DISTRICT OF COLUMBIA
WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance and Budget Committee

Thursday, April 22, 2004
9:00 a.m.

MEETING MINUTES

BOARD MEMBERS	WASA STAFF
Glenn Gerstell	Jerry Johnson, General Manager
Anthony Griffin	Paul Bender, Chief Financial Officer
Lucy Murray	Wendy Hartmann Moore, Interim General Counsel
Michael Hodge	Linda Manley, Secretary to the Board
Alexis Roberson	
David Lake	

Mr. Gerstell called the meeting to order at 9:15 a.m.

Financial Overview

Paul Bender, Chief Financial Officer, reported that the Authority's financial performance continued to be on track for revenues, expenditures, and reserves at the end of March. Capital disbursements continued to run ahead of schedule, driven by liquid processing projects at Blue Plains. Mr. Bender provided an update of the AMR program, with approximately 200 large meters installed by the end of March, and a schedule calling for approximately 250 large meter installations for the balance of the fiscal year. With 50 percent of the year completed, revenues were at 50 percent of budget, and Mr. Bender noted that revenues are projected to end the year on budget.

Operating Expenditures

Mr. Bender reported that March year-to-date operating expenditures were $87.6 million. Personnel services continued to run at less than budgeted rates due to vacancies. Chemical expenditures are running lower than expected due to capital projects that have not yet come online, e.g., the centrifuges. Although spending is expected to increase toward the end of the year, savings of approximately $2 million are now projected in this area.

Alexis Roberson inquired about expenditures for lead. Mr. Bender said that approximately $1 million has actually been spent, but that the budget for lead-related activities will be approximately $13 million, including some contingency. These activities will be paid for with operating savings and a supplemental appropriation, and Mr. Bender noted that an in-depth analysis will be presented at the May Finance and Budget Committee meeting.

Capital Expenditures

Jean Wilson, Senior Financial Analyst, summarized March's capital disbursements, and gave an overview of the mid-year capital spending projections for the balance of the fiscal year. March spending was $17.9 million, and year-to-date spending totaled $136.2 million, or 61 percent of the disbursements budget with 50 percent of the fiscal year completed.

Projects at Blue Plains, particularly in the Liquid Processing program area, continued to drive the high level of capital disbursements. Due to the levels of spending for the grit and screens project and the primary treatment facilities upgrade, year-end disbursements in this area are projected to end the year at 160 percent of budget.

Other large variances from budget include:

1. Projects in the CSO service area will end the year at 126 percent of budget, due to accelerated activities associated with the EarthJustice consent decree;
2. Projects in the Water Service area will end the year at 125 percent of budget, due to the lead service replacement program and the Bryant Street pumping station rehabilitation;
3. Projects in the Sanitary Sewer service area will end the year at 84 percent of budget due to project delays; and,
4. Capital Equipment disbursements will end the year at approximately 82 percent of budget due to savings and delays caused by focusing technology resources on the lead service command center.

David Lake, Montgomery County Board member, thanked the Budget and Finance Department for the first semi-annual county meeting that was held on April 14 to brief the county members on the mid-year status of capital spending in FY 2004.

Cash Reserve, Investments, and Capital Financing

Robert Hunt, Treasury Manager, reported that the cash balance at the end of March was $166.1 million, including an operating reserve of nearly $100 million, a rate stabilizaion fund of $21.5 million, and $45 million for the federal CSO appropriation. Mr. Hunt reported that as of March 31, the operating reserve could drop to $85 million for the remainder of the year and still meet the average reserve requirement $95.5 million. This is based on the year-to-date level of reserves and projected reserves of approximately $120 million for the remainder of the year, due to higher than budgeted grant reimbursements.

Mr. Bender noted that we will receive approximately $10 million more in grants than budgeted due to stepped up capital project activity, as well as WASA's improved processing for reimbursements.

March's interest earnings were $129,000.

Other Reports

Mr. Bender reported that the IMA operating settlement for FY 2003 has been sent out.

With the exception of Loudoun County, letters have also been sent out to Potomac Interceptor customers, making adjustments to their rates. Mr. Bender said that, in general, rates will increase by 90 percent, with $1.8 million to be recovered from prior years. There does not appear to be any issues with the billings. Adjustments were made to Loudoun County's rate in 1988, with nearly $40 million in prior year billings being recovered at that time.

Howard University and Soldiers' Home have both expressed their disagreement, in writing, to WASA's notification that we plan to charge for wastewater services, starting July 1. Mr. Bender said that we are analyzing the value of service and the value of land, and will be responding to both institutions soon.

Long-term Financing and Rating Agency Update

Mr. Bender discussed the advantages of variable rate debt, compared to fixed rate. Among the advantages of variable rate is lower interest costs, at least upon issuance, and interest paid on bonds is matched to interest earned on investments. Disadvantages include budgeting debt service at a high enough level to accommodate any increase in interest rates paid, as well as additional administrative activities. Depending on interest rate assumptions, Mr. Bender stated that annual savings could range from $1.1 million to $4.4 million compared to a fixed rate issue, calculated on an estimated $280 million borrowing.

Michael Hodge inquired about the need for a letter of credit for a variable rate issue, and Mr. Bender replied that an auction rate approach would be used. Under this scenario, bondholders could sell their bonds only if there were demand for them, eliminating liquidity issues. A letter of credit is not required for auction rate bonds, although pricing is similar to issues backed by a letter of credit. Mr. Bender further explained that debt service budget issues could be handled by budgeting for a high interest rate, with the requirement that this budget would be used for nothing other than debt service.

Michelle Cowan, of Public Financial Management, raised the possibility of purchasing an interest cap, which would assure that there is a ceiling that the Authority would pay on its variable rate debt. The cost of a cap would vary, depending on the rate at which the cap is set and the length of time that the guarantee would be in effect. In every scenario, Ms. Cowan pointed out that the cost of the cap would negate the savings associated with issuing variable rate debt. She further noted that the strong cash reserves of the Authority are invested, and would be earning at the same rate as the debt being issued, thereby minimizing interest rate vulnerability.

Mr. Gerstell expressed that the variable vs. fixed rate issue had been extensively discussed and considered by both the Committee and the staff, and that in his opinion there was now sufficient information and analysis to proceed with issuing variable rate debt, and agreed that our financial position makes us less sensitive to interest rate increases. Both Lucy Murray and Alexis Roberson concurred. Mr. Gerstell said that an alternative was to increase the size of the commercial paper program. Mr. Bender explained that the letter of credit terms may not be as attractive as those for our $100 million program, and also that two debt transactions would need to be completed in a six-month period.

Ms. Cowan explained that the government backing that West LB had in FY 2003, when it gave us such favorable rates, no longer exists. Mr. Gerstell noted that competition might lead to another favorable rate, and further explained that his initial reason for suggesting an increased commercial paper program was concern about approaching the rating agencies in the middle of the lead service line issue.

In light of Moody's and Standard & Poor's positive reactions regarding the Authority's handling of the issue, Mr. Gerstell expressed less concern, and he suggested that in addition to issuing long-term debt in FY 2004, staff should examine whether the commercial paper program is the appropriate size for our future capital program.

David Lake asked if the debt analysis presented to the Committee assumed no re-prioritization of the CIP, and Mr. Bender replied that no major projects, particularly the egg-shaped digester project, were being considered for deferral.

Mr. Gerstell concluded the discussion on variable rate debt, and with the concurrence of the Committee, this plan will be recommended to the full Board of Directors.

Insurance Policies

Mr. Bender gave an update on insurance policies that became effective on April 7, 2004. Although the cost of insurance was not significantly affected by the lead issue or the recently filed lead-related class action suit, coverage was affected. Both of the excess liability policies and the public officials' liability policy exclude coverage related to lead after the April 7 expiration of the old policies. In addition, the public officials' liability policy also excludes pollution claims subsequent to April 7. Mr. Bender informed the Committee that an extended discovery period for the expired $65 million excess liability policy and the public officials' policy could be purchased for approximately $300,000, if action is taken by May 7.

The $35 million excess liability policy already included an extended one year discovery period, and two more years could be purchased for $650,000. Staff will make its recommendation to the Committee on this extension in May, as that decision must be made by June 7, 2004.

Anthony Griffin suggested that a one-year extension should be pursued on the $35 million policy, and he also questioned the exclusion for pollution claims on the directors' and officers' policy. He noted that WASA is not getting coverage for a significant portion of the operations that it conducts, and Mr. Bender replied that he could not get clarification on this point from the insurance carrier. Mr. Gerstell emphasized this point, and said that it is probably the best coverage that we're going to get for now, and hoped that in another year, some of these exclusions would be removed.

The Committee consensus was to support the $300,000 purchase of extended discovery periods for the directors and officers and the $65 million excess liability policies. Mr. Bender noted that the dollar amount does not require approval of the full Board of Directors; due to the importance of this issue to WASA's bond rating, the Committee recommended forwarding this to the full Board for their consideration at its May 6 meeting.

Financing Alternatives for Customer Portion of Lead Service Replacements

WASA staff has been analyzing several alternatives for assisting customers with replacement of their portion of lead service lines, and two of the possible programs were presented to the Committee.

The first proposal presented to the Committee by Jerry Johnson, General Manager, was a low-interest loan for income-eligible customers. WASA's banking services institution, Wachovia, has expressed positive support for developing a loan program for customers whose income is 80 percent, or less, of the District's median income. Wachovia would absorb the administrative costs of this program, and may waive their normal 1.5 percent loan origination fee. The rate might vary between five and seven percent, depending on the length of the loan and the credit history of the customer.

A discussion on liens of the homeowners' properties was initiated by Alexis Roberson, and she expressed her concern that WASA would promote a program that could put the homeowner in jeopardy of losing their home in the case of default. Wendy Hartmann Moore responded that banks generally would not foreclose in the case of a second or third lien. Mr. Gerstell voiced his concern regarding the lien issue and recommended that staff try to get the bank to agree to accommodations such as limiting foreclosures or providing longer cure periods. Ms. Murray supported that position.

Michael Hodge suggested other approaches of financial assistance that could include Community Development Block Grants, and offered to contact the heads of appropriate agencies within the District government. Although there may not be monies available in the current fiscal year, there may be funding possibilities in FY 2005 and beyond, according to Mr. Johnson. Mr. Hodge also suggested a $1 million escrow fund, administered by a District agency, from which funds could be drawn down for replacement of privately-owned lead services. Alternatively, there may be future funds available under the lead abatement program of the District's Department of Housing and Community Development.

The second proposal for replacing the customer-owned portion of lead service lines was developing a standard rate for replacing the lines. This could possibly be set at $100 per linear foot and $500 for inside work as a baseline. Because WASA is prohibited from paying for replacement of the customer-owned portion of the line, the rate would need to be periodically adjusted to insure that costs for replacement are fully recovered by the Authority. Mr. Johnson verified for Anthony Griffin that all work would be done by contractors, and according to Mr. Bender, a standard rate would bring uniformity to the replacement process.

Mr. Griffin expressed that, in a utility business, this seems to be the best approach to take, and Mr. Gerstell expressed his recommendation to take the matter to the full Board for consideration, with a clear stipulation that the initial fee is periodically reviewed. This received unanimous agreement from the Committee, with the initial fee to be in place through September 30, 2004. It would be reviewed and reset, based on actual costs, for next fiscal year.

Mr. Gerstell adjourned the meeting at 11:15 am.