DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Joint Meeting of the Environmental Quality and Operations and Finance and Budget Committees

Thursday, November 18, 2004

8:30 a.m.

MEETING MINUTES

BOARD MEMBERS	WASA STAFF
Glenn Gerstell	Jerry Johnson, General Manager
James Caldwell	Paul Bender, Chief Financial Officer
David J. Bardin	Avis Marie Russell, General Counsel
Lucy Murray	John Dunn, Chief Engineering Officer
David Lake	Michelle Cowan, Director of Finance and Budget
Brenda Richardson	Leonard Benson, Director of Engineering and Technical Services
Stephanie Nash	Linda R. Manley, Secretary to the Board

Chairman Gerstell called the meeting to order at 8:45 a.m.

Operating Budget and Capital Improvement Program Review

Mr. Johnson provided a general overview of the revised FY 2005 and proposed FY 2006 operating and capital improvement budget requests. Several accomplishments for FY 2004 that Mr. Johnson noted include WASA continuing to maintain its “AA” category bond ratings; progress in negotiations for the Combined Sewer Overflow Long Term Control Plan; and improving programs and processes to benefit our customers. For the second consecutive year, WASA surpassed its capital spending targets and management expects this historically high spending trend to continue for the next three to five years. Mr. Johnson reported that in FY 2004 WASA replaced approximately 1,800 lead service lines, received National Biosolids Partnership certification, redesigned the WASA web site and issued $295 million in auction rate securities.

Mr. Johnson reported that the revised FY 2005 and FY 2006 budgets, capital improvement program, and ten-year plan reflect the Board’s strategic plan priorities. The FY 2005 operating budget totals $275.3 million, in line with the Board-approved budget, and the proposed FY 2006 operating budget totals $290.3 million, an increase of $15 million over the revised FY 2005 budget. Proposed staffing levels remain significantly less than 1998 levels even with the addition of 16 positions, 12 of which are included for support of lead-related activities. The proposed FY 2006 budget reflects a reduction of 13 positions due to the Blue Plains internal improvement program.

To support the FY 2005 and FY 2006 budgets, management proposes a five percent rate increase for FY 2006, less than previously presented to the Board, primarily due to better than budgeted financing results. Beyond FY 2006, rate increases of 7.0 to 9.5 percent are required, primarily due to WASA's addition of the lead program to the CIP.

Mr. Bender provided an overview of WASA's short-term and long-range financial plans and specific Board actions required to adopt the proposed operating and capital budgets. At the December Rates Committee meeting, Mr. Bender will provide further detail concerning the proposed rate and fees changes. The Finance and Budget Committee will be asked to recommend adoption of the following actions by the Board:

- Revised FY 2005 & proposed FY 2006 operating budgets
- FY 2004 – 2013 financial plan
- FY 2004 – 2013 capital improvement program
- FY 2006 capital authority request
- Proposed FY 2006 Stormwater Enterprise Fund budget
- 2005 reimbursement resolution
- Capitalization of lead program expenditures

The Environmental Quality and Operations Committee will be asked to recommend adoption of the following actions by the Board:

- FY 2004 – 2013 capital improvement program
- FY 2006 capital authority request
- Proposed FY 2006 Stormwater Enterprise Fund budget

In January, the Board will consider budget-related resolutions.

Mr. Bender presented an overview of the revised FY 2005 and proposed FY 2006 operating budgets. Mr. Bender reported that these budgets include a 5.0 percent annual increase for overall compensation adjustments, reduced the vacancy levels reflecting capital improvements at the plant and associated efficiencies. The cost for electricity impacts both the FY 2005 and 2006 budgets, representing a $5.4 million increase over original FY 2005 budget levels. The other major change is in the debt service category, where we anticipate a $135 million bond issuance for FY 2006. Mr. Bender discussed major assumptions underlying the ten-year plan including AMR-related consumption increases and the impact of a 20-year CSO LTCP implementation schedule versus the 40-year schedule outlined in the budget documents.

Chairman Gerstell inquired about the assumption regarding a one percent annual decline in consumption and whether this was in part due to increasing rates (price elasticity). Mr. Bender responded that reduced consumption is primarily attributable to WASA's declining customer base.

Mr. Bardin asked about the impact on the median residential customer of the change in the proposed FY 2006 rate increase from 6.5 percent presented this past summer and the current proposal of 5.0 percent. Mr. Bender explained that on a monthly basis a one percent change would represent 40 to 45 cents per month or approximately $5.00 per year.

Mr. Bender reported that the 10-year plan reflects the addition of the $300 million increase for the lead service replacement program, which is the reason for higher levels of rate increases in FY 2007 through 2009. The rate stabilization fund's $27.5 million is fully utilized during this three-year period to avoid even higher rate increases than currently reflected. Additionally, the impact of a 20-year CSO LTCP implementation schedule versus the 40-year schedule outlined in the budget documents causes higher rate increases in the latter years of the plan assuming no federal funding; if WASA receives federal funding, the projected rates would decline accordingly.

Mr. Bardin asked about the impact of 50 percent federal grant funding of the CSO LTCP. Mr. Bender responded that 50 percent grant funding would not significantly impact the current 10-year financial plan, but it would impact the next ten years of increases. Staff will report back to the Board after completing further analysis.

Chairman Gerstell inquired about the FY 2007 through FY 2009 increases, and whether the reduction in rates thereafter was because the impact of the rate increases is reflected in the base and no further rate increases are needed for the lead program. The Chairman asked Mr. Bender to provide further analysis of alternate scenarios including delaying or smoothing rate increases. Mr. Bender reported that the current plan supports the replacement of 2,800 lead service replacement in FY 2005, followed by consistent replacement of lead service lines at the rate of 3,500 to 4,000 for the remainder of the program. Mr. Bardin asked that Mr. Bender provide analysis that considers a level 8.5 percent increase for FY 2007 through FY 2009 by changing the early-year increases, including FY 2006.

Mr. Bender proceeded with an overview of WASA's rates as generally compared to other utilities. Mr. Bardin asked staff to compare WASA's rate structure and its attractiveness to water-intensive industrial users. Mr. Bardin also asked management to investigate whether surrounding utilities' rate structures may not currently reflect the level of spending required to address regulatory issues over the next ten to twenty years.

Mr. Johnson acknowledged that there is some conservatism in the comparisons: some jurisdictions are making PILOT payments, while others are not; some are multijurisdictional with varied rate structures; some of them have newer facilities while others have older facilities and are attempting to rebuild or renovate similar to what WASA is doing. One of the factors to consider is that the District of Columbia did not increase its rates for ten years; and, during that that period of time there was significant disinvestment in the system. At the time, rates were changed by 42 percent; it was changed under the recommendation of two outside consultants that they be increased by 70 percent in order to do what was necessary. WASA's rates are in catch up to other jurisdictions that may have been keeping up with spending and addressing other needs. Mr. Johnson noted that one factor to consider when making comparisons of various utilities to WASA's rates is structure. He added that WASA is fortunate to have policy direction and ratemaking authority, which is often not the case in many other utilities. In some instances large industrial users may be subsidizing residential users in the rate structure so it makes their rates look artificially low when used in comparison of residential versus all users in those jurisdictions.

Michelle Cowan provided a financial overview of the capital improvement program and noted that after years of relatively low capital spending and completion rates, in FY 2003 and FY 2004 WASA reached the peak of the current ten-year capital program with projected spending of $293 million and $317 million, respectively. The total CIP is $2.1 billion for FY 2004 through 2013, a $300 million increase above the plan adopted by the Board last year. The increase is attributable to the lead service replacement program, increase in digesters and the change in the CSO LTCP from a 40-year to 20-year schedule. The biggest part of the capital program is still Blue Plains totaling approximately $713 million, of which close to half is for the new digester at around $310 million. The second largest component of the CIP is water projects totaling $568 million, half of which is for the lead program. The third largest component of the program is CSO, which is a change from the 40-year plan that was distributed in the budget books. This reflects the first nine years of a 20-year program resulting in an increase of approximately $130 million over what was published in the budget document. The balance of the remaining categories remains relatively constant with prior years. Ms. Cowan reviewed the project disbursements schedule for the proposed FY 2004 through FY 2013 capital improvement program and the FY 2006 capital authority request.

A discussion of water quality issues followed with questions about the Washington Aqueduct's budget projections, and its impact on WASA's capital program. Mr. Johnson reported that staff continues to work with Washington Aqueduct staff to further develop and refine their long-range budget estimates. Mr. Thomas Jacobus, General Manager of the Washington Aqueduct, confirmed his staff's review of assumptions underlying the $10 million annual spending estimates.

Leonard Benson provided a summary of the FY 2004 – FY 2013 lifetime budgets, the basis for both the disbursements and authority budgets. Chairman Gerstell noted that several committee meetings are scheduled for December during which remaining questions concerning the capital program can be addressed. Mr. Gerstell also encouraged Board members to submit their questions in writing before next month's meetings so staff can address all questions. Mr. Johnson also encouraged Board members to submit any questions they have concerning the capital program to the Board Secretary so that she can track them and ensure quick response.

Mr. Bender proceeded with an update on the electricity procurement. WASA received five bids with market prices approximately five percent higher than they where in the first indicative pricing received in early October 2004. The current bids are now within about five percent of Pepco's standard offer service, and as a result we have rejected all of the bids. Our strategy at this point is to go back to each of the suppliers to discuss the possibility of working out price caps or buying options contracts either through them or separately to cap our costs at about the current levels. This would provide WASA the ability over the course of the year to buy energy on an indexed rate and take appropriate action based on price changes. All of these options were available under the current request for proposals. We have until mid-January to work out all of the terms of the procurement.

Next Mr. Bender discussed two fact sheets associated with the rolling owner-controlled insurance program (ROCIP). Both contracts exceed the Board's threshold limit of $1 million and require Committee review and action. The contracts are for Aon Insurance Services, $2.5 million, to secure excess general liability insurance through October 2009 and program administration services for one year for WASA's ROCIP program. The second contract, for Ace Insurance Services, is for $3.4 million to secure primary worker compensation and general liability insurance through October 2009 for WASA's ROCIP. Based on lower bids for construction contracts that we are experiencing, we expect approximately $5 million in savings over the five-year period, or approximately 1 percent of capital project costs. Other benefits include lower insurance costs and an improved safety program.

Next, Mr. Johnson led a discussion of issues surrounding the Washington Aqueduct's water treatment processes and recent news events. Mr. Johnson referred to a City Council hearing on November 17 concerning the Spring Valley cleanup efforts led by the Army Corp of Engineers. At the last Board meeting, Mr. Jacobus briefed the board on the perchlorite issue that was the subject of a Washington Post article. Staff has been closely monitoring and working with the Aqueduct and will continue to update the Board with developments. Mr. Thomas Jacobus provided an overview of the Aqueduct's treatment process, including their drainage systems and their potential impact on chemical compositions of groundwater (not in the water treatment process). Mr. Jacobus also discussed elevated perchlorite levels found in the Spring Valley area. EPA has no maximum contaminate level for perchlorite in drinking water, which can have damaging effect on the thyroid. However, the EPA does provide a method detection limit of 4ppb for perchlorite and to date the EPA has made clear statements that the Aqueduct is well below the level of concern and that there is not a drinking water problem. The Aqueduct knows that there is contamination in the groundwater that passes beneath their sedimentation basins. There is speculation about ammunitions buried near the Dalecarlia Treatment plant and the potential for high levels of perchlorite in the sedimentations that could possibly affect the reservoir and pass into the water treatment process. EPA has several simultaneous efforts underway which are unclear at this point and the Aqueduct is doing additional sampling. To date none of the groundwater contamination is coming into the basins.

Brenda Richardson asked that staff invite a representative from the Health Department to speak to the Board concerning health impacts of perchlorate.

Mr. Bardin expressed concerns about WASA continuing to provide free, no cost filters to everyone, whether they are rich or poor. Mr. Bardin stated for the record his disagreement with the proposal to capitalize filter costs. The Board will discuss this matter in December.

At 10:58 p.m., Chairman Gerstell ordered a closed session to discuss a litigation issue.

The Committee reconvened into open session and the meeting was adjourned.