DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance and Budget Committee

Thursday, March 24, 2005

MEETING MINUTES

BOARD MEMBERS	WASA STAFF
Glenn Gerstell	Jerry Johnson, General Manager
Anthony Griffin	Paul Bender, Chief Financial Officer
Paul Folkers	Michelle Cowan, Director of Finance and Budget
	Meena Gowda, Principal Counsel
	Linda Manley, Secretary to the Board

Chairman Gerstell called the meeting to order at 9:07 a.m.

Financial Overview

Michelle Cowan, Director of Finance and Budget, reported that at the end of February, we are five months through fiscal year 2005 and the fiscal year is 42 percent complete. March marks the midpoint of fiscal year 2005, with 50 percent of the fiscal year complete and as in prior years, staff will provide the Board with a detailed financial review at next month's Finance and Budget Committee meeting.

Operating Receipts

Continuing with highlights for the month of February, Ms. Cowan reported that all revenue categories are on track with budget with no significant issues to report and with 42 percent of the fiscal year complete, we have collected 46 percent of our budget. The federal government, wholesale customers and the District government pay their bills on a quarterly basis. Ms. Cowan reported that even if we exclude customers who remit quarterly payments, receipts are 2 to 3 percent ahead of budget.

Operating Expenditures

Next, Ms. Cowan provided an update on operating expenditures at the end of February, with 42 percent of the fiscal year complete. Operating expenditures totaled $101.7 million (including debt service and PILOT/ROW), or 37 percent of the $278.1 million revised operating budget. Excluding debt service and PILOT/ROW, for operations and maintenance costs, the budget is $205.5 million, of which we spent $76.2 million or 37 percent.

Approximately 80 percent of WASA's operations and maintenance budget, excluding debt service and PILOT/ROW, is accounted for by three categories of spending: personnel services, contractual services and water purchases from the Aqueduct. These categories are on track with budget. Personal services is on track because of vacancies as well as lower than budgeted overtime spending and even if we were to fill all of the recruitments currently underway we will still end the year within budget in this category.

Ms. Cowan reported that there are no significant issues in contractual services and that WASA should end the year under budget in the water purchases category.

As previously reported to the Board, the two areas of potential budget risks are chemicals and utilities. Ms. Cowan noted that staff will discuss utilities in more detail later in the meeting. In discussing chemicals, Ms. Cowan explained that WASA experienced its first month of significant price increases for chemicals that were included in the Council of Governments (COG) chemical contracts that began February 1. Beginning in February, we experienced higher costs for methanol and some of the larger chemicals. Ms. Cowan assured the Board that at this time we expect the budget contingency to accommodate variations in prices and fluctuating chemical volumes. Staff will continue to monitor chemical costs and report any issues to the Board.

Ms. Cowan reported good performance in the debt service area where WASA's annual budget for debt service is $56.3 million. Year-to-date debt service payments total $18.8 million, or 33 percent of budget with 42 percent of the fiscal year completed. Although rates have increased in line with the general market, performance remains strong as compared to budget on the $295 million of auction rate securities. Ms. Cowan reported that auction rate program savings to date are approximately $2.8 million. Although short-term rates have been increasing, WASA is paying 1.70 percent year-to-date as compared to the FY 2005-budgeted interest rate of 4 percent.

Chairman Gerstell asked whether the auction rate program savings are savings in comparison to the budget or to what the fixed interest rate would have been if WASA had issued fixed rate debt last year. Mr. Bender responded that the fixed rate would have been approximately five percent and year-to-date the average interest rate paid has been under 2 percent for every month. Ms. Cowan noted yesterday's 35-day notes sale increased to 2.40 percent, which is the highest we have experienced. Last month's 35-day issuance was at 2.08 percent.

Capital Expenditures

Ms. Cowan reported that WASA's capital budget is $297 million and year-to-date spending is lower than originally projected. To provide context in reviewing capital spending, Ms. Cowan noted that we are spending substantially higher than we have historically and the capital disbursements budget is higher. Ms. Cowan noted that spending for FY 2004 was $238 million and for FY 2003 $204 million.

Capital disbursements in February totaled $14.2 million. With 42 percent of the fiscal year complete, total capital spending is $83.4 million, or 28 percent of budget. Ms. Cowan advised the Committee that staff prepares quarterly capital spending budgets and original projections. At the beginning of the fiscal year, we estimated $151 million of capital disbursements by the end of March 2005, but at current spending levels we will not meet that target. The largest area of spending this year is for Blue Plains wastewater treatment area projects which accounts for 40 percent of the capital budget. In February, significant spending occurred for Primary and Secondary Treatment Facilities Upgrade projects and the Grit and Screen Facility Upgrade projects.

Water Service Area projects are approximately 30 percent of the capital budget. At the end of February, year-to-date spending on water capital projects totaled $25.6 million, or 28 percent of the

FY 2005 budget. This category includes the lead program where disbursements have been slightly less than anticipated. However, we expect spending to accelerate over the next five months as existing contracts continue and work proceeds under an additional construction contract recently put in place for the lead program. Staff will update their analysis of capital spending in March and will report the results of the analysis at Finance and Budget Committee meeting in April.

Cash Reserve and Investments

Ms. Cowan reported that the current cash balance is $223.9. The cash balance includes reserves for the Combined Sewer Overflow appropriations fund ($75.1 million) and the rate stabilization fund ($27.5 million). Net of these two reserves, the operating reserve balance totaled $121.3 million, in excess of the Board required of $97.7 million. Ms. Cowan reported that for the remainder of the year we should be well above Board reserve policy targets.

Our yield in February on the Authority's investment portfolio was 2.45 percent as compared to our targeted benchmark, the three-month Treasury bill, which had a return of 2.58 percent, a difference of 13 basis points. We are lagging behind the Treasury bill rate because of the two-year discount notes that WASA entered into last summer when rates were relatively low. We are exceeding our budgeted interest rate of 2.25 percent so there are no budgetary or revenue issues to report. Ms Cowan noted that with the Federal Reserve's rate increase this week, short-term rates are also increasing.

Electricity Procurement Update

Mr. Bender discussed the status of current prices, which are increasing, and WASA's next procurement for electricity service beginning in January.

__Pricing.__ Mr. Bender distributed charts showing average monthly pricing at the PJM Western Hub for the past five years. As previously reported to the Board, at an average price of $42, prices for 2004 were the highest experienced during the past six years. In 2003, the average price was approximately $37. We started our new contract for Blue Plains' power with Amerada Hess on January 22, 2005 and locked in pricing for 23 percent of our load and we are floating the remaining 77 percent. During the first three months of experience under the Amerada Hess contract, pricing is comparable to or lower than the same period in 2004, which as noted above, was a historical high. Mr. Bender cautioned that pricing could be volatile due to oil prices, weather and other factors so there is no guarantee that we will end the year in the $42 range. Mr. Bender noted that historically we have experienced the highest prices during the months of January, February and March. In February, prices averaged $53 per MWH. If prices continue at current levels, Mr. Bender emphasized that there will be budgetary issues, however, it is premature to discuss at this point.

Mr. Griffin asked what our budget anticipated in terms of average prices per MWH. Mr. Bender reported that Board-authorized contract and FY 2005 budget assume an average of $42 per MWH for the full year for the variable portion, or approximately 77 percent of our electricity prices that WASA is purchasing on the spot market. In February, we paid $53 per MWH as compared to the budget of $42 per MWH. We need to average under $40 for the remainder of this fiscal year in order to remain within budget, which appears to be achievable if prices decrease.

Mr. Griffin asked what assumptions underlie the FY 2006 budget. Mr. Bender reported that the budget assumes that approximately one-quarter of our load locked in at $47. We are projecting $45 per MWH for the remaining load.

__Procurement Alternatives for 2006.__ Mr. Bender reported that staff has begun preparation for our next power procurement for 2006. One option is to partner with WSSC. Other alternatives include continuing WASA's contract with Amerada Hess, or advertising an RFP within the next few months similar to the WSSC contract with Constellation, where Constellation runs auctions on behalf of WSSC for all block power purchases. WASA would solicit proposals for a provider to run the auctions. The provider would charge a fixed price for this service, and to the degree that WASA chose not to lock in pricing for blocks of power, the provider would supply power at PJM Western Hub index rates. The contract would have a longer term, allowing WASA to lock in power purchases via the auction process for beyond a year if pricing met our benchmarks.

Mr. Gerstell asked whether joining with other purchasers would provide WASA with more market power and what are the geographical limits on power purchases. Mr. Bender explained that bigger is not necessarily better. Bigger and more chaotic or variable load where providers cannot figure out what the customer's ultimate demand for power will be is probably worse as the providers will require a premium for that uncertainty. Similarly, certain governmental contract provisions and procurement requirements can also result in pricing premiums. For example, requiring providers to hold prices open for a lengthy period (beyond a period of hours) in order to secure governing body approval can result in pricing penalties. Another example is termination for convenience clauses that allow the government to get out of a contract with no notice and no financial penalty. Mr. Bender noted that the District entered into a two year contract for roughly the same amount of electricity as WASA. Pricing was \$62 per MWH and included certain similar provisions. Mr. Bender noted that WASA's load is very stable at Blue Plains, making it attractive to providers. Other utilities such as WSSC can have similar load factors (with the exception of pumping facilities), making them potentially attractive partners with WASA.

Mr. Griffin noted that in Virginia, the counties and cities joined together to form a local government network organized by the Virginia Municipal League (VML) to negotiate a three-year contract with Dominion Power.

Mr. Bender reported that the Washington Aqueduct would be a good entity to partner with however federal procurement issues would present concerns.

Mr. Johnson will explore the possibility of WASA partnering with VML, and noted that he understood the VML arrangement to have differential rates for pumping facilities, general municipal governments, etc. Mr. Griffin noted that a challenge WASA may face in a partnership with VML would be that the provider is different. Mr. Bender noted that Dominion is planning to become a supplier in the PJM network and WASA would potentially have the option to contract with Dominion once they become a supplier in the PJM network.

Insurance Update

Next, Mr. Bender provided an insurance update for policies expiring in April. WASA's costs will be slightly lower this year. Under the public officials' liability policy, terms have improved since last year. The retention amount (i.e., "deductible") has been reduced from \$500,000 to \$350,000 for standard claims and from \$1,000,000 to \$500,000 for bond-related claims. On liability coverage, the AEGIS and EIM excess liability policy coverage is still the best option. They were proposing about a 30 percent premium increase for the FY 2005/2006 renewals. However, during the negotiations our insurance/risk management consultants were actively involved and successful in highlighting a variety of improvements underway at WASA. These discussions resulted in a 5 percent premium increase for the FY 2005/2006 renewals. The improvements should mitigate the kind of large claims issues that concern insurers. Now the premium costs relate to specific events rather than solely the general condition of the utility. This was a good outcome, however staff will continue to monitor this area closely for next year.

Extension of policy terms. Mr. Bender reported that staff included quotation options on all coverages to extend the policies until June 15, 2006. We also plan to shift the upcoming October 2005 property insurance renewal date to coincide with the June 15 date to make the insurance renewal process more efficient. Staff selected the June 15 date to ensure adequate time to finalize insurance before the hurricane season. Mr. Bender referenced the attached premium summary that shows costs for a 12-month period. The cost of the extensions is a pro rata increase for 2 ½ months.

Third Party Claims Administrator. Mr. Bender reported the selection of a TPA firm at the end of a very competitive process. Total annual costs for TPA services are projected at $133,500, a 60 percent reduction from what we pay our current TPA. The competitive market is a reason for this reduction, but our substantially reduced claims experience over the past two years is also a major factor. Mr. Gerstell asked staff to provide copies all of the new policy binders, especially the D&O policy.

D.C. Workers Compensation Commission

Mr. Bender reported concerning an issue that has existed for four years. Since April 2001, WASA has been self insured for the first $1 million per claim for workers compensation. Subsequently, the D.C. Workers Compensation Commission verbally notified WASA's Risk Manager of its conclusion that WASA was required to obtain their approval to be self-insured. WASA's Risk Manager notified WASA's CFO that she had verbally obtained the opinion of WASA's General Counsel that WASA was not required to obtain the approval of the D.C. Workers Compensation Commission to be self-insured.

In October 2004, the Workers Compensation Commission informed WASA's CFO of its continuing conclusion that WASA was required to obtain their approval to be self insured for workers compensation, submitted invoices for self insurance fees of approximately $400,000 for FY 2003 actual and FY 2005 forecast, and notified WASA that it would have to post security acceptable to the Commission.

WASA's General Counsel reviewed this issue in early 2005 and concluded that WASA was under the jurisdiction of the Commission for administration of its workers compensation program. WASA's CFO then met with the Commission staff and reached agreement on the terms under which WASA would be self insured:

- Pay the outstanding assessments for FY 2003 and FY 2005 – no assessments would be imposed for F Y2001 or FY 2002. The Commission staff informed WASA that all self-insured companies in the District pay the same fees on the same basis as WASA's fees were calculated.

- Pay future assessments. In September of 2005, WASA will receive assessments for FY 2004 actual and FY 2006 forecast, estimated at approximately $400,000 for the two. Ongoing assessments thereafter are estimated at approximately $275,000 annually.

- Post security by either 1) a Board authorized reservation of WASA's cash reserves or 2) a letter of credit – this is a variance from the usual Commission requirement for a bond and will be more economical for WASA. Commission staff estimated the security requirement to be less than $2 million.

Staff believes this agreement is reasonable, have paid the Commission's assessments and believe this resolves this issue. The Workers Compensation Commission agreed to a $1 million allocation rather than us having to secure a bond and have the option to drop this bond at a later date. Next month, staff will bring the agreement before the Board for consideration.

Letter of Credit

Mr. Bender reported that WASA's commercial paper program and the letter of credit that backs the program is in place until November 2006. Our letter of credit is with a German bank, West LB. Since we have put the commercial paper program in place, West LB is going to lose the backing of the state government, which backstops the bank at this point and results in the bank's double-A credit ratings. Since WASA does not have any commercial paper outstanding and market conditions are good for these services right now, we are considering changing the existing letter of credit. This would entail redoing the commercial paper program, something we would likely have to do by November 2006 anyway when we would have commercial paper outstanding at that time.

The options are to go with a different letter of credit provider, which is essentially another bond deal or possibly sign a five to ten year extension with West LB. Staff will provide a recommendation to the Board for consideration next month.

WSSC Question

Mr. Folkers asked for additional detail concerning the costs and issues surrounding the WSSC receivable. Staff will provide this information. Mr. Johnson reported that Mr. Bruce Romer arranged an introductory meeting with the new WSSC General Manager and several of WASA's management staff. Now that WSSC management is stabilized, Mr. Johnson expects continuing communications with WSSC to resolve outstanding issues.

Chairman Gerstell adjourned the meeting at 9:44 a.m.