DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Finance and Budget Committee

Thursday, October 28, 2004

9:00 a.m.

MEETING MINUTES

BOARD MEMBERS
Glenn Gerstell
Anthony Griffin
Paul Folkers

WASA STAFF
Jerry Johnson, General Manager
Paul Bender, Chief Financial Officer
Avis Marie Russell, General Counsel
Michelle Cowan, Director of Finance and Budget
Linda R. Manley, Secretary to the Board

Chairman Gerstell called the meeting to order at 9:45 a.m.

FY 2004 YEAR-END FINANCIAL PERFORMANCE

FY 2004 Financial Highlights

Michelle Cowan, Director of Finance and Budget, reported that the Authority ended the year on target with budget and with the projections that staff presented to the Committee in September. At year-end, cash receipts were at 102.5 percent of budget; expenditures other than lead at 97 percent of budget. The current year-end projection for lead-related expenditures is $11.2 million versus the $13.3 million originally estimated. The lead spending estimate is conservative and additional savings may be realized.

As previously reported to the Committee, the Authority ended the year with capital spending at 106 percent of the cash disbursements budget. Because of the generally better than budgeted performance, we were able to contribute $6 million to the rate stabilization fund. This increased the balance to $27.5 million, and this higher level is factored into the our ten-year plan and projected rate increases.

Revenues and Cash Receipts

Revenues totaled $268.1 million and were $6.5 million or 2.5 percent ahead of budget, due primarily to the impact of monthly billing on residential, commercial and multi-family customers. Staff expect continuing increases in consumption and receipts during FY 2005 and 2006 because of the installation of new AMR meters on large commercial accounts.

All other categories generally ended the year at 97 to 98 percent of budget. Ms. Cowan noted that municipal revenues ended the year at 96 percent of budget due to St. Elizabeth's Hospital repairing major leaks in their system.

In the wholesale category, year-end receipts totaled $49.9 million, or 101 percent of budget due to backbilling payments by certain Potomac Interceptor users. As previously described to the Committee, these rates had not been updated since 1979, and backbilling from this period through 2003 totals $1.8 million. The National Park Service has made full payment of the backbilling in the amount of $132,000 and the Metropolitan Washington Airports Authority has made a partial payment of $250,000, with the balance to be paid pending completion of their rate consultants' review of our rate analysis. Going forward, all users have agreed to be billed at the new rate.

Operating Expenditures

Ms. Cowan provided an overview of operating expenditures by category. Year-end operating expenditures (excluding lead) total $251.2 million, approximately 97 percent of budget. Primary cost savings were realized in personnel services, due to higher than budgeted vacancy rates, and lower chemical usage resulting from delayed capital project completion and more efficient plant operations. Contractual savings were realized in biosolids, maintenance contracts and paving. These savings are offset by higher than budgeted spending in the water purchases category due primarily to the lead-related flushing contract.

The FY 2004 closeout process is now underway and staff is making a number of GAAP-related accruals, taking into account claims and litigation contingencies to ensure an accurate accounting for all costs incurred in FY 2004. Staff will update projections and keep the Board informed as we wrap up that process.

Utilities spending is projected to be approximately 105 percent of budget because of metering issues and unprecedented peak electric demand at Blue Plains over the last few months. Staff is currently discussing these issues with Pepco and we are accruing for the full amount of the bills. The Authority filed a formal protest with Pepco and withheld approximately $800,000 of payments as the Authority work through metering and billing issues with Pepco. Mr. Bender explained that if WASA prevails in the negotiations, we hope to receive a refund before the books are closed and will recognize savings in FY 2004. If a refund is received after the books are closed, there will be a credit to FY 2005.

Lead Operating Expenditures

In September, WASA executed a memorandum of understanding with the District that provided operating budget authority for the additional lead-related costs WASA incurred. The District transferred the cash to WASA at the same time the MOU was signed. In addition, the FY 2005 Appropriations Act that was signed by the President included language to fund repayment of lead costs as outlined in the MOU. As a result, WASA will transfer cash back to the District early next month with interest.

Ms. Cowan reported that WASA expect to end the year at $11.2 million for lead-related expenditures, which is a conservative estimate. Staff continues to work with the

Department of Health to obtain their final year-end projections. All the other costs are firm, including call center, sampling, filters, and other lead-related costs. If the lead MOU had not materialized WASA would have ended the year at approximately $3.6 million above the Board's originally revised budget level of $258.9 million.

Debt Service

Ms. Cowan reported that WASA ended the year on budget in debt service, with good performance on the auction rate securities. On the seven-day paper, which is half of the program, the average rate for September was 1.28 percent; the seven-day index published by the bond market association was 1.38 percent. WASA's 35-day paper averaged 1.54 percent, and comparable issuers were at 1.43 percent. Ms. Cowan noted that the comparable issuers priced on different days than WASA, and rates increased between the date they priced and when WASA rolled over its 35-day paper.

Capital Expenditures

Ms. Cowan reported that FY 2004 capital disbursements totaled $238 million, or 106 percent of budget. This level of spending was an all-time high for WASA, compared to spending of $205 million in FY 2003 and $140 million in FY 2002.

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 ended the year at 137 percent of budget.

Other large variances from budget include:

1. Projects in the CSO service area ended the year at 128 percent of budget, due to accelerated activities associated with the EarthJustice consent decree;
2. Projects in the Water service area ended the year at 125 percent of budget, due to the lead service replacement program and the Bryant Street pumping station rehabilitation;
3. The Sanitary Sewer service area ended the year at 72 percent of budget due to project delays; and,
4. Capital Equipment disbursements ended the year at 63 percent of budget due to savings in water and sewer services general utility equipment purchases, delayed disbursements on the new asset management system, and savings in the new copier purchase.

Cash Reserve and Investments

Bob Hunt, Treasury Manager, reported that the cash balance at the end of September was $206.1 million. Of that total, $106.4 was in operating reserves, $27.5 million in the rate stabilization fund (this includes the $6 million deposited at the end of September). The Authority ended the year with $72.2 million in the Combined Sewer Overflow Long-Term Control Plan (CSO LTCP) account. The yield on the Authority's investment portfolio in September was 1.72 percent as compared to the three-month Treasury bill rate of 1.68, a difference of 4 basis points.

REPORTS

Electricity Procurement

Paul Bender reported on the progress of WASA's electricity procurement. As described previously to the Committee, Pepco rate caps on the generation portion of electricity costs will expire in February 2005, which will result in significant price increases. Total electricity costs are approximately $17 million, the bulk of which is at Blue Plains.

WASA issued a request for proposals for electric generation and transmission services in September, and received five responses with indicative pricing on October 4. Earlier in October, the Board authorized management to move forward on a contract with one of the five suppliers for a total not-to-exceed cost of $20.8 million, or 25 to 30 percent above WASA's current generation cost levels. The proposals received on October 4 were in excess of the Board-approved not to exceed amount. In addition, since the receipt of proposals, prices have increased by an additional ten percent, although in the days prior to the Committee's meeting, prices had begun to moderate slightly.

Mr. Bender explained that WASA is pursuing several strategies over the next 30 to 60 days. WASA will ask for best and final pricing in the second week of November, and if pricing falls within the targeted 25 to 30 percent range, staff plan to execute a 12-month contract. If it does not fall within that range, staff plan to execute a contract for 48 smaller accounts that represent approximately $150,000, and have widely varying loads. Staff believe that this will allow suppliers to focus on the largest accounts at Blue Plains and certain pumping stations, which together total over 95 percent of WASA's load. Suppliers will also be asked to provide pricing for three, six and twelve-month increments, and we may sign a contract for a shorter period at currently higher prices in anticipation of more moderate pricing in the long run.

Mr. Bender noted that WASA is also pursuing other strategies, including participation in the District's Municipal Aggregation Program, which to date has seen slightly higher bids than WASA's. WASA also met with Washington Suburban Sanitation Commission staff to review their energy management practice. Finally, Mr. Bender reported that WASA is also exploring purchasing electricity futures/ options that could cap or hedge the total price WASA would pay in FY 2005, thus limiting our exposures.

Mr. Gerstell explained that this discussion relates to generation costs, but that Pepco will continue to provide distribution and account services. Mr. Bender noted that 75 percent of WASA's costs are for generation and transmission.

Mr. Bender explained that a contract could be signed as early as November if pricing is attractive, otherwise a contract would be executed in December or January.

Paul Folkers asked how quickly staff could reset pricing if it is not attractive. Mr. Bender explained that WASA can request bids every twenty-fours if needed, but to ensure sufficient interest by bidders, pricing requests would be asked for less frequently.

Owner-Controlled Insurance Program (OCIP)

Mr. Bender reported that OCIP is now in place and running smoothly. The two lead service replacement contracts are the first projects under the OCIP program and staff currently project savings of $200,000 to $300,000. The additional benefits of OCIP are that WASA procures substantially higher level of insurance for all contractors rather than each contractor obtaining insurance individually and allows smaller firms to bid on WASA's contracts who normally could not because they cannot meet WASA's insurance requirements.

The insurer, Ace Insurance Company, requires a drug-testing program. Mr. Bender reported that most of the contractors are knowledgeable of drug testing and have not raised any significant concerns.

Mr. Bender noted several issues that the Attorney General's Office in New York is investigating with large brokers, of which Aon is one of the companies being investigated. The specific issue they are investigating is bid rigging. WASA has asked Aon, our OCIP Administrator, about this issue and they have assured us that no bid rigging occurred with the Ace procurement. Our independent insurance consultants, Albert Risk Management, also reviewed and monitored the procurement and believe we obtained a very competitive proposal. Staff will continue to closely monitor this issue.

ACTION ITEMS

Legal Services Contracts

Mr. Bender presented three legal services contract extensions for Board consideration. The contracts fall under the policy management brought to the Board approximately three years ago, related to GSA and legal contracts. Until that time, such contracts had not been submitted for Board approval. The Board requires approval of any contracts over $1 million and since the GSA and legal contracts were always annual contracts they rarely exceeded the $1 million threshold and consequently never came under Board review. Management now presents to the Board any GSA or legal contracts which over a rolling three-year period exceed $1 million.

O'Melveny & Meyers assist the Authority with lead-related litigations, McGuire Woods LLP are environmental attorneys focusing on the Combined Sewer Overflow project, and Greenberg and Traurig provide labor relations legal support. Contract extensions will allow for payment of all outstanding invoices and cover projected spending in FY 2005.

Chairman Gerstell asked General Counsel, Avis Russell, to provide a more detailed outline of costs already incurred by year, projected costs for each of the legal contracts requiring extensions, and the type of work each firm provided.

Chairman Gerstell noted that one of the reasons the Authority hired O'Melveny & Myers LLP, was an agreement to discount their legal rates and fees given the public interest nature of the litigation. Mr. Johnson assured Chairman Gerstell that staff will ensure that the firm honors its commitment.

Ms. Russell will provide additional detail concerning each of the contract extensions for Board consideration.

REVISED FY 2005 & PROPOSED FY 2006 BUDGET REVIEW SESSION

Mr. Johnson provided an overview of the budget schedule and noted an upcoming joint meeting of the Operations and Budget and Finance Committees on November 18th to review the budget.

Mr. Johnson's overview included an outline of FY 2004 successes and FY 2005 and 2006 financial highlights as well as various initiatives and priorities. A complete copy of his presentation can be found at www.dcwasa.com. The Revised FY 2005 operating budget totals $275.3 million and is in line with the Board-approved budget. The proposed FY 2006 operating budget totals $290.3 million, an increase of $15.0 million over the revised FY 2005 budget due in part to increasing debt service costs.

Anthony Griffin inquired about the potential impact of proposed new stadium construction to the FY 2006 budget and upcoming years since the stadium is being constructed adjacent to facilities owned by WASA. Mr. Johnson reported that management is conducting a utilization review on how WASA could use 11 acres of property that WASA owns directly across the street from the planned stadium facility. There are some major utilities that traverse that site and would have to be relocated, not at ratepayer expense but rather at the expense of the owner of the facility.

Implications for WASA at the O Street location are substantially different and require a closer look at development potential and future utilization in light of the stadium's construction. Management will provide continuing updates to the Board concerning the stadium and its impacts upon WASA.

Chairman Gerstell thanked Mr. Johnson for the informative budget overview and encouraged staff to post the overview on WASA's website.

Chairman Gerstell inquired concerning the impact on WASA's budget resulting from the Washington Aqueduct's budgetary concerns as they relate to solids handling and increasing public scrutiny. Mr. Johnson noted that detail is included in the budget, which addresses the solids handling issue with the Washington Aqueduct.

Mr. Johnson commended the budget staff for an excellent job in getting the budget document prepared. Anthony Griffin and Chairman Gerstell also extended thanks to Mr. Johnson, Mr. Bender, Ms. Cowan and staff.

Mr. Johnson asked that board members direct any questions concerning the budget to Linda Manley, Board Secretary, to ensure proper tracking and timely staff response to the questions posed.

Mr. Gerstell adjourned the meeting at 10:58 am.