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**DISTRICT OF COLUMBIA**

**WATER AND SEWER AUTHORITY**

# Board of Directors

Finance and Budget Committee

## Thursday, April 24, 2014

11:00 a.m.

MEETING MINUTES

**Committee Members in Attendance DC Water Staff**

Timothy L. Firestine, Committee Chairperson George Hawkins, General Manager

Robert L. Mallett, District of Columbia Mark Kim, Chief Financial Officer

Adam Ortiz, Prince George’s County Randy Hayman, General Counsel

James Patteson, Fairfax County Gail Alexander-Reeves, Director, Budget

Obiora “Bo” Menkiti, District of Columbia (via phone) Robert Hunt, Manager, Treasury and Debt

Linda Manley, Secretary to the Board

**Other Presenters and Guests**

Nelson Bush (PFMAM)

Robert Cheddar (PFMAM)

David Calvert (PFMAM)

**Call to Order**

Chairperson Timothy Firestine called the meeting to order at 11:00 a.m.

**Operating Revenues, Expenditures and Capital Disbursements**

Mr. Mark Kim, CFO, provided an executive summary of the operating revenues, expenditures and capital disbursements due to the extensive agenda items for discussion at the meeting. At midyear of FY 2014, Mr. Kim reported that operating revenues were on target while, operating expenditures and capital disbursements are tracking very close to budget for this reporting period. Increased personnel expenditures are consistent with the wage adjustments effective in FY 2014, while the increased electricity costs are attributable to the extreme cold weather conditions (Polar Vortex effect). Staffs are reviewing futures market prices and anticipate purchasing electric hedges for the summer peak period.

In response to Chairman Timothy Firestine’s question on attributing part of the electricity cost increase to the tunnel boring project, Mrs. Gail Alexander-Reeves, Director, Budget responded that the associated costs would be capitalized with no impact on the operating budget and being reported as part of the overall Authority’s electricity costs. She also noted that the year-to-date capital labor charges are consistent with anticipated costs for the reporting period with year-end estimated at $16 million.

Mr. Kim also cautioned the Committee concerning an increase in capital disbursements due to planned acceleration of activities in the Clean Rivers, Digester, and Enhanced Nitrogen Removal (ENR) Projects during the second half of the fiscal year. Anticipated increase is $75 - $100 million over previous projections and the Chief Engineer would provide detailed review in next month’s report.

**2014 Plan of Finance Update**

Mr. Kim outlined the Plan of Finance for 2014 and reported that the kickoff meeting is planned for this afternoon (4/24/2014) with our financing team. The plan calls for issuing approximately $350 million in new debt, with a sale date of late July 2014. The structure currently under consideration comprises two series of bonds: (1) $250 million fixed rate (“century” bonds) in the taxable market and (2) $100 million variable rate (30 or 40-year final maturity) in the traditional tax exempt market. He explained that the proceeds of the fixed rate series will be used to finance a portion of the Clean Rivers Project which are comprised of tunnel assets designed with minimum service life of 100 years. He further noted that to better match DC Water’s assets and liabilities, the financing team is planning to issue 100 year bonds to finance these assets. The issue of “intergenerational equity” was also raised and discussed.

Mr. Kim briefed the Committee that while this is a first in the industry and for DC Water, it is not an uncommon practice around the world, noting that other large corporations, sovereign nations, financial institutions, transportation and higher education institutions with high credit ratings have accessed the century bond market. In response to Committee members’ inquiry, Mr. Kim noted that due to the unique, innovative and unprecedented nature of the century bonds concept, he plans to review the feasibility of issuing these long dated bonds with the Committee in the upcoming months. He further noted that the Authority would seek to certify these bonds as “Green Bonds” with a new class of socially responsible investors (SRIs), which would make the bonds more attractive and increase the number of potential buyers. The prospect of issuing century bonds will be further discussed with the bond rating agencies and underwriters in May.

**Investment Portfolio Management Update**

Mr. Kim stated that to date, DC Water’s investment portfolio has been managed part time by in-house staff, Mr. Robert Hunt, and plans to move towards active portfolio management using an external team of investment professionals. Since the portfolio has grown exponentially since inception from $25 million to $250 million currently, and expected to rise to $600 million with new bond proceeds, there is a need for professional active portfolio management. He briefed the Committee that DC Water already has a contract with PFM Asset Management LLC (PFMAM), which has been producing the required monthly investment report, and is being recommended to provide investment advisory services going forward. This is expected to provide the Authority with greater portfolio diversification and investment returns. PFMAM representatives gave a brief presentation of their company’s investment strategy and philosophy, and addressed questions from Committee members.

**Investment Policy Revisions**

Mr. Mark Kim briefed the Committee on management’s proposed revisions to DC Water’s Investment Policy, which included the following 5 changes aimed at providing safety, liquidity and return on investment:

1. Deletion of Diversity as an object;
2. Changes to and additions to the types of Authorized Investments;
3. Addition of Sector and Issuer limits on investments;
4. Change in the description of Core Portfolio; and
5. Addition of the Engagement of Investment Managers.

In response to a question from Mr. James Patteson, Mr. Kim and PFMAM representatives discussed the risks and cost-benefits the Authority would derive from making the proposed modified changes to the Investment Policy. While the expansion of the investments includes greater portfolio diversification and higher investment returns, there are appropriate management controls in place to manage the associated higher risks being undertaken. These risk controls include limitations on duration of the investments (< 5 years), established credit rating triggers at the AA level (consistent with the U.S. Government and DC Water's credit ratings), established concentration limits around each of the asset classes and active portfolio management by outside team of professionals. CFO Kim stated that these changes would set forth the investment and operational policies for management of the Authority’s funds.

Additionally, in response to Chairman Firestine's inquiry on the affected funds, Mr. Kim confirmed that these investments will be used for all funds except as restricted by bond documents.

**Banking Services RFP Recommendation**

Mr. Robert Hunt, Manager, Treasury and Debt, presented a Fact Sheet with recommendation to award the Authority’s banking services to TD Bank, N.A., for a one year contract base period with four option years. He gave an overview of the RFP process, responses and evaluations undertaken for the three proposals received with TD Bank being the highest rated offeror. Mr. Hunt reported that the services of TD Bank over the past years were deemed satisfactory and introduced the representatives of TD Bank and Industrial Bank responsible for the management of DC Water's accounts.

**Action Items**

The Committee members recommended moving the following action items for Board approval:

1. Revisions to the Investment Policy; and
2. Banking Services Contract with TD Bank, N.A.

**Agenda for May Committee Meeting**

The Committee accepted the agenda for the May Committee Meeting, scheduled for May 22, 2014; at 11:00 a.m. with no changes.

**Executive Session**

The Committee went on executive session at 12:05 p.m. to discuss proprietary matters related to outsourcing of the Authority’s investment portfolio management services. The Committee reconvened into open session at 12:30 p.m.

**Adjournment**

Chairperson Firestine adjourned the meeting at 12:30 p.m.

**FOLLOW-UP ITEMS**

1. Identify the pros and cons of issuing century bonds and impact on DC Water’s current and future assets **(Mr. Patteson).**