DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance & Budget Committee

Thursday, May 24, 2007

9:00 a.m.

MEETING MINUTES

COMMITTEE MEMBERS	**WASA STAFF**
Robin Martin, Chairman	Jerry Johnson, General Manager
Timothy Firestine	Avis M. Russell, General Counsel
Paul Folkers	Olu Adebo, Acting Chief Financial Officer
Keith Stone	Linda Manley, Board Secretary

<u>Other Board Members Participating</u>
David J. Bardin (By Telephone)

Chairman Robin Martin called the meeting to order at 9:24 a.m. and explained that Board member David Bardin would participate in the meeting by telephone. Chairman Martin asked Mr. Firestine, Chairman of the Audit Committee, to provide a summary report from the 8:00 a.m. meeting today of the Audit Committee.

Independent Fire Hydrant Audit

Mr. Firestine reported concerning a matter raised by the General Manager during an earlier meeting of the Audit Committee today. On May 23, Mr. Johnson attended a meeting convened by the District of Columbia Council Committee on Public Safety and the Judiciary. The meeting, and a subsequent report today in the Washington Post, focused on the recent fire hydrant issues. Concerns have arisen concerning two governmental agencies (D.C. Fire Department and WASA) representing different opinions with respect to the number and availability of hydrants in the system. One recommendation, which the Audit Committee and Mr. Johnson agree is a good approach, is to provide for an independent review or analysis. This would lend credibility to what could be perceived to be a serious public safety issue in the District of Columbia. WASA would hire a reputable audit firm that would assist in defining the scope of the audit, with a short turn around time, to provide some preliminary results and conclusions regarding the two approaches used by both agencies. The full Board will receive information later today concerning this recommendation. Mr. Johnson will attempt to make this review a joint effort by both the D.C. Fire Department and WASA to ensure that both agencies provide their perspectives and support this effort.

Board Chairman Martin identified the driving force for this activity, which is to provide working hydrants throughout the District of Columbia. WASA's core value, and therefore the basis for the recommended fire hydrant audit, is to ensure public safety and service to first responders and citizens involved in unfortunate fire activity by ensuring that they have access to water. It is essential that the Fire Department has access to fire hydrants that are in good working condition. Also of paramount importance is that both agencies identify non-working fire hydrants, conduct timely repairs or replacements and quickly place the fire hydrants back in service. Chairman Martin expressed confidence on behalf of the full Board and General Manager Johnson that the Authority welcomes the audit and is both responsible and sufficiently responsive so that whatever results from the audit.

April 2007 Financial Report

Next, Chairman Martin asked Mr. Adebo, Acting Chief Financial Officer to provide the monthly financial report. Mr. Adebo reported that at the end of April, the Authority continued to meet all of its key financial and budgetary expectations. With approximately 58 percent of the fiscal year completed, revenues totaled $173.9 million or 57 percent; operating expenditures slightly trail budget at $154.1 million or 49.3 percent; and, capital spending $99.2 million or 44.3 percent of budget. Actual average daily cash balances for the month totaled $121.1 million, which is $10.4 million above the Board's 180-day reserve requirement.

Chairman Martin asked why the year-to-date financial performance table shows an expenditure budget for FY 2007 that appears to be higher than revenues (receipts). Referring to the FY 2007 Cash Flow Summary, Chairman Martin asked whether the transfers to capital account for the difference. Mr. Adebo explained that the $312.4 is the expenditure budget while the cash flow statement includes the cash flow budget. In providing additional clarification, Mr. Firestine explained that expenditures would include obligations where no cash has changed hands so the two statements are not comparable, which is fine as one is on an expenditure basis and the other statement is presented on a cash basis. Mr. Adebo explained that the cash flow statement is included because it shows from a coverage perspective that WASA has sufficient revenues in excess of expenses. Chairman Martin asked about presentation of year-to-date financial performance data. In response, Mr. Adebo asked the Committee for additional guidance concerning information they would like to see, or format preferences for the monthly financial reports.

Operating Revenues and Receipts

Mr. Adebo summarized operating revenues and receipts for the month of April. Revenues are $173.9 million or 57 percent of budget. Residential, commercial and multi-family receipts totaled $90.3 million thru April and this category accounts for approximately 53 percent of total revenues. Revenues in this category are slightly trailing budget, however, Mr. Adebo expects revenue will increase during the summer months when consumption increases and he expects to end the year on budget in this revenue category.

At $21.9 million, federal receipts are on track with budget and the financial report reflects WASA's receipt of the third quarterly payment. All other revenue categories are on track with budget and there are no major revenue issues to report.

In referring to the table on page three of the report which provides a breakdown of retail receipts into water and sewer, Mr. Bardin asked what time period the table applies to. Chairman Martin responded that the table covers the same time period as the entire report, through April 30, 2007. Mr. Bardin asked Mr. Adebo to add the period information to the table for future reports.

Operating Expenditures.

Next, Mr. Adebo provided a report of operating expenditures as detailed in the financial report. At the end of April, expenditures totaled $154.1 million, or 49 percent of the FY 2007 Board budget and all spending categories are in line with budget. Mr. Adebo continued with a report on an exception basis.

In referring to the overtime section of the report, Chairman Martin stated that for ongoing issues, the report should provide information on management's recommendations and any actions taken to address budget pressures. Mr. Johnson explained that overtime spending remains within the Authority's $4.7 million overtime budget and pending pressures are occurring in several departmental areas. Mr. Adebo explained that WASA typically experiences increased overtime usage in the winter season associated with water main and other emergency system repairs. Typically overtime usage declines during the spring and summer months, however this year, several departments such as Water Services and Sewer Services have experienced more overtime usage due primarily to fire hydrant repairs and other system repairs.

With the exception of the chemicals category, Mr. Adebo expects to end the year within budget in all operating categories. Mr. Adebo expects WASA will overspend the budget for the chemical line item by approximately $1.5 to $2.0 million; and, he expects to absorb this increase thru savings in other categories. He projects total operations and maintenance spending will remain within the authorized budget level.

Mr. Firestine asked Mr. Adebo to explain the $10.2 million Right of Way/Payment in Lieu of Taxes (ROW/PILOT) expenditure on a GAAP basis (for October through April) as detailed in the report. Mr. Adebo explained that the PILOT/ROW is a fixed amount, determined at the beginning of each fiscal year. Although WASA make quarterly payments to the District of Columbia for PILOT/ROW, we accrue for planned disbursements since the payment amounts are already known. The memorandum of understanding between WASA and the District of Columbia provides for a total annual obligation at a fixed amount, which totals $17.5 million for fiscal year 2007 of which $5.1 million is for ROW. The current agreement expires on August 15, 2013. The PILOT fee increases annually based on the increase in retail rates, an agenda topic planned for later in the meeting.

<u>April 2007 Capital Program</u>
Mr. Adebo reported that in April capital spending totaled 99.2 million, or 44 percent of the FY 2007 revised disbursements budget. Currently spending is on track with budget for projects in Blue Plains and Long-Term-Control Plan program areas. Spending for the Water service area is currently lagging, however staff will prepare revised capital program projections in July.

Chairman Martin asked about the report reference to the Washington Aqueduct's (WAD) first disbursement for FY 2007 at $2.3 million. Mr. Adebo explained that the WAD provides WASA with its spending plan and no requests for payments were made until April. WASA staff continues to work with WAD staff to update spending plans and identify projects that are running behind schedule. In July, as part of the third quarter capital project spending review, management will provide the Committee with updated spending projections for the WAD.

Electricity

<u>Mirant Plant</u>
Chairman Martin asked for a report on management's continuing efforts to mitigate the Authority's exposure to higher electricity costs by seeking electricity procurement alternatives and locking in additional portions of the Authority's electricity load. There are events now happening that may impact electricity production. Mr. Johnson reported that he sent to the Board copies of letters written to the Virginia Department of Environmental Quality, Office of Air Quality, regarding a hearing that was being held on Tuesday, May 22. Staff has completed considerable analysis on this issue. The Mirant Plant, located in Alexandria, Virginia, currently provides electricity to Blue Plains. Blue Plains is the largest single point user of electricity in this area. WASA recently had a

second feeder tied into the plant to come from another power source; however staff is concerned as to whether this source was totally independent from the Mirant Plant and experienced some problems when WASA energized the power supply from the second source. WASA wrote letters to urge the State of Virginia to allow the Mirant Plant to continue to operate. In May, a Department of Energy Order expires that directs the Mirant Plant to remain in operation. At the same time a temporary permit, previously issued by the Commonwealth of Virginia expires.

Locked-In Loads of Electricity

In response to a question from Mr. Folkers regarding the percent of electricity load currently locked in, Mr. Adebo explained that currently two-thirds of WASA's electricity load is locked for the summer.

Renewable Energy Requirement

In response to question by Mr. Bardin and discussions during previous Committee meetings, Mr. Adebo reported that WASA currently has a goal of procuring four percent of its energy as renewable energy. Mr. Bardin asked whether the four percent goal is a choice that WASA is making or is it a requirement by the Public Service Commission. Mr. Adebo responded that this is a requirement by the District and our current wholesale provider will provide for tier 1 and 2 renewable energy combined. The number increases every year and WASA suppliers are committed to providing that level of renewable energy. Mr. Bardin suggested that staff look at whether the District requirement is realistic.

Next, Mr. Bardin asked that staff graphically show what has happened to the cost of electricity over WASA's ten-year history as compared to the average retail rates WASA charged over the same ten-year period. Mr. Johnson expects this information will be available soon as he plans to include it during the Public Hearing on WASA's proposed FY 2008 retail rates.

Retail & Wholesale Accounts Receivable

Returning to a discussion of the financial report, Mr. Firestine asked for an explanation of the $31.7 million in wholesale accounts receivable reflected for December 31, 2005. Mr. Adebo explained that this receivable, primarily for the Washington Suburban Sanitary Commission, related to a settlement for a large contract in the early 1990s. During FY 2006, staff resolved this matter and the receivable no longer exists.

Mr. Bardin explained that last year in addressing this matter, the Board acted unanimously based on what was in the best interest of the Authority and the fiduciary obligation of each Board member. In addition to the Board members representing the District of Columbia, the discussions concerning the WSSC delinquent payments also included Board members representing the Montgomery and Prince George's Counties. There was a good deal of hard work by individual Board members including communication with County Council and other key elected officials in those counties. This is an example of how the Authority worked as intended when created in 1996, which not everybody that is new to the scene may fully understand.

FY 2007 Capital Projects Spending Update

Mr. David McLaughlin provided the 2nd Quarter Capital Projects spending update for the five service areas managed by the Department of Engineering and Technical Services. At the end of March, with 50 percent of the fiscal year completed, actual spending for the Capital Improvement Program (CIP) totaled $77 million, or 84 percent of the baseline disbursements budget of $91.4 million. Mr. McLaughlin projects spending for the fiscal year will total $181.4 million or 102 percent of the spending projection.

Next, Mr. McLaughlin discussed spending by service area. At the end of March, spending for the Wastewater Service Area totaled $32.9 million or 80 percent of projected spending through that period. This spending lag for the first half of the year reflects retainage payments on construction contracts. Projected spending for this service area through the end of the fiscal year is approximately $51 million.

In the Combined Sewer Service Area, spending through the end of March totaled $21.5 million or 111 percent of the projection. The current projected spending for the fiscal year is approximately $50 million. The biggest single impact in this area is the construction at combined sewer pumping stations located at Potomac, Eastside and Main & O Streets. Projects are moving along well and expenditures are occurring at a faster rate than originally projected.

Spending under the Stormwater Service Area through the end of March totaled $0.8 million or 87 percent of the projection. Projected spending for this service area through the end of the fiscal year is approximately $1.5 million. The biggest impact in this service area is completing design work on some of the stormwater trunk sewers where WASA continue to work with the National Park Service to incorporate their comments into the design work.

Spending for Sanitary Sewer Service Area projects totaled $10.2 million through the end of March or 254 percent of projected spending. We expect to spend $15.3 million for the year.

Chairman Martin asked that where there are expenditures that are projected to be over budget, what are the consequences for the rest of the capital budget – does WASA delay spending. What options does WASA have and how are those instances reported to the Board.

Mr. McLaughlin explained that the projects remain within the project budget although in some cases the rate of spending has been more rapid than originally anticipated. Generally speaking, if there is a budget issue, a budget request is provided to the General Manager for use of funds, typically within the service area and the individual adjustments do not affect the overall program.

Mr. Johnson explained that WASA receives Congressional authorization to spend the capital budget which is generally larger than we anticipate the expenditures to be in any given year. At one time there were multiple categories which made the process more complicated. Early in WASA's existence we established seven broad expenditure categories (Wastewater Treatment, Sanitary Sewer, Combined Sewer Overflow, Stormwater, Water, Washington Aqueduct and Capital Equipment). This provision provides required flexibility and enables WASA to provide adequate project funding to cover projects or contracts that have been executed. Management reports this information to the Board as a part of the quarterly capital spending reports.

Spending for projects in the Water Service Area totaled $18.2 million through the end of March or 53 percent of projected spending with spending for the year projected at $57.9 million. Major spending for this program area occurred for pumping facilities rehabilitation; staff anticipates releasing retainages toward the end of the fiscal year. Spending for the lead service line program is currently running at approximately 40 percent of projection.

Lead Service Line Replacement Program

Chairman Martin referred to ongoing discussions by the Council and others concerning the lead service line replacement program. WASA Board made a commitment to the citizens of the District of Columbia to replace all lead service lines in public space given the lead in drinking water issues. This program continues to be a major cost element for the capital program and ultimately impacts retail rates. Since that time, a countervailing view is that the chemistry was the cause of the lead in drinking water. The chemical treatment by the Washington Aqueduct (the Aqueduct) has now changed and WASA has a better ongoing communication with the Aqueduct to coordinate and understand the impact of chemistry changes on the District's water supply. At the three-year mark, some board members informally have expressed interest in re-evaluating the lead service line replacement program, reviewing the science and economics behind the project to determine whether or not the current program should continue as is or be modified. After further review, the Committee would provide a recommendation to the full Board in September for consideration.

Mr. Johnson reported that the issue was discussed during the Operations Committee Meeting on May 17 and management's plan based on that discussion was to consider this issue as a part of WASA's FY 2008 Revised and FY 2009 Proposed Budget preparation process, with Board review of the proposal in October. Mr. Johnson noted that significant savings were realized in repaving costs as a result of WASA's work in cooperation with the District Department of Transportation's repaving program. Also noted were some additional paving costs associated with streets that have more service line where additional service line replacements are needed. This additional repaving cost is currently estimated at $3 to $4 million for the year. Chairman Martin asked Mr. Johnson to prepare a separate report for board review and consideration. Given the timing, the report would not be available in time to affect the FY 2008 rates effective October 1.

Mr. Bardin asked for information concerning the impact on retail rates should the Board recommend discontinuing the program in its entirety and stated that he is not advocating continuing or discontinuing the program at this time. Mr. Bardin asked that staff prepare this analysis prior to the Public Hearing on the retail rates proposal to provide individuals an opportunity to testify concerning the program before the District board members. In addition, management should include this information in Public Hearing announcements. Mr. Johnson agreed that the financial data would be available prior to the Public Hearing; however, information pertaining to the Board's interest in understanding the science and other economics may not be available.

Later, Mr. Stone asked if there have been any considerations to slip line the service lines as opposed to replacing them. Mr. Johnson responded that the service lines leaving the house are too small to use slip lining so that approach is not practical. The water mains are not a lead problem only the service lines leading from the water main into the individual housing units. For the water mains WASA has a cleaning and lining process that spins cement inside the lines as opposed to slip lining. Slip lining is typically used with non-pressurized lines such as sewer lines.

Mr. Martin asked that he and Mr. Johnson meet to determine the agenda for the Public Hearing and the best mechanism for advance notices to the public.

Mr. Firestine asked that the Committee and management discuss the format for future financial reporting and suggested his opinion that there are other ways to gauge where WASA is in terms of its budget and financial position. Mr. Firestine is concerned about relying on percent of year that has elapsed relative to revenue and expenditures because of the seasonal variation. Expenditures and revenues do not tend to track straight line with the calendar month. Mr. Firestine suggested that the financial report should give the Board a sense from management if WASA is within budget for the fiscal year, if WASA is behind in revenues relative to where management projects we will end the year. With respect to the capital budget, a highlight page indicating what projects management projects will exceed the budget, what you were expecting to spend on that project and are we on track. He also requested a presentation on WASA's investment process to include a discussion of the Board's role in establishing operating reserves and is there a formal investment policy and who makes the investment decisions.

Retirement Program

Next, Mr. Firestine asked what type of retirement programs do WASA employees participate. Mr. Johnson responded that the retirement program is a 401(a) defined contribution plan managed by Fidelity. Pre-1987 employees are a part of the Civil Service Retirement System and their retirement benefits are managed through the U.S. Office of Personnel Management. Because WASA do not have retiree medical or benefits, WASA does not have an issue with the new GASB rulings. However, staff is looking at a program to benefit employees at retirement without taking on the new accounting requirements and liabilities. While WASA does not currently have a retiree benefits program, plans are underway to provide, through ICMA guidelines, a Retirement Health Savings Plan at termination of employment that will convert the value of unused sick leave at the time of an employee's termination and transfer the funds to an ICMA account to be used for health benefits. Ms. Grier added that the Board had recently approved an increase of the employer match by 2% in recognition of the need for retiree health care expenses. Although there is a 2% increase, this increase is not earmarked for retiree medical benefits. The employee continues to maintain investment discretion over the 401(a) investment fund allocation. Employees cannot make contributions to the 401(a) Plan. Currently, these benefits are only available to nonunion employees, because union benefits are negotiated.

FY 2008 Rates Process

Mr. Johnson reviewed the schedule of rates meetings and asked for additional input from Chairman Martin regarding the process for announcing the lead program discussions at the Public Hearing scheduled for June 13. Normally, staff would have included such information as an insert to customer bills, but we are already half way through the cycle so that is not an option at this point. Mr. Johnson explained that typically we have an independent consultant attend the public hearing to provide a brief presentation verifying revenue projections and spending. Management provides a brief presentation on how WASA utilize the funds and then the public provides comments. Any comments regarding the process should be provided quickly to enable staff to proceed with public announcements in a timely manner.

Mr. Bardin expressed, with reference to the PILOT payment that is included in the current budget proposal up for discussion at the public hearing, the retail rates proposal assumes that 100 percent of the PILOT is paid by the retail rate payers and zero PILOT payment from the wholesale customers. This is problematic and WASA should plan that this issue will come up at the public hearing. Based on the allocation method provided by staff, the estimated amount of the PILOT payment that could be charged to wholesale customers in FY 2008 would total $3.2 million, which would be half of the retail rate increase currently proposed. The public should be advised of this discussion.

FY 2007 Bond Issuance Update

Barbara Bisgaier, WASA’s Co-Financial Advisor provided an update on the 2007 bond issuance. The Authority successfully issued bonds on May 22 for approximately $218 million of 2007A tax exempt, fixed rate, subordinate lien revenue bonds, with settlement scheduled for June 6. The bonds were sold with municipal bond insurance, and although the Authority has a high credit rating, municipal bond insurance has become a very cost-effective alternative. FGIC was selected through a competitive procurement process to insure the bonds for the 2007 bond issuance. During the last bond issuance, the Authority paid 24 basis points for the insurance as compared to 16.2 basis points paid to insure the 2007 bonds, roughly two-thirds the price. Ms. Bisgaier attributes this outcome to recognition in the markets that WASA is doing a good job financially. The other issue discussed with the Rating Agencies was whether or not the Authority could avoid funding a debt service reserve fund. On many revenue bond issues there is such a requirement and is typically equal to the maximum annual debt service payment. Again, because of the Authority's demonstrated financial strength, each of the three rating agencies agreed that there would be no negative impact to the rating if the Authority avoided having a debt service reserve fund. All of WASA's borrowing is for project costs.

At the April meeting of the Committee and the May 3 meeting of the WASA Board, discussions surrounding the need to do a taxable Series B issuance for the $75 million taxable, auction rate, subordinated lien revenue bonds used to finance private use projects, i.e., the Washington Aqueduct Residual Project. There is a concept in tax exempt financing called "bad money". A portion of tax exempt issuance is allowed to be bad money, which would provide for financing of projects costs (up to 5 percent per bond issuance) ineligible on a tax-exempt basis. That provision allows WASA to take a portion of the Aqueduct's costs and move it from taxable to tax-exempt financing as the bad money in this issuance. The objective in the long run is to convert the entire taxable portion of this issue to tax exempt bonds. This will be a multi-year financing strategy to reduce the borrowing costs for the Aqueduct's projects through subsequent issuances.

Ms. Bisgaier further detailed that, Citigroup was the book running senior manager and Bear Stearns was the co book running senior manager on the transaction. We approached the market fortunately very early Tuesday morning with a variety of coupons or interest rate structures including bonds close to par, premium bonds, and very large premium bonds). The purpose was to offer diversity to the market to attract different potential buyers. On the premium bonds, the 5% bonds, we had to increase interest rates as the morning went on because there was virtually no interest at the rate we entered the market. But on the larger portion of the loan, the 2041 bonds which is approximately half of the loan, we started the morning at a yield of 4.23% and reduced to 4.20% at the end of the day. The net result is the true interest cost of 4.18%, which is a very low number considering this is a 30 year loan. This loan is interest only through 2035 with principal payments beginning in 2036. This loan is carefully structured to work together with the Authority's other debt. The Municipal Market Data (MMD) is a daily published index of insured bonds measuring bond performance. MMD allows you to see how the bonds traded against other bonds. Measurement is a little difficult for WASA because the index ends at 30 years. The index rate on the day WASA sold the bonds was 4.21%. Then you measure whether you were above or below the 4.21% index rate. WASA was above the index rate in the early maturities at the expected level and exceeded the index rate on the last maturity yielding extraordinary results to trade through MMD. Another alternative to evaluate how a transaction priced is to compare it to other transactions in the market. Again, this was difficult due to no other transactions at that time with 35 year bond. But the District of Columbia had a sale the day after WASA. Unfortunately for the District, the market was terrific on Tuesday morning and became very tentative in the afternoon which makes it difficult to determine the direction of the rates and pricing the transaction. When you compare the results of the two sales and consider the structures, maturity and differences in the sale, the index spread was some what worse on the day the District sold their bonds than on the day WASA sold their bonds.

On June 5th, the rate will be set for the Series B taxable auction rate bonds. Issuing variable auction rate debt with rates set weekly provides flexibility to retire the bonds over time. The jump ball technique will be used for auction rate bonds. Both broker dealers Citigroup and Bear Stearns will submit weekly bids from their customers for the bonds. This is essentially a reverse auction which establishes the rate at the lowest interest rate that clears the market and by having two competitive broker dealers, we hope they will be aggressive in bringing in bids and produce the lowest cost on the taxable side.

Mr. Firestine asked for the amount of the bond premium and if the bond was resized. Ms. Bisgaier replied the premium was approximately $15 million and the bonds were resized because we needed $200 million on the tax exempt side for the construction program. In order to accomplish the program purpose, premium bonds were sold.

Mr. Bardin asked how much WASA agreed to pay for issuance costs. Ms. Bisgaier answered the total underwriter's discount was $1.3 million. How does this compare to what the District of Columbia paid. Ms. Bisgaier replied that since their sale was competitive, this information is not generally published.

Bardin expressed that WASA has an ongoing difference of opinion with the District CFO. Currently, the DC Council is in the process of trying to pass legislation. If this legislation had passed prior to this bond issuance, would this bond issuance have proceeded differently and would the law require it to proceed differently. Attorney Russell responded that the Enabling Legislation provides that the WASA board issues the bonds; however, under the DCCFO responsibility, he would oversee the bond process while the Council is responsible for bond issuance. This is clearly an area of conflict between the two provisions even if the legislation passes because the legislation does not provide any clarification with regard to the conflict of the provisions. Mr. Bardin asked in instances where the DCCFO clearly has the responsibility to oversee the bonds and there is no WASA Board, would the DCCFO select bond counsel, underwriters, etc. Ms. Russell responded that the DCCFO would directly make the selections or through the CFOs of the other agencies. Mr. Bardin asked if the Sports Authority issues bonds through their Board, or their CFO or the DCCFO. Ms. Russell explained she would have to provide an answer at a later date.

Mr. Folker stated that the Board received an opinion clarifying that bonds for the WAD Residuals Project will be taxable and do we know what the costs is to WASA for the taxable versus tax exempt bonds. Also, looking forward is there any actions that can be taken in the future. Ms. Bisgaier explained that this issue arises in Federal tax law. This is a unique situation that a public municipal entity would issue bonds for a federal purpose. It would take a revenue ruling to achieve clarity on this point. Also, a calculation of the differential on taxable versus tax exempt has not been completed because we don't know how quickly the taxable portion can be converted to tax exempt. By way of an interesting point if WASA refunded some of the new or existing debt, a portion of the bad money can be used to get rid of the taxable debt. Because the taxable debt is in a weekly auction rate mode, it is a little less painful than long term 30 year fixed year debt. Mr. Folker also noted that the VA jurisdictions also get their water from the WAD and are trying to retain the interest from the funds until WAD is ready to use the money.

Chairman Martin asked if the 5% that can be used for bad money is it per year. Ms. Bisgaier explained of the total par bonds issued with some modest adjustment; essentially if you issue $200 million in bonds, 5% is available to be used as bad money. Also, Chairman Martin noted that WASA is exploring Office of Management and Budget (OMB) for a legislative solution to retain the interest on the funds that the WAD does not expend. Also, are we exploring legislative solutions and Internal Revenue Service (IRS) ruling for the entire question of whether the bond should be taxable? Mr. Johnson responded that to keep the interest on the funds that management has pursued this track for at least six years without success. The concern that has been expressed by OMB and by the appropriations is that such a provision would have national and broader based tax implications. What WASA recommended is a compromise that applies uniquely to the WAD. The proposed legislation relates to the Residuals Project only. WASA is not pursing an IRS ruling on the new taxable bonds. Pricing for the Series B issuance is scheduled for May 29. Closing for both series is scheduled for June 6. After further discussion, Chairman Martin congratulated management and consultants on a good sale.

Rolling Owner-Controlled Insurance Program (ROCIP) Briefing

In order to provide the Committee with the background of the WASA's ROCIP program, Mr. Johnson explained that several years ago staff began to look at breaking out the various costs associated with contracting for the business that we do. The objectives were to identify potential construction cost savings, protect the interests of the Authority and to increase minority and small firm participation. Today's presentation not only looks at the savings or benefits of the program, but also reviews the way the program is structured, how it works and how we calculate ROCIP savings.

Mr. Stuart Cowart of Albert Risk Management Consultants, continued with the background, history and advantages of a ROCIP. Next, Mr. Cowart provided an overview of WASA's five-year ROCIP, which began in mid-2004 with an estimated $1 billion in projects or $106 million of contractor payroll to be enrolled. In discussing WASA's ROCIP design Mr. Cowart discussed workers compensation, general liability and excess coverages and WASA's deductible limits. Through a competitive process WASA retained ACE as the insurer for the ROCIP and Aon Risk Services, as broker/administrator to handle contractor enrollment and to track all costs for the program. Mr. Cowart noted that one aspect of the program that has been very beneficial, is the enhancement of WASA's uniform safety program, which ensures that each contractor has to submit its safety program in order to perform work on WASA's ROCIP construction projects.

As of April 2007, the program is on track for estimated savings of $3 million. The program currently has 42 projects enrolled and 121 contractors. Actual incurred losses are currently lower than originally expected, due in large part to contractor safety awareness. Thirteen of 42 prime contractors are minority firms.

In response to a question by Chairman Martin concerning WASA's insurance program as it relates to the general liability claims process, Mr. Johnson agreed that management would plan to provide such a briefing to the Committee.

Mr. Bardin asked about the annual contractor costs for ROCIP. Mr. Adebo estimated costs for the program total $15 million, which includes both premium and administrative costs. Management plans to provide the Board with a breakdown of the total costs of the program, including both premium costs and administrative costs.

Mr. Johnson lauded both the safety and risk management achievements under the ROCIP and noted that while WASA is not subject to Occupational Safety and Health (OSHA) standards, WASA voluntarily follows OSHA's guidelines and prepares reports accordingly.

At the conclusion of the briefing, Chairman Martin asked the Committee to consider the ROCIP Insurance Broker Services action item. Mr. Adebo explained that the action item requests approval to execute the third option year for broker services provided by Aon Risk Services, Inc. The Committee recommended the action item for full board consideration at their meeting on June 7.

2007 Insurance Renewal

Mr. Adebo explained that the 2007 insurance renewal process is currently underway and although the threshold is within the General Manager's approval authority, management informs the Board as a practice on insurance renewals. Mr. Adebo expects an overall 12 percent reduction in WASA's insurance premiums, due primarily to the multi-insurance broker strategy used for this renewal. Originally, management anticipated a nine percent increase, but due to savings in property and equipment premium identified during the multi-insurance broker process we identified approximately 30 percent premium savings. Mr. Cowart explained that the PEPIP program is a

West-based program that is reaching out to the East Coast. The PEPIP program, unlike the currently FM Global program, offers multiple insurers with a layered approach. There are two key differences in coverage. First FM Global provides $500 million in terrorism coverage under the terrorism recovery insurance acts (TRIA), while PEPIP provides $200 million for that coverage. On the other hand, PEPIP offers $100 million flood coverage for the Blue Plains facility, while FM Global only offered $15 million due to their perceived flood exposures risks. WASA is still negotiating with PEPIP and has the option to purchase additional terrorism coverage and plan to brief the Board on the results of insurance negotiations at the Board meeting in June.

Payment-In-Lieu of Taxes (PILOT) Presentation

In response to a request by Mr. Bardin for an approximation of what the wholesale user share of the PILOT fee would be assuming that some action would be taken to allow WASA to assess that fee and allocate it to the wholesale users. Mr. Adebo reported that there are two fees WASA is assessed by the District of Columbia, the PILOT and the right-of-way fee (ROW). The ROW fee, through a recent agreement is locked at $5.1 million for a ten-year period, through 2013. The agreement gave WASA credit for the PILOT with the ROW payment. The methodology used for the wholesale calculation is a two-tiered approach which assumes that the PILOT is an operating expense that is allocable to all users of the system. Historically the spilt between joint and non-joint use has been approximately 45 percent and 54 percent respectively. The joint use costs result from the wastewater treatment costs and associated indirect cost allocations. Although the percentage may vary slightly on an annual basis, assuming that 45 percent assumption holds true, the joint use costs are then shared based on average flows as determined by the Intermunicipal Agreement. Historically the surrounding jurisdiction's percent of average flows has been approximately 54 percent of total flows to Blue Plains, or when applied approximately 24 percent of the total operating costs would be the wholesale customer share of the PILOT/ROW fee. Next, Mr. Adebo explained the potential impact on the retail rate customer bill. The FY 2008 proposal is $0.47 per Ccf and assuming a $3.2 million reduction for FY 2008 in the amount WASA is required to collect from retail rate payers, the fee could be reduced to $0.38 per Ccfs. For future years the amounts were escalated based on what we know as PILOT/ROW drivers, which is the increase in retail rates resulting in cumulated rate reductions totaling 14.25 percent.

Based on staff's presentation, Mr. Bardin provided history of WASA's PILOT/ROW fee. Historically, the PILOT was collected partially through the water rate and partially through the sewer rate. Over six years ago PILOT/ROW was separated on the bill which resulted in a three-part bill for the water rate, sewer rate and PILOT/ROW. After the billing change, the water rate and sewer rate declined but for all practical purposes, the retail customers paid 100 percent of the cost for PILOT/ROW. The ROW was included during a time when there was tremendous controversy about telecommunications lines being built into the streets so the city imposed the ROW fee on utilities including telecommunications, electrical, natural gas and WASA which includes both the sewer and water lines. The PILOT/ROW, which provides for police, fire protection services and other services the District provides, increases each year as the retail rates increase.

Mr. Folkers stated that the PILOT/ROW should be a topic of discussion for the IMA negotiations as the IMA sets out the terms of payments between the wholesale customers and WASA. Any changes should be reflected in the negotiated IMA.

Mr. Johnson reported that the issue is that when the IMA was created it did not anticipate the creation of WASA and the PILOT/ROW fee. One view is that the discussion is part of the IMA negotiations, while another view proposes that it is a part of the ongoing operating expenses for WASA and that wholesale customers should share in that cost.

Mr. Bardin reported that he attended the April meeting of the Blue Plains Regional Committee, a committee created under the IMA. At that meeting, participants asked where is the thinking of the WASA Board's Finance and Budget Committee on the question of the PILOT. During the IMA negotiations last year, board members were assured that the negotiations would be completed by July 2006 and signed by December 2006. Somewhere along the way somebody decided that it would be a good idea for the Finance and Budget Committee to express an opinion on the subject. In fact the IMA was not renegotiated last year, nor is there any assurance that it ever will be. There is an issue about all ten years of WASA's existence and the PILOT/ROW as to whether the wholesale customers should have been paying a portion of this cost. While IMA negotiations continue and the Finance and Budget Committee considers the matter, the urgency is the impact to retail rate payers. During the Public Hearing on June 13, WASA is asking to raise the retail rates by several million dollars as of October 1. Yet there seems to be reasonable rationale that there is approximately $3.2 million of over charges to the retail rates customers right now. This is what WASA would normally call an indirect cost that has to be allocated to both joint and non-joint users. Mr. Bardin asked Attorney Russell if there is a legal impediment to charging the wholesale customers their share of the PILOT/ROW fee immediately. Ms. Russell provided an opinion that whether or not the wholesale customers should pay a portion of the PILOT/ROW fee which is an operational cost of WASA is different from where that should be determined. The WASA Board has the authority to establish rates, while the process for charging the participants in Blue Plains is set forth in the IMA.

Chairman Martin asked what would happen if WASA increased its operating costs for payroll which through the allocations resulted in a $3 million increase to the wholesale customers. That is something that is completely within the WASA Board's jurisdiction. Ms. Russell disagreed and said the IMA provides for those costs. Chairman Martin asked whether the IMA specifies what is or is not an operating cost to be allocated. Does the IMA specify what an indirect cost is. Ms. Russell said the IMA does not say that because at the time the IMA was created Blue Plains was a District Government owned the Blue Plains facility. Chairman Martin asked what distinguishes this cost from other costs the Board clearly has the right to approve. Ms. Russell said it is an operating cost, but how the cost is allocated as indirect costs is an issue for the IMA; not that wholesale users should not pay but that the issue should be a part of the IMA negotiations. Chairman Martin again referred to Mr. Adebo's analysis which used the formulas set forth in the IMA based on flows and allocation methodology and allocated the wholesale customer share on that basis. Mr. Martin asked Ms. Russell why she is of the opinion that the inclusion of the PILOT/ROW fee into the allocation formula should be decided by the IMA and why is this any different than any other costs. Ms. Russell said that there have been other issues with the IMA and WASA recently went through an extensive MOU. Mr. Johnson noted that those issues were not taken to a negotiation group as administrators, but were brought to the Board to be resolved. In response, Ms. Russell replied that the IMA is a poorly crafted document and over time issues have been raised with regards to how things should be handled. The parties have been operating with technical and financial agreements that were entered to clarify working relationships. The IMA has participated in resolving the issues because of the unique relationship WASA' has to the District. Ms. Russell advocates that WASA is the operating entity; the District and the other parties are to resolve the issues. Ms. Russell is also of the legal opinion that the fee for the PILOT that is allocable to Blue Plains should be paid by the wholesale customers. Mr. Johnson added that the only portion of the PILOT/ROW fee that the wholesale customers would be responsible for would pertain to joint use facilities and associated indirect costs because the wholesale customers do not have any interest in payment for the water distribution or sewer collection system in the District of Columbia.

In response to the methodology previously discussed, Mr. Adebo explained that using the theory that the PILOT/ROW is agreed upon to be an operating cost, the same methodology staff would use to allocate any of the other operating costs that are not direct in nature would be to use the appropriate cost driver.

Mr. Bardin said that Mr. Adebo is being more precise about the law than WASA's General Counsel. The IMA is one contract which prescribes various allocation formulas amongst others and provides for indirect costs. The WASA 1996 Enabling Statute, that the District Council is trying to amend now, also creates the joint-use, non-joint use categories and includes an appendix with a list of what are the joint use facilities. The principle joint use facility is Blue Plains. There are a hand full of other joint use facilities, such as some pipes or force mains, pumping stations some of which are joint use, while others are non-joint use. Mr. Adebo has done a reasonable job to provide an allocation method that follows literally what is in both the IMA and the statute. If one of the wholesale customers has a better methodology Mr. Bardin would be open to consider. Mr. Bardin asked management to draft a resolution for consideration at the June Board meeting which directs the General Manager to bill at the appropriate allocation method beginning October 1 for the PILOT/ROW share for the wholesale customers with a reduction to the bills for retail customers. Someone will need to look at the entire ten-year period to determine how to address prior-year PILOT/ROW payments. Mr. Bardin stated that this issue is directly analogous to the delinquent wholesale customer bills. The only difference here is that the General Management sent out bills for the previous issue but no bills have been issued to the wholesale customers for their share of PILOT/ROW fees. The approach would be to render a bill to the wholesale customers, discuss the billing with them, and perhaps use the Blue Plains Committee to assist with the matter.

Chairman Martin asked Mr. Adebo to provide additional information on how the 45 percent joint use calculation. Mr. Adebo again explained how the figures were derived. Chairman Martin asked whether Mr. Adebo used the PILOT/ROW expense, specifically to create a new allocation for that fee. Mr. Johnson responded that this is the same methodology used for every joint-use allocation. Mr. Bardin does not believe it reasonable to expect the District to be able to allocate the amount of fire protection and other service fees for use in this regard.

Although it is a legitmate issue, Mr. Folkers stated that proposing action for Board consideration in June is premature. Some agreement should be worked out through the Blue Plains Regional Committee and the IMA negotiation process. There are many board members who have not been educated on the history of the IMA and the structures in place to address these issues. That may be the best place to start.

Mr. Firestine agreed with Mr. Folker. In the absence of a clear legal judgment on what is and what is not covered under the IMA. How are indirect costs handled? Is it clear that all indirect costs are included? Who makes the judgment?

In response, Ms. Russell explained that the fact that there is a PILOT/ROW fee that is an operational cost for the joint use facilities that should be borne by the wholesale customers, WASA would say we have a bill that has to be paid. Then it is a decision under the IMA as to how that issue should be handled. That is a discussion that should occur among the users.

Mr. Bardin asked do the users agree to pay what they want to pay. The IMA is a contract. Ms. Russell agreed that the IMA is a contract and that WASA is an operating entity that receives the funds to operate the Blue Plains pursuant to what was negotiated in the IMA.

Chairman Martin asked whether fees are specifically discussed in the IMA, and they are not. Ms. Russell responded that there is no provision in the IMA to pay for anything other than what has been negotiated and the WASA Board has only the right to set rates for retail customers and the legislation sets forth what the joint use and non joint use costs are. Chairman Martin indicated that the Board determines what are indirect costs and this language is not specifically discussed in the IMA.

Ms. Russell said it is arguable that some users could make the point that fire protection, and police protection was all provided before WASA was created.

Mr. Bardin stated the Board does not have to increase rates and questioned the General Manager why he has not billed the wholesale customers for their share of the PILOT.

Mr. Johnson responded that if he is directed to bill the wholesale customers, he will comply, but to date he has not received any such direction from the Board. This issue in addition to the reserves issue was brought before the Board which to date has taken no action or provide any direction.

Chairman Martin asked that between now and September, more research and discussion is needed with the Chief Administrative Officers and the Blue Plains Regional Committee or further discussion by the Retail Rates Committee of Finance and Budget. This would provide more definition. Additionally, a firm legal position is needed. The matter will not be resolved today. Chairman Martin directed the General Manager to prepare a document that would be used to bill the wholesale customers for the allocable portion of the PILOT fee. Mr. Firestine opposed preparation of a resolution as further legal direction and full Board discussion is needed. Mr. Bardin asked that the minutes of the meeting, to be distributed to the full Board, reflect the discussion. In addition, Mr. Bardin asked the General Manager to provide a copy of the meeting minutes to the principal wholesale customers and any appropriate information so that they are in the loop. Mr. Folkers agreed.

In providing further direction for the staff, Mr. Martin asked that staff prepare and distribute to the full Board the minutes of the meeting to include the presentation prepared by Mr. Adebo. Mr. Johnson agreed to expedite the preparation of the minutes from today's meeting.

Mr. Martin agreed with Mr. Firestine's position since the public hearing on the rates in June is not a final action and there will be further Board discussion so there is additional time to prepare a resolution before September.

Other Business

<u>D.C. Council Legislation</u>
Mr. Bardin expressed concern regarding Budget Support Act legislation before the Council which is scheduled for a second reading a week from Tuesday. One is a proposal to amend the composition of the WASA Board without any public hearing, without any notice to the surrounding Counties without any discussion concerning the rationale for the changes. Another issue concerns the conflicts pertaining to the DCCFO.

It is hard to ask Congress to resolve some conflicts before one has done some homework, held a hearing, have one or more alternatives, in fair detail. Mr. Bardin offered to write a letter in an attempt to persuade Council not to pass the legislation on its second reading. They could detach these provisions from the Budget Support Act and put it in separate legislation and have the legislation run through its usual course to allow for hearings and a level of discussion between elected officials or staff officials to try to reach a consensus. The Board does not meet again before the Council acts, however it meets afterward and that would be a second opportunity for the Board to write Mayor Fenty to ask him to use his line-item veto to strike these provisions. Mr. Firestine responded that based on his discussion with the City Administrator and Mr. Bardin is correct on that point. After discussion, Mr. Bardin offered to write his own personal letter to the members of the City Council. Mr. Bardin solicited the help of Ms. Russell in writing this letter, for Board consideration, before the Council votes. If no one makes the case before the Council votes and then asks the Mayor or Congress to correct it, the silence may be questioned. Mr. Firestine reported that the Montgomery County Council discussed this issue earlier during the week and they shared Mr. Bardin's concerns. The hope by the Montgomery County Council is that the issue would be taken off the table at this time to provide all parties an opportunity to work out a joint solution rather than a unilateral decision by the District that goes to Congress. It is Mr. Firestine understands that the last time this issue proceeded on its way to Congress; Congress said that this is a local issue and asked the local governments to try to resolve the matter, which has not happened. Montgomery County has also drafted a letter, which the Montgomery County Council asked be sent to District Council to take the matter off their agenda otherwise Montgomery County will seek their Congressional representative in an attempt to resolve the matter.

Chairman Martin asked Mr. Bardin to circulate his proposed letter to all board members so that each can decide how he or she might want to provide support.

Hearing no further business, Mr. Martin adjourned the meeting at 12:47 p.m.