



Introductory Section (Unaudited)

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DISTRICT OF COLUMBIA WATER AND SEWER AUTHORITY | 5000 OVERLOOK AVENUE, SW | WASHINGTON, DC 20032

January 31, 2017

Board of Directors
District of Columbia Water and Sewer Authority
5000 Overlook Avenue, S.W.
Washington, D.C. 20032

Dear Members of the Board:

I am pleased to present the District of Columbia Water and Sewer Authority's ("DC Water" or the "Authority") Comprehensive Annual Financial Report ("CAFR") for the fiscal year ended September 30, 2016. The Authority's financial statements were prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), as promulgated by the Governmental Accounting Standards Board ("GASB") and audited by a firm of independent certified public accountants retained by DC Water. In accordance with the Authority's enabling legislation, DC Water is required to perform an annual audit of its financial statements and submit it to the District of Columbia's Mayor, Chief Financial Officer, and District Council.

Responsibility for the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with DC Water's management. To the best of my knowledge and belief, the information contained in this report is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the Authority. All disclosures necessary for the reader to gain an understanding of DC Water's financial activity have been included.

DC Water's management is responsible for establishing and maintaining an internal control structure designed to ensure that its assets are adequately safeguarded against loss, theft, or misuse and to maintain accurate and reliable financial records for the preparation of financial statements and the representations made by management. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: 1) the cost of internal controls should not exceed the benefits derived from the controls; and 2) the evaluation of costs and benefits requires management's exercise of judgment. To the best of my knowledge and belief, DC Water's internal accounting controls adequately safeguard its assets and provide reasonable assurance of the proper recording of financial transactions in accordance with GAAP.

KPMG LLP, Certified Public Accountants, has been retained by DC Water to serve as its independent auditors and has issued an unmodified ("clean") opinion on DC Water's financial statements for the

years ended September 30, 2016 and 2015. The independent auditors' report is located at the front of the financial section of this report.

GAAP requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis ("MD&A"). This letter of transmittal is designed to supplement the MD&A and should be read in conjunction with it. DC Water's MD&A is located immediately following the independent auditors' report.

Overview of DC Water

DC Water provides retail drinking water distribution and wastewater conveyance and treatment services to approximately 672,000 residential, commercial and governmental customers in the District of Columbia, and wholesale wastewater conveyance and treatment services to approximately 1.6 million users in Montgomery and Prince George's Counties in Maryland, and Fairfax and Loudoun Counties in Northern Virginia.

DC Water is governed by a Board of Directors consisting of eleven principal and eleven alternate members who represent the District of Columbia, Montgomery and Prince George's Counties in Maryland, and Fairfax County in Virginia. The Mayor of the District of Columbia appoints, and the District Council confirms, all District Board members, including the Chairperson. In addition, the Mayor appoints the five principals and five alternate members who represent the surrounding jurisdictions based on submissions from those jurisdictions. DC Water may only take action on policy matters after it receives a favorable vote of no less than six members of the Board of Directors. All Board members participate in decisions directly affecting the general management of the joint-use facilities. Only the District of Columbia Board members participate in matters that affect District ratepayers.

In the early history of the District, there were separate sewer, water and sanitation departments. Over the years, DC Water underwent several name and organizational changes, while remaining committed to its core mission. Between 1935 and 1938, DC Water operated as the District of Columbia Department of Sanitary Engineering. It was during this time that the first sewage treatment plant at Blue Plains was constructed. In the early 1970s, DC Water was known as the District of Columbia Department of Environmental Services. Later, in 1985, DC Water became a part of the District of Columbia Department of Public Works.

In 1996, the regional participants in DC Water's service area, including the District of Columbia, Montgomery and Prince George's Counties in Maryland, Fairfax and Loudoun Counties in Virginia, and the United States Congress agreed to create an independent, multi-jurisdictional water and wastewater authority from its predecessor agency. In April 1996, the Council of the District of Columbia passed the "Water and Sewer Authority Establishment and Department of Public Works Reorganization Act of 1996 (as amended)" (the "Act"), a statute that established DC Water as an operationally, financially, and legally independent authority on October 1, 1996.

In accordance with the Act, the District authorized DC Water to use all of the property and assets related to its water distribution and wastewater treatment and conveyance services and transferred to DC Water any liabilities that were directly attributable to those assets. The District has retained full legal title to these assets. The assets will remain under the control of DC Water for as long as any revenue bonds remain outstanding.

The Act also requires DC Water to establish rates, fees and other charges for all services provided by DC Water. These rates, fees and charges, in addition to certain wholesale wastewater treatment contracts, are projected to generate revenues adequate to pay all of the costs of operating DC Water. DC Water's rate setting powers are not subject to the oversight of, or regulation by, the District or any other agency or authority.

DC Water's service area below is approximately 725 square miles and covers the District of Columbia, most of Montgomery and Prince George's Counties, and portions of Fairfax and Loudoun Counties.



Accounting and Budget Processes

Basis of Accounting

The financial statements of the Authority have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") as applicable to governmental entities. The Governmental Accounting Standards Board ("GASB") is the accepted primary standard-setting body for establishing governmental accounting and financial reporting standards. DC Water prepares its financial statements using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recognized when incurred, regardless of the timing of the related cash flows.

Financing Policies

The primary objective of DC Water's financing policies is to ensure that its financial practices result in high quality investment-grade bond ratings to achieve the lowest cost of capital necessary to finance DC Water's capital improvement program. Under its Master Indenture of Trust, DC Water is legally obligated to maintain 1.2 times debt service coverage on its senior lien debt and establish an operating reserve fund equal to 60 days of operations and maintenance costs (O&M). By policy, the Board has established more conservative financial targets and is committed to maintaining 1.4 times debt service coverage on its senior lien debt and an operating cash reserve requirement equivalent to the greater of 120 days of O&M or \$125.5 million. In addition, DC Water has established policies for utilizing any operating surplus for funding pay-as-you-go capital expenditures (Pay-Go) or contributing to the Rate Stabilization Fund (RSF).

Budgetary Control

Budgetary control begins with the preparation of annual operating and capital budgets, which are developed on an expenditure basis. After a comprehensive review process by the Board's Finance and Budget, Environmental Quality and Sewerage Services, Water Quality and Water Services, and DC Retail Water and Sewer Rates Committees, the budget is approved by the Board of Directors. DC Water's financial management system is designed to prevent overspending of the budget without appropriate approvals. The Budget Department prepares monthly management reports for each operating unit as well as for the Board of Directors and its various committees. The reports are reviewed and acted upon each month to ensure DC Water complies with its authorized budget.

Annual Budget Process

After approval by the Board, DC Water is required to submit its annual operating and capital budgets to the District for inclusion in the Mayor's annual budget. The Mayor's budget is in turn submitted to the District Council for its review and comment. Importantly, neither the Mayor nor District Council has the authority to modify or revise the annual budgets of DC Water. The District

then includes DC Water's budget as an enterprise fund as part of its own budget submission to the U.S. Congress for approval.

Economic Condition and Outlook

Washington, D.C., is not only known as being the nation's capital, but it is also an international city with a vibrant tourist industry and business climate. The U.S. Census Bureau estimated that there were 672,228 residents in Washington, D.C. in 2015, an increase of 2.0% from the same period of the prior year. The Washington Metropolitan Region has a population of more than 6.1 million individuals and is the seventh largest metropolitan area in the country.

The District's economic base is driven by the federal and local governments as well as diplomatic embassies and international organizations. The federal civilian workforce in the District averaged 234,205 employees, while thousands more are estimated to work elsewhere in the metropolitan area. The District is host to more than 180 foreign embassies and other recognized diplomatic missions. A number of international organizations, such as the International Monetary Fund, World Bank, Inter-American Development Bank and Organization of American States are headquartered in the District. An estimated 21.3 million people visit the Washington Metropolitan Region on an annual basis, not only to do business with the federal government and local firms, but also to visit the national monuments, historic sites, museums and other major cultural attractions.

Income has grown considerably in the District in recent years. The unemployment rate in the District decreased from 8.2% in 2012 to 6.5% in 2016. The District's economy grew consistently faster than the national economy for much of this decade and is expected to continue to grow in 2017. The District's economy is relatively more information and service industry dependent than most states, accounting for the region's insulation from the most recent national housing and credit centric recession.

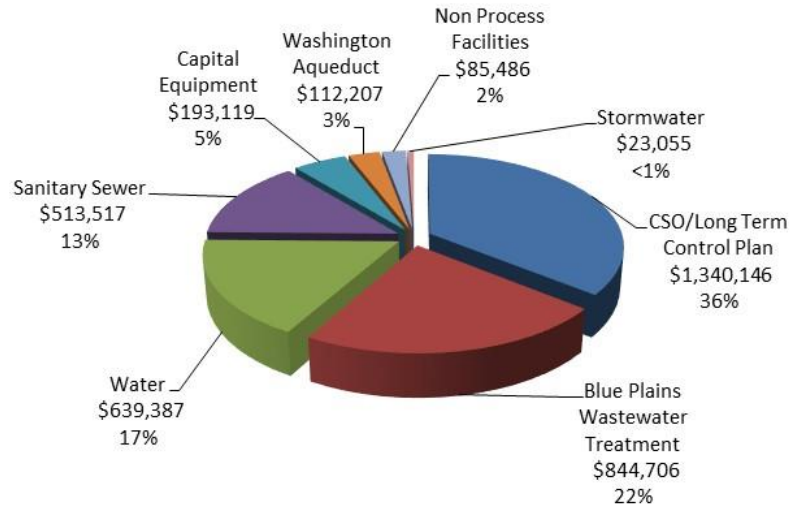
Major Initiatives

Capital Improvement Program

DC Water's ultimate success in achieving its mission of providing world-class water and wastewater services as a leading steward of the environment depends in large part on the implementation of its 10-year \$3.8 billion capital improvement program ("CIP"). Approximately 36.9% of the CIP is either federally mandated or required by a court-ordered consent decree, including the Enhanced Nitrogen Removal Facilities ("ENRF") and the Clean Rivers Project.

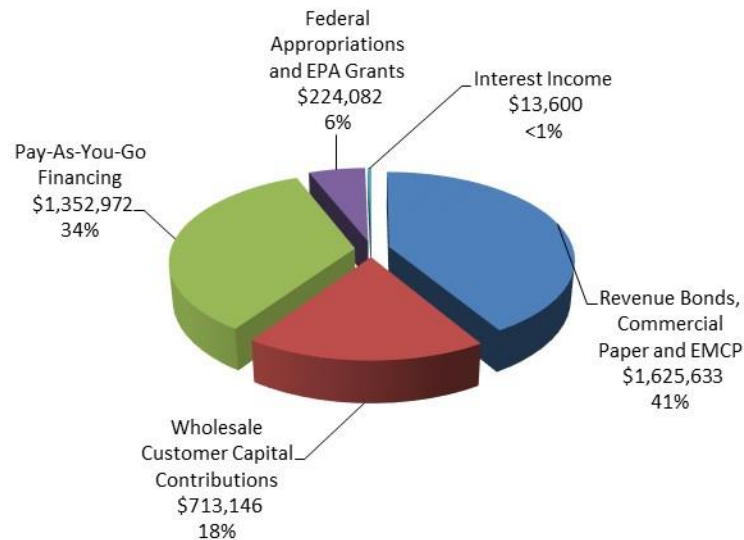
The Board approved Fiscal Year 2017 – 2026 CIP is broken into seven service areas, as shown in the following graph.

**Capital Improvement Program FY 2017 – FY 2026
Uses of Funds (\$ in 000's)**



DC Water plans to finance its \$3.8 billion capital improvement program from a variety of sources, including the issuance of revenue bonds, grants from the U.S. Environmental Protection Agency (“EPA”), federal appropriations, capital contributions from wholesale customers and Pay-Go. Interim financing through issuance of commercial paper (“CP”) or extendible municipal commercial paper (“EMCP”) will be periodically converted to long-term financing through the issuance of bonds. As shown on the following chart, approximately 41% of capital financing will come from debt issuances.

**Capital Improvement Program FY 2017 – FY 2026
Sources of Funds (\$ in 000's)**



Clean Rivers Project

Approximately one-third of the District of Columbia is served by a combined sewer system, in which both sanitary sewage and storm water flow through the same pipes. When either the collection system or the Blue Plains treatment plant reach capacity, typically during periods of heavy rainfall, the system is designed to overflow the excess diluted sewage directly into District waterways. These events are referred to as combined sewer overflows (“CSO”). Combined sewers are not unique to the District and are commonly found in older wastewater collection systems especially in Northeast and Midwest regions of the United States. The Clean Rivers Project is being implemented on a schedule included in a consent decree between the EPA, U.S. Department of Justice (“DOJ”), District of Columbia, and DC Water. The consent decree was entered by the Court on March 23, 2005. The 2005 decree is a “grey” solution that required construction of three tunnel systems in the Anacostia River, Potomac River, and Rock Creek sewersheds.

The benefits of the Clean Rivers Project will be significant when fully implemented. CSOs are projected to be reduced by 93 percent into the Potomac River watershed and by 98 percent on the Anacostia River watershed and 90 percent in the Rock Creek watershed resulting in improved water quality and a significant reduction in debris from the combined sewer system in our local waterways. In addition, the Clean Rivers Project serves as a cornerstone of the District’s waterfront redevelopment initiatives including commercial, residential and other development projects on the Anacostia River.

The Clean Rivers Project is a \$2.8 billion capital project that includes a variety of capital improvements throughout the District including three massive, deep tunnel systems which will capture and store CSOs from storm events until they can be conveyed to Blue Plains for treatment.

Green Infrastructure (GI) technologies capture, infiltrate, treat and reuse polluted runoff before it enters the sewer system. These practices include rain gardens, porous pavements, green roofs, infiltration planters, trees and tree boxes, and rainwater harvesting for non-potable uses, such as toilet flushing and landscape irrigation.

On May 20, 2015, DC Water, District of Columbia, EPA and DOJ announced an agreement to modify the 2005 consent decree to allow for large-scale GI installations and other modifications to the Clean Rivers Project impacting the Potomac River and Rock Creek watersheds. The modification was approved and became effective on January 29, 2016. Anacostia River watershed will proceed with the planned tunnel solution. Under the modified agreement, DC Water is expected to eliminate or reduce the previously-planned underground tunnel for Rock Creek and Potomac River watersheds if the pilot GI projects in these watersheds are deemed practicable. Upon determination of their practicability, DC Water will instead build green infrastructure and targeted sewer separation to manage the volume of runoff produced by 1.2" of rain falling on 365 impervious acres of land that currently does not absorb stormwater. This portion of the project will be completed by 2030. If the pilot projects are deemed impracticable, DC Water will revert to grey solutions with same completion date of 2030.

These measures are intended to achieve compliance with EPA's nutrient limits for nitrogen and phosphorus as required by the current NPDES permit. The amended decree will provide DC Water an additional five years to complete the work required to address CSOs resulting in an extension of the final compliance date from 2025 to 2030.

The GI projects underway for Rock Creek and Potomac River watersheds will be implemented during the next five years and results will be evaluated to determine either implementation of large-scale GI or return to "grey" infrastructure solution. In order to protect DC Water stakeholders, DC Water issued the industry's first Environmental Impact Bond. Similar in nature to "pay for success" bonds, the borrowing is designed to pay bondholders for successful results achieved in the GI projects or pay bondholders less in the event that successful results are not achieved. This historic issuance is expected to introduce the wastewater industry to alternative sources of funding for a national issue regarding EPA required effluent composition reductions to the nation's waterways.

Digester Project

DC Water's Biosolids Management Program ("BMP") is in operation. Expected savings are being realized related to electricity generation, biosolids hauling and land application costs. Efforts continue to develop alternative revenue sources through commercialization of class A biosolids.

Recent Developments

Water System Replacement Fee

DC Water successfully implemented the Water System Replacement Fee (WSRF) on October 1, 2016 without interruption in customer billing and collection activities. The WSRF is a new fixed fee to fund the one percent per year drinking water system replacement program that will cost approximately \$40 million annually.

2-Year Rate Increase for FY 2017 & FY 2018

First time multi-year rate proposal adopted by the Board

- Greater certainty with respect to budget
- Reduced volatility with respect to revenues

Credit Rating Upgrades

In February 2016, Standard and Poor's Investors Service upgraded DC Water's credit rating for senior lien revenue bonds from AA+ to AAA, the highest rating available by a rating agency and the highest credit rating in DC Water history. Additionally, in April 2016, Moody's Investor Service upgraded DC Water's credit rating for senior lien revenue bonds from Aa2 to Aa1.

Government Finance Officers Association Awards

CAFR Award

The Authority's 2015 CAFR received the Government Finance Officers Association's ("GFOA") Certificate of Achievement for Excellence in Financial Reporting. The CAFR was judged based on its conformity to GAAP and its compliance with other financial, legal and contractual provisions. The Certificate of Achievement is the highest form of recognition in governmental accounting and financial reporting, and its attainment represents a significant accomplishment for any municipality or government agency. To date, DC Water has received the GFOA's CAFR award for every year of its existence as an independent Authority, for a total of nineteen consecutive awards.

Budget Award

The Authority's 2015 operating and capital budgets received the GFOA's Distinguished Budget Presentation Award, the highest form of recognition in governmental budgeting. In order to qualify for the Distinguished Budget Presentation Award, DC Water's budget document was judged to be proficient in several categories, including presentation as a policy document, financial plan, operations guide and a communication device. The Authority has been the recipient of this prestigious award for the last sixteen years.

ACKNOWLEDGEMENTS

With deep appreciation, I wish to recognize the outstanding leadership and personal commitment of Controller John Madrid and his dedicated team of professionals for their collective effort in drafting DC Water's FY 2016 Comprehensive Annual Financial Report.

Respectfully submitted,



Mark T. Kim
Chief Financial Officer



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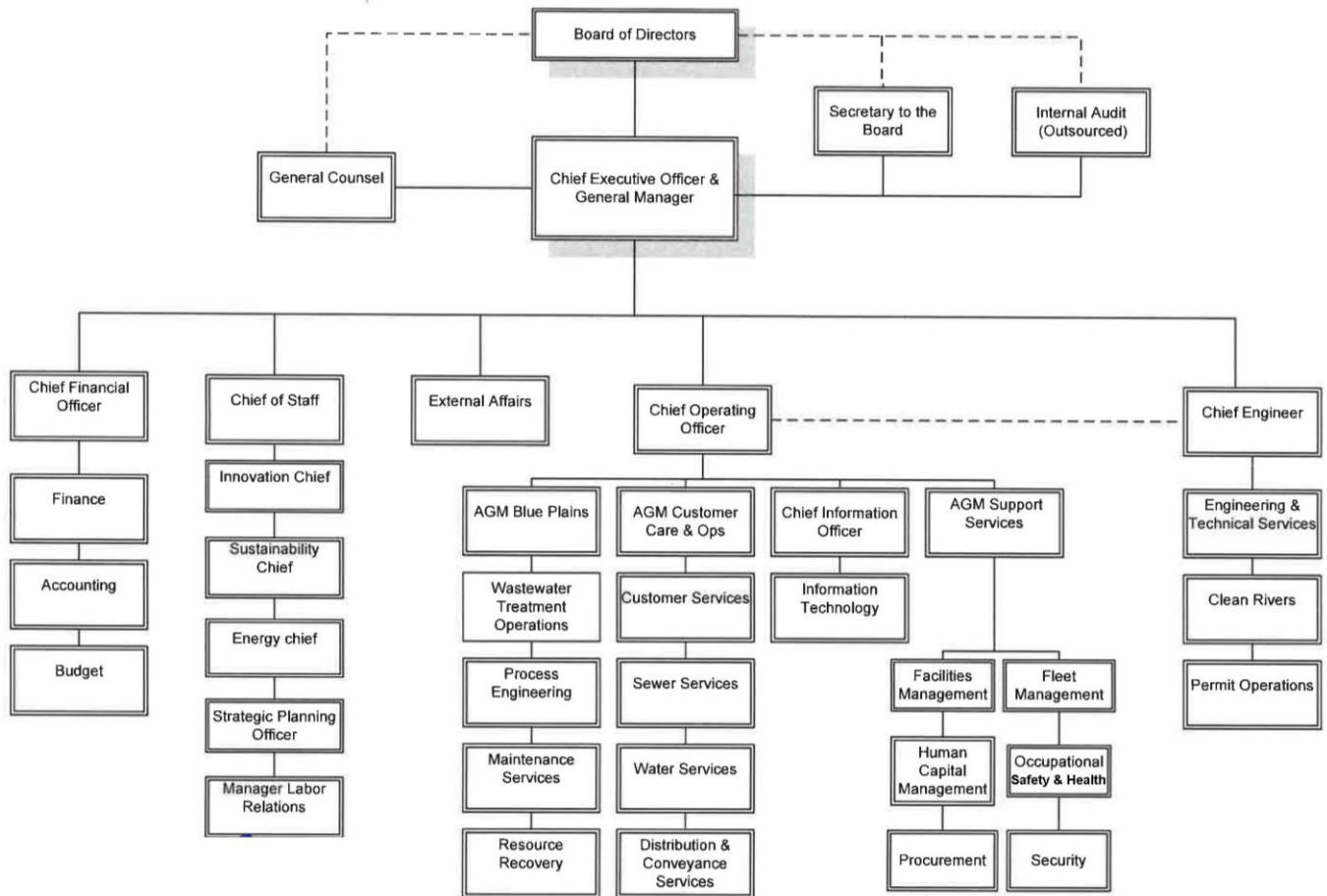
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Governance and Organizational Structure





Government Finance Officers Association

**Certificate of
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Presented
to

**District of Columbia
Water and Sewer Authority**

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

September 30, 2015

Executive
Director/CEO