DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance & Budget Committee
Thursday, June 26, 2008

9:00 a.m.

MEETING MINUTES

COMMITTEE MEMBERS
Robin B. Martin, Chairman
Dr. Jacqueline Brown

WASA STAFF
Jerry Johnson, General Manager
Olu Adebo, Acting Chief Financial Officer
Yvette Downs, Director Finance and Budget
Avis Russell, General Counsel
Debra Mathis, Executive Assistant to the Board Secretary
Dave McLaughlin, Acting Director, Eng. & Tech. Services
Tanya DeLeon, Risk Manager
Bob Hunt, Treasury Manager

Presenters
Stuart Cowart, WASA's Independent Insurance Advisor
Barbara Bisgaier, WASA's Financial Advisor

Chairman Robin Martin called the meeting to order at 9:02 a.m.

May 2008 Financial Report

Mr. Olu Adebo, Acting Chief Financial Officer, and Ms. Yvette Downs, Director of Finance and Budget, presented the May 2008 financial report. With 67 percent of the fiscal year completed, Revenues totaled $219.8 million or 65 percent of budget, Operating Expenditures totaled $205.2 million or 60 percent of budget and Capital Disbursements totaled $222.7 million or 69 percent of budget. Ms. Downs reported that she expects revenues and expenditures will be within the overall budget by year-end.

Consistent with previous reports to the Committee, the Authority continues to experience budget pressures in the chemical and electricity categories. Ms. Downs reported her expectation to accommodate these budget pressures with savings in other budget categories and to end the fiscal year within the overall budget. Management will update the Committee with year end projections at the July meeting.

Chairman Martin asked for an explanation of WASA's block purchase strategy for electricity. Mr. Adebo explained that due to the past experience with purchasing electricity and the volatility of the spot markets, staff adopted the approach of purchasing electricity ahead for our load at various points in time, including additional purchases during the winter (December to February) and summer peak (July to September) periods at best available future market prices; and the balance floating at the spot market prices.

Dr. Brown inquired about the $71.42 price on the electricity chart, which represents the budgeted level for the current fiscal year. Mr. Johnson suggested that WASA's consultants could provide the Committee with a review of strategies the Authority uses to manage and purchase electricity. Chairman Martin and Dr. Brown concurred due to the magnitude of the rapidly increasing electricity expenditures. Mr. Johnson also informed the Committee about delays in filling the Energy Manager's position and explained that the Human Resources Department may need to modify the job description in order to attract a greater pool of candidates.

Chairman Martin asked if the Budget Office had evaluated prior-year performance in making accurate projections for future year overtime budgets. Ms. Downs explained that the key driver of overtime this fiscal year has been the unanticipated level of work associated with the District's Fire Hydrant Inspection program coupled with vacant positions in WASA's Fire Hydrant program. The Budget Office is conducting their review of overtime use with the goal of reducing overtime by improving the allocation and management of personnel.

Ms. Downs also reported that staff will update debt service projections and provide this information to the Committee in July. That report will also include the impact of the debt issuance that closed on June 25.

Continuing with the financial report, Ms. Downs explained that spending for contractual services is lagging behind budget due to slower-than-anticipated invoicing by some vendors and some pending contracts now in the RFP process.

Chairman Martin asked management for an update on the District's Chief Financial Officer (DCCFO) Cost of Service Study as it relates to the PILOT fees. Mr. Adebo responded that there was no update from his meeting with the District's Budget Director last week. The DCCFO had been in the process of issuing an RFP for a firm to conduct the cost of service study. Chairman Martin requested that management provide the Committee with an update at the July Board meeting.

Investments
Ms. Downs reported that budget for interest income is based on achieving a 3.75 percent interest rate on an approximate cash balance of $118 million. Through May 2008, WASA has earned interest income at a rate of 3.70 percent on an average cash balance of $129.6 million. Ms. Downs informed the Committee that the Association of Public Treasurers of the U. S. and Canada recently approved WASA's revised investment policy. At their annual meeting held in August, WASA will receive the Investment Policy Certificate of Excellence Award from this organization.

President's Budget
Mr. Johnson informed the Committee that House appropriations approved $14 million for continued support of the CSO LTCP as part of the President's Budget for FY 2009.

Capital Projects Quarterly Update
Mr. Dave McLaughlin presented the report on the Capital Projects for the second quarter, ended March 31, 2008. All priority 1 & 2 projects are on schedule and within budget. Currently, there are 50 active Architectural/Engineering (A/E) agreements valued at $184.8 million. A total of 41 working construction contracts are underway and are valued at $684.3 million. The current spending projection for the year is $206,148, or 96 percent of budget.

Mr. McLaughlin reported that the Lead Service Replacement Program is on track to meet the set goal of 3,000 lines for the current fiscal year and spending year to date is within budget. The lower 30 percent for the number of replacements at mid-year is typical because production typically increases during the summer months.

Chairman Martin inquired how staff would allocate the cost of hiring a Program Manager for the Nitrogen Program between the District and the Counties. Mr. Johnson responded that these costs would be allocated consistent with the project allocation, which is the formula specified by the Intermunicipal Agreement (IMA). Mr. Johnson explained that the biggest hurdle is obtaining adequate engineering knowledge of how the system works and flow data, which would serve as a prerequisite for agreement on allocation of flows to the wholesale customers. Expenditures for the District's portion of this project, which will continue to increase over the years, are being paid with debt service funds.

Dr. Brown inquired about the percentage of the overall WASA budget, both capital and operating, that is paid by the wholesale customers. Mr. Adebo responded that the percentages for the operating and capital budgets are 18% and the low 20% for fiscal years 2008 and 2009, respectively. Mr. Johnson noted the relevant portion for the wholesale customers should be based on their respective level of involvement in the costs of joint use activities, which is about 60 percent, and not the overall budget which includes water services and other District only or retail-oriented activities. Dr. Brown stated that the issue of an IMA Agreement update and associated cost allocation should receive priority attention. Mr. Johnson responded that the issue falls outside of the WASA Board and is an issue for the representatives from the various jurisdictions to resolve. Mr. Johnson agreed to advance this issue through the Metropolitan Washington Council of Governments (COG), since that organization is responsible for scheduling such meetings.

Chairman Martin asked for an in-depth briefing on how capital program management is carried out to include contract administration, bidding and general oversight of the capital program. The Committee members and management agreed on the relevance of holding a briefing, particularly for the new members on the Board.

In referring to section 6 of the 2nd Quarter Capital Project Report, Dr. Brown requested that the future reports designate projects as Joint-Use or Non Joint-Use.

Mr. Adebo stated that management will include a projection for year end for capital expenditures in the July financial report to the Committee.

Insurance Program Update

Ms. Tanya DeLeon, Risk Manager, and Mr. Cowart, WASA's insurance consultant, provided an update on the Authority's Insurance Program. Ms. DeLeon reported that WASA was successful in renewing all of its insurance policies at a nominal increase in cost, except for the property insurance policy that will renew on July 1, 2008. Ms. DeLeon provided the Committee with an update on the Rolling Owner-Controlled Insurance Program (ROCIP). Currently, WASA has 36 active projects in ROCIP out of a total of 54 projects.

Ms. DeLeon noted that WASA has received notice from FEMA that the DC flood maps have been generally rescinded and that staff is currently reviewing the maps for any impact on WASA. Mr. Johnson stated there might be some unresolved issues in the rescinding of the flood zone maps and additional inquiries will be made as to whether it was inclusive of the Plant or not. This is being reviewed and would be reported to the Committee later.

Chairman Martin inquired about the cost increase of 12 percent in the Umbrella Policy and whether it was reflective of the industry-wide cost increases or WASA's experience. Mr. Cowart attributed the increase to WASA's placement and experience, because the industry has experienced flat renewals in this type of policy. The main drivers for this increase were the two large cases involving fleet-related matters.

Chairman Martin stated that this is a signal for management to effectively review and manage the claims that are causing these increases. Dr. Brown inquired about the current programs being undertaken by the Authority for automobile related activities. Staff responded that a number of things have been done to address this, including mandatory defensive driver training and the development of new driver policies.

Other Business

Mr. Adebo reported that on July 25, 2008, the Authority refinanced the last $44 million of the Taxable 2007 Series Bond by issuing Commercial Paper at 2.75 percent for the first week and expects to take it out for a longer period of up to three months if the market responds positively. Chairman Martin inquired if the Commercial Paper will be a continuing plan or if it will terminate with the new debt issue in 2009. Mr. Adebo responded that the strategy with the $44 million is to maintain it in the variable mode as Commercial Paper for flexibility purposes with the opportunity to retire part of it with the issuance in 2009.

Mr. Adebo referred to the letter from the General Manager to the Committee members on June 25, 2008, about the downgrading of Financial Guaranty Insurance Company (FGIC) by all three rating agencies to below investment grade. WASA had used a surety from FGIC, rather than cash, to fund the debt service reserve requirement of $16,822,864.31 for its $176,220,000 tax exempt bond issuance.

Ms. Bisgaier, WASA's financial advisor, reported that, like many municipalities and local governments around the Country, WASA is affected by the downgrading of FGIC. The bond documents of the Master Trust Indenture require that if the Authority has a surety, it be issued by a company in the highest of the two rating categories of AAA or AA, and FGIC is no longer in this category. However, WASA has not received any formal notification from the Trustee on the need to take action to date.

Ms. Bisgaier explained that there are two realistic options for WASA at this point in time, both of which include leaving the FGIC surety in place. The two options are either to deposit cash in the amount of $16.8 million into a debt service reserve fund or to obtain a Letter Of Credit (LOC) as a backup for the FGIC policy. Chairman Martin and Dr. Brown inquired of the possibility of WASA getting rid of the policy with FGIC and obtaining a surety from another company. Ms. Bisgaier stated that there are only two bond insurers that meet the AAA investment rating requirement, Financial Security Assurance, Inc. (FSA) and Assured Guaranty. Neither of the two potential providers initially insured the 2003 bonds and would therefore not be an option for a new surety.

Dr. Brown requested that an analysis of the various scenarios with the associated costs and risks be provided to the Committee in order to have a better understanding before reaching a final decision. Ms. Bisgaier stated that both the LOC and the Debt Service Reserve fund will take a second loss position to FGIC. This means, if the Authority fails to make a payment, the trustee will make a draw on the FGIC surety policy first. If FGIC does not honor the draw, the trustee will then obtain the funds from the second loss position; either the LOC or the Debt Service Reserve account.

Chairman Martin asked about the timing or urgency of taking the appropriate steps in line with WASA's Master Indenture of Trust which requires WASA to act "immediately." The only immediate step would be to place cash in the reserve fund. He suggested the need for the Committee to recommend that the Board at the July meeting authorize the General Manager on receipt of notice from the Trustee, or earlier if deemed necessary, to place $16.8 million into the Reserve fund subject to release when a Letter of Credit is obtained. Mr. Johnson concurred with the need for the Board approval in order to provide a safety net pending the release of the funds.

Chairman Martin asked that management forward a resolution to the Committee next week authorizing the General Manager to place the $16.8 million with clarity of any event or decision by the General Counsel that can trigger the investment. Chairman Martin stated the General Manager's authorization will be an action subject to further discussion, analysis and recommendation to the Board for consideration at its meeting in September.

Dr. Brown inquired if the CFO bill has been signed by the President. Mr. Johnson responded that staff would make inquiries on the status. Chairman Martin noted the need for the Committee to have a clearer understanding of the effects of the bill on WASA's operations and the relationship of the CFO to the District CFO. Mr. Johnson stated that the General Counsel is presently working on a report for the Governance Committee regarding this matter.

Hearing no further business, Chairman Martin adjourned the meeting at 10:50 a.m.