



DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance and Budget Committee

*Thursday, March 25, 2004
9:00 a.m.*

MEETING MINUTES

BOARD MEMBERS

Glenn Gerstell
Anthony Griffin
Lucy Murray
Michael Hodge
Alexis Roberson
Paul Folkers
Stephanie Nash
David J. Bardin
Alexander McPhail
Larry Coffman

WASA STAFF

Jerry Johnson, General Manager
Paul Bender, Chief Financial Officer
Wendy Hartmann Moore, Interim General Counsel
Linda R. Manley, Secretary to the Board

Mr. Gerstell called the meeting to order at 9:05 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 February. He noted that capital disbursements continued to run ahead of budget. Overall, revenues were at 43.5 percent of budget with 42 percent of the fiscal year completed, and operating expenditures were at 36.4 percent of budget.

Operating Expenditures

Viola Davies, Senior Financial Analyst, reported that February year-to-date operating expenditures were \$72.2 million. Personnel services continued to run at less than budgeted rates due to a vacancy rate that was higher than anticipated. Ms. Davies noted chemical expenditures will increase toward the end of the year as new capital projects, such as the centrifuges, come online, but savings are anticipated in this area at the end of the year.

Capital Expenditures

Jean Wilson, Senior Financial Analyst, summarized February's capital disbursements, which were approximately \$19 million, bringing year-to-date disbursements to \$118.3 million. This was 53 percent of the total disbursements budget, with 42 percent of the fiscal year completed. This rate of disbursements continued to be driven by projects at Blue Plains, particularly the grit and screening projects. Ms. Wilson noted that the mid-year update for spending projections will be presented to the Committee in April.

Cash Reserve, Investments, and Capital Financing

Robert Hunt, Treasury Manager, reported that the cash balance at the end of February was \$176.6 million, including an operating reserve of \$110 million, a rate stabilization fund of \$21.5 million, and \$45 million for the federal CSO appropriation. Mr. Hunt reported that, as of February 29, the operating reserve could drop to \$88 million for the remainder of the year and still meet the average reserve requirement \$95.5 million. This is based on cash reserves exceeding \$105 million year-to-date.

February's interest earnings were \$207,000.

Long-term Financing and Financial Policy Changes

Mr. Bender provided details for the long-term debt issuance that is planned for this summer. Staff proposes to issue between \$230 and \$280 million in variable rate bonds. Mr. Bender explained that, with the exception of our commercial paper program, WASA's long-term debt is 100 percent fixed rate at this time. Variable rate debt carries a more favorable interest rate than fixed, and Mr. Bender noted that only once in the past 15 years has interest on variable debt exceeded the fixed interest rate.

In response to a question from Mr. Bardin, Mr. Bender affirmed that the bonds would be callable, allowing us to reissue at a fixed rate if the interest environment were more favorable. Mr. Bardin expressed concern that interest rates might possibly go up after the November presidential election. Mr. Bender indicated that staff would provide the Committee, at its April meeting, a plan for the steps that the Authority would take if interest rates were to increase and how debt service will be budgeted.

Mr. Gerstell inquired about raising the ceiling on our commercial paper program by an additional \$50 million, to \$150 million. He suggested that issuance of long-term debt could then be pushed out by approximately six months. Mr. Bender introduced Michelle Cowan of Public Financial Management, who explained that the Authority would need to find a new letter of credit provider if it were to change the commercial paper limit. The Authority's current LOC provider, West LB no longer has the government guarantee that it did when the Authority initially selected them. Their rate was extremely favorable, and rebidding for an LOC provider will most likely add to the cost of any new commercial paper issues.

Mr. Bender discussed the proposed auction rate structure for the bond issue, which has the advantage of not requiring a letter of credit. There will be a generally level debt service amortization, with a schedule that will smooth out the spike in debt service associated with the FY 2003 issue. Because this will be subordinated debt, there will be no debt service reserve fund required.

Two changes were proposed to the Board's financing policies, to be made in conjunction with the upcoming debt issuance. The first change would revise the date for meeting the Authority's operating reserve requirement, from September 1 to an average daily balance. The other proposed change would reduce the renewal and replacement reserve from two percent of plant in operation to \$35 million, with the reserve level to be revisited every five years. This change was based on the improved condition of the plant due to the completion of the Capital Improvement Program.

Mr. Bardin questioned the proposed five-year time period for adjustments to the renewal and replacement reserve. He voiced support for a four-year period to coincide with the four-year terms

of appointed Board members. Mr. Bardin felt that changing the review period to four years would commit each member to the fiduciary responsibility of managing this reserve fund. Mr. Gerstell agreed, as did the rest of the Committee, and the proposed changes in financing policies will be forwarded to the full Board of Directors, containing the shorter review period.

Lead Service Replacements

The plan for lead service replacements has changed considerably from the plan that was originally budgeted in FY 2004. At the request of Lucy Murray, Mr. Bender described the \$13.3 million in costs that are associated with the additional activities that have been undertaken. These include water testing, water filters and replacement filters, blood testing activities that the D.C. Department of Health is carrying out, staffing and additional hours of operation for the lead service hotline, communications, and investigations.

Although the costs for activities that have been undertaken would normally be considered operating expenses, staff proposed capitalizing these costs over a 15-year period so that they would not be borne only by those who are WASA's customers in FY 2004. This treatment is consistent with Financial Accounting Standards Board Statement #71.

Mr. Gerstell asked about alternatives to capitalizing these costs, and Mr. Bender replied that the only alternative was to charge these activities to the operating budget. This would involve either reducing the levels of other operating activities or going to Congress for a supplemental appropriation. Mr. Gerstell stated that he would be willing to go to Congress, and Mr. Griffin agreed that should be the Authority's primary approach. Mr. Bardin also expressed that he could not support the capitalization approach.

Mr. Gerstell further expanded on his position, saying that there are many agencies involved with this issue, and he would like to put the costs that WASA has incurred in front of the public by way of a request for a supplemental appropriation.

Ms. Murray inquired about the process, and Mr. Bender told the Committee that the request would first go to the District Council, which would take action on moving the issue to Congress. He further explained that the supplemental appropriation is necessary before September 30th in order to comply with the Anti-Deficiency Act. Both Mr. Gerstell and Mr. Bender emphasized that we are not asking for money, rather we are asking for Congressional budget authority to increase our operating expenditures over the approved FY 2004 amount. The first step, to be taken immediately, will be to contact the D.C. Chief Financial Officer.

Larry Coffmann inquired about continuing costs in FY 2005, and Mr. Bender responded that we hope that expenditures for such things as water testing won't be needed in the next fiscal year. Michael Hodge inquired about replacing lead service lines, and Mr. Bender replied that there is adequate capital budget authority.

There was consensus from the Committee that the costs for lead service activities should not be capitalized.

Alexander McPhail introduced a proposed resolution to state the Board's policy on lead service lines at the March Customer and Community Services Committee meeting, and this resolution was further discussed at the Finance and Budget Committee meeting. Mr. Bardin noted that this would more clearly define where the obligations of the Authority begin and end in relation to lead service replacements, and it would also publicly define the capital costs and impact on rates associated with these replacements. Mr. Gerstell suggested that the draft resolution would be subject to a public comment period, and the Committee agreed. Mr. McPhail requested Board action on the

resolution at its June meeting, rather than letting the process extend into the summer months. The Committee also agreed to this timeframe, even if the June meeting needs to be pushed past the first week of the month in order to accommodate the public comment period.

Insurance Policy Expirations

Mr. Bender introduced Stuart Cowart of Albert Risk, who discussed insurance policies that are expiring on April 7, particularly the excess liability and directors' and officers' insurance. Our liability policies with AEGIS and EIM will both increase.

The AEGIS premium will increase from \$300,000 to \$400,000. This policy was initially proposed without any exclusions, but pursuant to a filing of a class action lawsuit against the Authority related to lead service lines, the policy is now proposed to exclude coverage for claims related to lead. This will exclude only damages that occur after the expiration of the current policy on April 7.

There was discussion among Committee members regarding the difficulty in determining when damages occur, and Ms. Murray pointed out that lead-related cases may follow other environmental litigation. Mr. Gerstell expressed hope that full coverage would be reinstated when the lead issue is resolved.

The EIM premium will increase from \$135,000 to \$200,000. This increase was expected because the premiums for the existing policy were locked in prior to September 11, 2001.

Mr. Cowart further explained that the public official liability policy, also with AEGIS, had a full pollution exclusion in the new policy. Mr. Gerstell asked if this would include effluent at Blue Plains, and Mr. Cowart replied that it would. Mr. Gerstell expressed his discontent and dissatisfaction with this exclusion. Mr. Bender and Mr. Cowart noted that proposals had been solicited from 15 to 20 other firms, based on the AEGIS exclusion, but that none of those firms responded.

Mr. Bardin expressed concern that these insurance exclusions would have a negative effect on the rating agencies view of WASA's financial stability, and Mr. Bender replied that we would update the agencies when the new policies are actually in place.

Mr. Gerstell adjourned the meeting at 10:35 am.