DISTRICT OF COLUMBIA
WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance and Budget Committee

Tuesday, January 25, 2005

9:00 a.m.

MEETING MINUTES

BOARD MEMBERS	WASA STAFF
Glenn Gerstell	Jerry Johnson, General Manager
Anthony Griffin	Paul Bender, Chief Financial Officer
David Lake	Michelle Cowan, Director of Finance and Budget
	Linda R.Manley, Secretary to the Board

Chairman Gerstell called the meeting to order at 9:14 a.m.

Financial Overview

Michelle Cowan, Director of Finance and Budget, reported that first quarter financial performance is on track with budget. Revenues are slightly ahead of budget; operating expenditures are slightly below budget and capital disbursements are below original projections.

Operating Receipts

With 25 percent of the fiscal year completed, the Authority collected 27 percent of its budget. The difference between the original projection and actual receipts is attributable to the tail impact of WASA's transition from quarterly to monthly billing, which was completed late last summer. As a result, the Authority experienced an increase in receipts during October and November 2004. All other revenue categories are on track with budget with no significant issues to report.

Operating Expenditures

Ms. Cowan reported that year-to-date operating expenditures totaled $61.1 million or 22 percent of budget with 25 percent of the fiscal year completed. In the chemicals and supplies category, the Authority's year-to-date spending is 21 percent of the budget with 25 percent of the year completed. Ms. Cowan noted that we have recently rebid many of our chemical contracts as part of the Council of Governments' (COG) procurement process. The price increases on all of the chemicals that were included in that process were significant, ranging from 10 to 80 percent. In discussions with the Authority's vendors and with its partners at COG, it appears that a significant portion of this increase is related to the increase in oil prices over the last year. The Authority is working with its counterparts in other jurisdictions to understand the reasons for this increase and procurement alternatives to include possibly locking in for a six-month contract as opposed to a twelve-month contract. From a budget perspective, the Authority have historically included intentional contingency to accommodate variations in chemical volumes resulting from changes in prices or flows. Given the current price increases the Authority will likely utilize all contingency funding and potentially be at or above budget in the chemical and supplies category. Staff will be monitoring this area very closely over the balance of the fiscal year.

In the utilities category, year-to-date spending is at 22 percent of budget with 25 percent of the fiscal year completed. Ms. Cowan noted that we are still under the existing PEPCO rates. In January the Authority began its new contract with Amerada Hess under which approximately 77 percent of our power purchases will be made on a floating rate basis and expect spending to increase through the balance of the fiscal year.

Year-to-date debt service payments total $41.3 million, or 20 percent of budget with 25 percent of the fiscal year completed. All of the savings are due to the auction rate program. Since inception of the program the average interest rate has been 1.48 percent and fiscal year-to-date the interest rate has been 1.63 percent. The budgeted interest rate in FY 2005 for this program is 4 percent.

Capital Expenditures

Ms. Cowan reported that December capital disbursements totaled $25.2 million, which is higher than the last few months with spending of $25 million in December, $14.3 million in November and $17.3 million in October. First quarter spending was $56 million, which is 19 percent of the budget with 25 percent of the fiscal year completed and spending is below budget in all categories with the largest differences in wastewater treatment and water projects.

The Department of Engineering & Technical Services has completed its first quarter project by project analysis of capital spending, and will present this analysis to the Environmental Quality and Operations Committee. The revised year-end projection totals $277 million, or $20 million less than the original projection, or seven percent less than originally budgeted. Because it is very early in the fiscal year and this level of potential under-spending will not have a significant impact on retail rates or the timing of our next financing, the Authority have not revised its overall cash flow projections. Staff will complete this overall review after the end of the second quarter and prior to beginning the retail rates process in late spring.

Mr. Lake asked if the underspending is the impact of accelerated spending in several project areas. As a result of those projects coming closer to an end, it has the impact of a spending lag in the later phases of the project because we spent the funds earlier than anticipated. Mr. Bender noted that that impact should have been in the original projections. Staff will be reviewing the capital program before DETS publishes the second quarter results, which will be just prior to the beginning of the rates process.

Mr. Lake asked whether the Authority is on schedule for the egg-shaped digesters project. Mr. Bender responded that the Authority is on schedule with that project.

Cash Reserve and Investments

Ms. Cowan reported that the current cash balance is above Board reserve requirements and projected to remain at or above those levels through year-end. The December yield on the Authority's investment portfolio was 2.18 percent as compared to the three-month Treasury bill return of 2.22 percent, and we are about 4 basis points behind. Ms. Cowan noted that the budget is

2.25 percent and over the last seven months staff have been locking in 9, 12 and 15-month investments because rates were so low.

Chairman Gerstell asked if the Authority have changed its approach in that the Authority have typically been 30 points ahead of the three-month T-bill return. Mr. Bender explained that if the Authority would have invested 100 percent of its portfolio over night or invest out to 30 days the Authority would be well ahead of the three-month Treasury bill return. Last year the Authority was earning approximately 1 to 1.2 percent on those short-term investments. The Authority took an opportunity to lock in some investments, some of which were two years in maturity at about 2.50 to 2.60 percent. This helped the Authority's overall performance last year, but this year those investments are dragging down the Authority's overall yield for this year. The benefit this year is budget certainty for a good portion of those earnings as the budgeted rate of return is 2.25 percent. Those investments mature summer 2005 into early 2006.

Ms. Cowan added that a portion of the Authority's portfolio does float and the Authority is out performing the market on that portion of the portfolio.

FY 2004 Final Audit Results

WASA's Controller, Olu Adebo reported that for the seventh consecutive year, the Authority received an unqualified opinion. In February, staff will publish the Consolidated Annual Financial Report, which contains the audited financial statements. Also in February, Thompson, Cobb, Bazilio & Associates (TCBA) will present management letter comments to the combined Budget and Finance and Audit Committees.

As part of finalizing the audit process, the Authority will complete the A133 single audit (grants audit) with the report issued by the end of February.

Mr. Adebo reported that the Authority will begin the solicitation for WASA's next audit contract. The current contract with TCBA expires this year. Mr. Bender noted that there are 36 qualified vendors under the GSA schedule and we will send a request for interest to all of the vendors and the Authority will encourage joint ventures for any small business that are interested.

Electricity Procurement Update

Mr. Bender distributed charts for discussion of average monthly, annual, and daily pricing at PJM Western Hubb. The Authority is under the Hess contract at this point for most of our electric usage.

Mr. Bender outlined the areas of exposure that exist in new contract with Hess. The biggest area of variability is the cost of energy, which is approximately 80 of the total power bill. Under the Hess contract, energy prices are determined at the PJM Western Hub, which staff understands to be the most transparent point of pricing for the generation component of power. Purchasing at the PJM Western Hub allows us to isolate and separately track the other components of pricing that are discussed in more detail below.

Mr. Bender noted that our budget and Board authorization assumed an approximate 40 percent increase in power prices. Because the first four months of FY 2005 are under the lower regulated Pepco rates, the Authority could purchase power at approximately $50 per MWH on average and still remain within budget. January is averaging around $46 per MWH, with very high prices over the last few weeks compared to $19 per MWH on January 1.

On an annual basis, last year prices averaged about $42 in a very volatile market, which is one of the reasons the Authority went with this type of structure last year. On a monthly basis, January through March have shown to be the most volatile months for the past two years. The summer months have averaged less. Staff will continue to watch this market daily and have the option of locking in when prices approach $40, however, until that occurs we will continue to buy on the spot market for the time being.

Mr. Bender explained that in addition to pure energy costs of $40, there are about five other elements that the Authority pay for that add approximately $8 to $10 to the price. The five elements include transmission services, capacity in the PJM network, losses and congestion. Four of these items are fixed in price however congestion prices vary hourly. Congestion is based on the units that must be dispatched in the PJM market to get the electricity to PEPCO; if the electricity comes on its most direct route congestion costs are very low; however, if a unit that the Authority would normally get electricity from cannot be dispatched and they have to dispatch a unit from further away, we would have to pay additional congestion costs. On a typical day, congestion costs run from $0.50 to $3, but can run as high as $20 to $30. The congestion costs over the past few years has been just under $2. We also pay for ancillary services, which includes a profit to Hess, and that is $3. Last week the Authority locked in its capacity costs at about $0.43 per Mwh, a historic low in the market.

Staff will meet with the Washington Suburban Sanitation Commission's energy manager on January 26 and this can be beneficial to WASA. WSSC and WASA have somewhat similar approaches to power in that not all of the power needed for a fiscal year is locked in; purchases of future blocks of power are made based on market conditions and other business needs. WSSC has a somewhat different contract with Constellation Energy in that they do a competitive procurement every time they want to lock in prices for future blocks of power. They get 3 to 5 bids from wholesalers and Constellation Energy is officially their retailer. Staff have to negotiate the prices with Hess. Staff is looking at sharing information and the potential for entering into a cooperative purchasing arrangement with WSSC and other entities.

Mr. Johnson reported that the District Government has invited WASA to partner with them in their power-purchasing procurement; WASA is not directly involved at this time, but is reviewing any opportunities. In addition, staff is reviewing the job description for the energy manager position. There seem to be a number of fairly diverse functions that the person would need to perform in addition to those mentioned by Mr. Bender in regards to the acquisitions and watching the market. Mr. Johnson hopes to have the position advertised in a few weeks.

PB Consult Contract Extension

Mr. Bender requested that the Committee consider extension of WASA's contract with its rate consultant, PB Consult. Spending under the PB Consult contract is approaching $1 million and therefore will require Board approval of this GSA contract in order to extend the contract over the next 12 months. Mr. Gerstell asked why WASA needs an independent consultant to prepare the bond feasibility study. Ms. Cowan replied that the underwriters and markets typically like to see an independent review every 3-5 years. In 2004, this was also requested in light of the significant increase in the capital improvement program due to the lead program. Ms. Cowan also noted that the feasibility consultant also provides certain indenture-required opinions. The Committee approved $1 million of additional contractual authority and forwarded the item to the Board for final action.

Chairman Gerstell adjourned the meeting at 9:50 a.m.