

Other Board Members in Attendance
David J. Bardin

Chairman Glenn Gerstell called the meeting to order at 9:10 a.m.

FINANCIAL OVERVIEW

Olu Adebo, Acting Chief Financial Officer, reported that at the end of September, the Authority continued to meet its key financial and budgetary expectations. September is the last month of the fiscal year, and the report includes expenditure projections. Staff will finalize a number of year-end accruals for claims and other estimated costs over the next two months. Because of stronger than anticipated performance in FY 2006, WASA made a contribution of $27 million to the rate stabilization fund, raising the balance to $58.5 million.

Operating Revenues and Receipts

Next, Mr. Adebo reported that fiscal year 2006 operating receipts (reflecting all revenue categories) totaled $296.2 million, or 102 percent of budget. This better-than-budgeted performance is due in part to WASA's strong collections program.

Operating Expenditures

Mr. Adebo continued with a review of operating expenditures. As of this report date, year-to-date operating expenditures totaled 92 percent of budget. Management currently projects that WASA will end the year at approximately 94 percent of the board-revised budget with savings of approximately $17.5 million. In the chemicals and supplies area WASA expect to end the year at approximately 108 percent of budget because of higher unit prices on the majority of its contracts. Spending for water purchases will end the year at 116 percent of budget. Mr. Adebo explained that water purchases are currently paid on a consumption basis; a rate is determined at the beginning of the fiscal year and based on the rate and consumption, WASA pays its share based on consumption to the Washington Aqueduct. WASA pays approximately 76 percent of the Washington Aqueduct's actual costs and at year end we provide an actual settlement based on actual costs.

Mr. Bardin inquired about the $3 million increase in water purchase expenditures and the historical year-end actual trends versus budgetary estimates in each year. In providing historical perspective on the water purchases category, Mr. Johnson explained that several years ago management discovered that the Washington Aqueduct was holding excessive reserves for WASA's water purchases. In order to use those excess reserves in a manner that would best benefit WASA's customers, management worked out an arrangement with the Washington Aqueduct. The arrangement allowed the Washington Aqueduct to provide WASA a rate at the beginning of each fiscal year with adjustments to that rate on an annual basis to reduce the Washington Aqueduct reserve balance. After exhausting the reserve balance, WASA began to pay the rate as billed and make an adjustment at year end based on actual consumption.

Mr. Bardin requested a written explanation of WASA's basis for estimating the Aqueduct's charges and an overview of WASA's process for accounting for year-end actual costs to WASA. Additionally, Mr. Bardin requested that at the time the Retail Rates Committee considers retail rates, that management provide a tentative update to ensure Board consideration of that information. Mr. Adebo added that retail rates the Board approves are based on the revised budget. Mr. Bardin asked whether the wholesale customers remit their payments based on the revised budget or actual expenditures. Mr. Adebo responded that the wholesale customers pay based on the revised budget and there is also an annual true-up based on actual costs. The wholesale customers' settlements are typically completed in March of each year. Mr. Bardin asked management to provide a report on the wholesale customer settlement amounts. In comparing the wholesale customer settlements to retail customers, will the retail customer enjoy any true-up or downward adjustment in their rates. Mr. Johnson responded that retail customers benefit from WASA's use of Pay-Go financing for certain capital projects; and, from WASA's contributions to the rate stabilization fund, which offset expenses.

Mr. Bardin stated that if the Board had known when it set the rates that expenditures would be 6 percent less than anticipated it may not have approved a 5 percent rate increase in retail rates because it would not have been justified. Mr. Gerstell acknowledged that as part of the nature of the the Aqueduct procedures, there is a point at which there is a true-up and recognition of the actual costs. Mr. Gerstell noted, however, that during the course of the Rate Committee's and the Board's deliberations in approving the 5 percent rate increase, there was an acknowledgement of declining costs. It was noted, moreover, the rate that was approved are not tied to a particular year's budget. The rates are set in part based on actual expenditures over the then, current fiscal year in addition to a consideration of how much WASA should charge in rates today to account for future debt service requirements. Even if there were a dramatic decline in expenditures for one fiscal year, the Board could still, based on WASA's gradual and predictable rates policy, increase the rates. Mr. Bardin asked who makes the decision concerning the amount of funds to transfer to the rate stabilization fund (RSF) at year-end. Mr. Gerstell responded that management makes that decision, with Board review and approval. As part of the Retail Rates Committee's budget review session, management will provide both historical on the RSF and a proposed policy for Board consideration that outlines the utilization of the rate stabilization fund.

Dr. Brown asked whether the Washington Aqueduct is a separate fiscal entity and if WASA has an arrangement with the Aqueduct to reimburse WASA for water purchases. Mr. Johnson responded that there is a water purchase agreement that WASA executed with the Washington Aqueduct. This Agreement lays out the terms of the purchases and the method of payment. In prior years the Washington Aqueduct placed monies remitted into their reserves. Early in the history of WASA, management determined that the Aqueduct had a higher level of reserves than warranted. We worked out a projected rate, and WASA received credits from the existing reserves, thereby holding down the costs to our customers. In addition, WASA takes advantage of the interest on those reserve funds. Based on the current agreement, WASA pays for approximately 76 percent of the Washington Aqueduct's capital operating expenses.

Mr. Griffin stated that 25,000 customers in Fairfax County receive their water from the Washington Aqueduct through the City of Falls Church and there is not any more control over what the costs are, similar to electricity. The Washington Aqueduct essentially determines what its costs are and passes those costs on to its customers, often with no prior notice for significant increases. This is why WASA's Board has expressed interest in the potential of WASA eventually controlling the Washington Aqueduct since a majority of its purchases are made on behalf of citizens of the District of Columbia. The Washington Aqueduct is unique to the Army Corps of Engineers and is ultimately under the supervision of the District Engineer.

Continuing with the financial report, Mr. Adebo reported that utilities expenditures will exceed budget by approximately 13 percent, or $3 million due to high electricity prices; the September average price for electricity was considerably lower than in prior months. Mr. Adebo anticipates savings in several categories that will offset projected overspending in chemicals and utilities. Specifically, savings in personnel services are attributed to higher than budgeted vacancies in the major operating departments and less than budgeted union pay increases based on the arbitrator's settlement with the union; in contractual services primarily because of underspending in the biosolids management program; and, and in debt service where we will end the end the year at 25 percent less than budget due primarily to lower than projected capital spending. We expect these savings to offset budget issues in chemicals and utilities.

Capital Spending

Capital spending totaled $191.3 million, or approximately 80 percent of the Board's approved disbursements budget. Disbursements were less than budgeted in the wastewater treatment, sanitary sewer, Washington Aqueduct and capital equipment service areas. The Department of Engineering and Technical Services is in the process of completing their project-by-project, year-end review of the capital program and will provide this report next month.

Rate Stabilization Fund, Cash and Investments

The actual average operating reserve balance for September totaled $118.3, or $15.9 million in excess of the Board reserve requirement of $102.4. Because of stronger than anticipated performance in FY 2006 and a $22.4 million settlement received from the Washington Suburban Sanitary Commission. (WSSC), we contributed $27 million to the rate stabilization fund increasing the balance to $58.5 million.

In discussing WASA's investment performance, Mr. Adebo reported that the September yield on the Authority's investment portfolio was 5.35 percent. The targeted benchmark is the three-month Treasury bill, which had a return of 4.93 percent, or 42 basis points higher than the targeted benchmark rate.

Mr. Gerstell asked that management provide the rate stabilization fund report to the other members of the Finance and Budget Committee as well as to the Retail Rates Committee. Mr. Bardin agreed providing the rate stabilization fund information to both committees could prove useful.

Retail and Wholesale Accounts Receivable

To ensure clarity of information provided on the "Retail Accounts Greater than 90 Days by Customer Class", Mr. Bardin asked for an explanation of the table on page 5. After discussion, Mr. Griffin suggested that staff change the first column heading from WASA to Active which would further clarify the information provided in the table. This will provide a clearer reference for accounts and dollars reflected for commercial, multi-family and residential customers.

Automated Meter Reading

Mr. Bardin noted that according to the graphs provided in the report, with approximately one-third of the installation period gone, only 17.31 percent of large meter installations and 14.39 percent of small meter installations have been completed and unless the program is accelerated the July target completion date will not be met. Mr. Bardin asked staff for a report in two months to discuss how staff will meet the July completion date and include in the monthly reports a graph on how the AMR consumption changes from month to month, currently reported at 80 percent. The consumption number has been flat for the last several months. Mr. Johnson responded that customers are not necessarily resisting meter implementations, but there have been several ancillary issues such as standardizing the approach for installing the meters, installing screens to reduce maintenance costs. In addition, there was difficulty finding a contractor to do the work and many large buildings could not shut down business during the summer months while we installed the meters so work was postponed until the fall of the year. It was management's view that we would be able to catch up after the cooling season is over. In some cases we will have to provide a water by-pass while we complete the meter installation. Management had planned to reassess progress at the end of December or first of January and then further assess the July target completion date. Overall, WASA have received support from the customers as WASA work through these issues and continue to aggressively manage this project. Mr. Bardin asked General Counsel Avis Russell to research WASA's authority as it pertains to action on recalcitrant accounts. Specifically, does the General Manager have authority to discontinue water service; if not, whether the Board can provide the necessary authority if it is not provided.

Electricity

Mr. Folkers asked whether staff is considering locking in a larger percentage of WASA's electricity load at the lower rates. Mr. Adebo responded that the strategy used throughout the year is that one-third is locked for most of the year, one-third is locked during the peak periods of August through September, and December and February; and, WASA float the final one-third. Staff also continues to explore electricity procurement alternatives including participation in the DC Energy Office's Municipal Aggregation Program (DCMAP). Mr. Folkers suggested that staff take advantage of the cycles and pricing to lock in when prices are historically the lowest. Mr. Adebo reported that the proposed FY 2008 budget estimates electricity costs at $60 per MWH.

Accounts Payable Performance

Mr. Bardin noted the progresses made in accounts payable performance since WASA's inception. Recent accounts payable performance has declined to 90 percent in FY 2005 and 89 percent in FY 2006. Given the fact that recent performance is lower than the goal, Mr. Bardin asked whether the goal is reasonable and if so what measures are underway to prevent further slippage and ensure continuing performance. In responding to this question, Mr. Johnson noted that the issue is one of how staff review and analyze some of the billings. For example, in one area where the department have relatively low performance, the department head has saved WASA a significant number of dollars as a result of closer scrutiny of the bills. Because of understaffing in the administrative staff for this department, the department head continues to review each bill. Mr. Johnson would like to maintain the 97 percent goal and see what happens once we are appropriately staff in the departments and in our Accounts Payable unit. Mr. Gerstell asked when the 30 day clock begins. Mr. Johnson responded that the clock begins upon WASA's Accounts Payable Unit's receipt of the invoice; disputed invoices are not included in calculating the bill payment completion rates. After further discussion, Mr. Johnson agreed that management will continue to assess accounts payable actual performance as well as the performance goals.

Budget Calendar

Mr. Johnson reviewed the FY 2008 budget calendar, Attachment 3 to the report, and outlined recommended dates and milestones for completion of the budget reviews with the Committees and final action by the full Board. Following the same outline as in prior years, any questions from board members pertaining to the FY 2008 budget proposals should be directed to Board Secretary Linda Manley who will distribute the questions to staff for response and ensure that the board members receive timely response to their inquiries. Ms. Manley will schedule budget review sessions for the Finance and Budget, Environmental Quality and Operations and Retail Rates Committees.

Mr. Bardin asked if February 1 is the last possible date for Board adoption to meet statutory obligations. Mr. Adebo responded that in the past the board has adopted the budget in January which allows staff to forward the budget to the District for inclusion in their March budget submittal. Staff will research statutory requirements, if any, and deadlines for submittal of WASA's budget to the District; and, report back to the Board during the Committees budget review sessions.

Action Items

Next, Mr. Johnson asked the Committee to consider three contract action items:

- **Financial Advisor** – Committee approved the selection of Public Financial Management (PFM), Inc. to provide financial advisory services including advice on the Authority's debt management program, the Authority's overall financial plan, sizing and timing of debt issuances, short-term funding strategies, investments and other assistance as requested. Dr. Brown asked about minority participation under the PFM contract. Mr. Adebo responded that PFM is partnered with a Miami-based minority firm; PFM did not receive any preference points because the company is not locally-certified firm.

- **Extension of Rates and Financial Consulting Services Contract** – PB Consult currently serves as WASA's rate and financial consultants and provides rate-setting, financial consulting, insurance and risk management services. Performance to date by PB Consult has been satisfactory and the contract expired in September 2006. To emphasize the importance of expanding WASA's outreach to minority-based firms, Dr. Brown asked about the percentage of minority participation under the PB Consult contract. Mr. Gerstell expressed the importance of applying a consistent approach to reviewing contract. Mr. Adebo responded that PB Consult does not have any minority subcontractors. After discussion, the Committee tabled this action item to allow further review by the Retail Rates Committee. Since the contract primarily includes retail rates matters; Mr. Bardin suggested that in addition to the Finance and Budget Committee, the Retail Rates Committee should also review this contract. If required, Mr. Bardin suggested that staff should process a one or two-month contract extension to allow for through Committee review.

The Committee requested that the Board Secretary Linda Manley distribute PB Consult contract to members of the Retail Rates Committee electronically for review. Mr. Gerstell asked Ms. Manley to include it as an administrative agenda item during the November Board meeting to allow Board members to raise any issues at that time.

- **Exercise Option years for the Lease of 810 First Street, NE** – Committee action is needed to ratify the original contract agreement from 10/15/98 through 9/30/03 and to continue on an annual basis from 10/1/03 through 10/14/08. Based on a recent staff audit, this contract was noted for Board review and action as it exceeds the $1 million threshold requiring Board review. Mr. Gerstell asked whether Mr. Johnson is satisfied that necessary financial system and controls are in place to flag all contracts as they approach the $1 million threshold. Mr. Johnson assured Mr. Gerstell that the necessary controls are in place and staff will provide a report on the specific controls in place during next month's Committee meeting. The Committee approved this contract extension.

General Manager's Budget Presentation

Ms. Manley distributed copies of the operating and capital budget proposals for FY 2007 and 2008.
Next, Mr. Johnson provided his review of FY 2006 accomplishments and presented financial highlights contained in the budget documents. Mr. Johnson outlined various initiatives and priorities, which underlie the budget. The capital improvement program (CIP) and ten-year plan reflects Board Strategic Plan priorities: customer and community services, organization effectiveness, environmental quality and financial stability. The revised FY 2007 operating budget totals $311.2 million, $0.5 million less than the approved FY 2007 budget. The decrease in the revised FY 2007 budget is due primarily to lower debt service costs resulting from lower capital spending in FY 2006.

The proposed FY 2008 budget totals $341.1 million, a $30 million increase over the revised FY 2007 budget. As in prior years, the majority of this increase is due to additional debt service as the capital program progresses. In addition, the Authority's utilities budget increases to accommodate electrical energy costs consistent with market trends and pricing.

This year's 10-year capital program totals $2.2 billion (on a cash disbursements basis), which is 22 million less than last year's CIP plan, primarily due to reductions in the wastewater treatment area where plant upgrade completions will result in less funding for Blue Plains Plant-related projects after 2010; and the Water Service area, with conclusion of the lead service replacement program in 2014.

Mr. Johnson commended Olu Adebo and the budget staff for their hard work in preparing the budget proposals for doing a tremendous job in pulling this information together.

Mr. Gerstell asked whether the current budget proposals include any CSO LTCP funding other than the initial $140 million of capital budget amounts originally approved. Mr. Johnson responded that CSO LTCP funding is included in the proposed CIP.

Mr. Gerstell asked how much of the $21 million debt service increase in FY 2008 is attributable to debt service costs as opposed to interest rates forecasts. Mr. Adebo stated that the debt service increase is almost entirely attributable to newly issued debt.

Mr. Bardin asked when the changes in the stormwater rates will occur, as WASA has recommended this action to the District Council. Mr. Johnson responded that he is hoping that this change will occur in FY 2007, to be effective FY 2008 and would result in doubling the stormwater fee. Mr. Bardin asked that staff footnote this information to advise retail customers concerning this potential increase.

Mr. Bardin asked discussions with wholesale customers on their reasonable share of the right-of-way/payment-in-lieu of taxes fee. Mr. Johnson responded that the wholesale customers have asked for documentation to support what their reasonable share of the PILOT/ROW cost would be which would be approximately 60 percent of their portion to wastewater treatment plant operations. There are also lost opportunity costs cited concerning 52 acres of properties in the District. Staff continues to discuss this matter with the wholesale customers. Mr. Bardin asked for a monthly footnote concerning the wholesale customers' share and the bottom-line impact to retail customers assuming enactment of these changes.

Chairman Gerstell, Paul Folkers, Dr. Brown Anthony Griffin and Paul Folkers extended congratulations to Mr. Johnson, Mr. Adebo and the budget staff for their preparation of the budget proposals.

Hearing no further business, Chairman Gerstell adjourned the meeting at 11:16 a.m.