



OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR

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District of Columbia Auditor

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Letter Report: Sufficiency Review of the
Water and Sewer Authority's Fiscal Year 2010
Revenue Estimate in Support of the Issuance
of \$225,000,000 in Commercial Paper
(Taxable and Tax Exempt)

July 9, 2010



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The Honorable Vincent C. Gray, Chairman
The John A. Wilson Building
1350 Pennsylvania Ave., NW, Suite 504
Washington, D.C. 20004

Letter Report: Sufficiency Review of the Water and Sewer Authority's Fiscal Year 2010 Revenue Estimate in Support of the Issuance of \$225,000,000 in Commercial Paper (Taxable and Tax Exempt)

Dear Chairman Gray and Members of the Council of the District of Columbia:

Pursuant to D.C. Code, Section 34-2202.09 (h) and a request from the General Manager of the District of Columbia Water and Sewer Authority (WASA),¹ the District of Columbia Auditor (Auditor) conducted a sufficiency review of WASA's fiscal year (FY) 2010 revenue estimate in support of a \$225,000,000 Commercial Paper (Taxable and Tax Exempt) issuance.²

The purpose of the commercial paper issuance was to provide financing for WASA's capital improvements and capital equipment. This report sets forth the results of the Auditor's analysis of WASA's FY 2010 revenue estimate of \$378,181,106 in support of the proposed commercial paper issuance.

¹ On June 15, 2010, the District of Columbia Water and Sewer Authority unveiled a new name and now goes by DC Water. However, throughout this report they are referred to as WASA.

² According to a draft copy of the Issuing and Paying Agency Agreement between WASA and Deutsche Bank Trust Company Americas, WASA's Commercial Paper Notes (letters of credit) will be issued as follows: Series A, for \$100,000,000, Series B, for \$50,000,000; and Series C, for \$75,000,000. The Letters of Credit supporting the Commercial Paper program are being issued pursuant to a Master Indenture of Trust, dated April 1, 1998, as amended.

Auditor's Responsibilities Related to WASA's Issuance of Bonds, Notes or Other Obligations or Borrowing of Money

D.C. Code, Section 34-2202.09(h) states that:

During each fiscal year in which debt service on the proposed bonds and outstanding revenue bonds issued by the Authority, and the transfer provided in Section 34-2202.07(f) becomes due and payable, the Authority may not issue bonds, notes, or other obligations or borrow money unless the Authority first certifies, to the reasonable satisfaction of the District of Columbia Auditor [Auditor's Emphasis], that the revenues of the Authority are sufficient to pay its costs, the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by the Authority, and amounts equal to the debt service payments on District general obligation bonds issued by the District prior to October 1, 1996, which financed Department of Public Works, Water and Sewer Utility Administration capital projects, as such bonds and transfers become due and payable. The Authority's certification shall be supported by expert study and analysis.

Results In Brief

Based upon a review of the expert study and analysis, the representations of WASA's management, and other information provided by WASA personnel, and other independent sources in support of the proposed commercial paper issuance, it appeared that the revenue estimate of \$378,181,106 would be sufficient to cover WASA's FY 2010 costs, debt service requirements, and other obligations. Therefore, with regard to WASA's \$225,000,000 Commercial Paper (Taxable and Tax Exempt) issuance, the Auditor determined that, at the time of the Auditor's examination, WASA's revenue estimate appeared sufficiently supported and achievable. Based on this determination, the Auditor certified WASA's revenue estimate of \$378,181,106.

Information upon which WASA's revenue estimate is based can, and often does, change rapidly. Further, relative uncertainty in the overall revenue estimating process and unforeseen national and local events may substantially change WASA's economic outlook and result in significant changes to the revenue estimate certified by the Auditor. The certification sufficiency review was especially challenging in light of unprecedented economic factors including a recession, ongoing turmoil in the financial markets, and other factors.

The validity and accuracy of the Auditor's sufficiency certification are predicated upon the extent to which WASA officials have provided sound revenue estimates for FY 2010 and have fully disclosed and provided reliable and accurate information to the Auditor regarding WASA's operating expenditures, debt service and contract costs, and any other expenses relevant to the Auditor's sufficiency certification.

This certification was conducted in accordance with standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States. The review included such tests of the documentation and other procedures as deemed necessary and appropriate under the circumstances. The Auditor believes the procedures used in conducting this attestation engagement provided a reasonable basis for certifying WASA's FY 2010 revenue estimate.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine whether WASA's FY 2010 revenue estimate of \$378,181,106, as certified by WASA's Chief Financial Officer (CFO) in a signed certificate dated May 4, 2010, was reasonably sufficient to pay WASA's FY 2010 costs,³ the principal of and interest on and other requirements pertaining to the proposed notes and outstanding revenue bonds issued by WASA, and amounts equal to the debt service payments on District of Columbia general obligation bonds issued by the District of Columbia prior to October 1, 1996, which financed Department of Public Works, Water and Sewer Utility Administration (WASUA) capital projects, as such bonds and transfers become due and payable.

In preparing this certification, the Auditor reviewed WASA's FY 2010 operating and capital budgets, WASA's Comprehensive Annual Financial Reports for FY 2007 through FY 2009, and additional supporting documentation provided by WASA as deemed necessary by the Auditor. Discussions were held with WASA officials, including its General Manager, CFO, General Counsel, Internal Auditor, and others including WASA's co-financial advisors, Public Financial Management Group and P.G. Corbin and Company, Inc. The Auditor also reviewed information from the following rating agencies: Fitch and Standard and Poor's.⁴

³ According to WASA's Revised FY 2010 and Approved FY 2011 Operating Budgets, Adopted February 4, 2010, page III-12 (Cash Flow Summary), operating disbursements (costs) are projected to be \$376,975,000 for FY 2010.

⁴ See Public Finance report issued by Fitch Ratings entitled "2010 Water and Sewer Medians" dated April 6, 2010 and Standard & Poor's Ratings Direct report entitled "Key Water and Sewer Utility Credit Ratio Ranges" dated September 15, 2008.

The Auditor also reviewed an expert study and analysis conducted by Amawalk Consulting Group LLC (Amawalk),⁵ an outside consultant retained by WASA, and held discussions with representatives from Amawalk. In its expert study and analysis, Amawalk reported that WASA made reasonable revenue projections in that WASA: (1) provided adequate documentation of the principal assumptions underlying the forecast; (2) developed the forecast using the most current information available; (3) thoroughly understood and considered the risk factors inherent in the forecast; and (4) computed projections accurately. Amawalk concluded that WASA's FY 2010 revenue estimate had been reasonably developed and was attainable. The Auditor relied, in part, on representations contained in Amawalk's expert study and analysis, information obtained from independent sources, as well as additional information obtained directly from WASA's management to support the certification of the revenue estimate.

BACKGROUND

The Water and Sewer Authority (WASA) was established pursuant to D.C. Law 11-111, effective April 18, 1996. Prior to the establishment of WASA, WASUA, which was under the organizational umbrella of the District's Department of Public Works (DPW), managed the District's water and sewer utility operations. In accordance with D.C. Law 11-111, WASUA was abolished and its functions were transferred from DPW to WASA. D.C. Law 11-111 was amended by D.C. Law 11-184 to clarify WASA's relationship with the District government and provided for the Auditor's analysis of revenues certified by WASA.

According to published information, WASA provides retail water and wastewater services to more than 592,000 residents of the District of Columbia (2008) and more than 1.6 million residents of Prince George's and Montgomery Counties in Maryland and Fairfax and Loudoun Counties in Virginia.

WASA is governed by an 11-member board of directors. The chairperson and five members represent the District and are appointed by the Mayor of the District of Columbia with the advice and consent of the Council of the District of Columbia. The remaining five members represent the surrounding jurisdictions of Prince George's and Montgomery Counties in Maryland and Fairfax County in Virginia. A General Manager provides day-to-day management of WASA.

⁵ See Preliminary Official Statement Certificate, District of Columbia Water and Sewer Authority, dated March 8, 2010, issued by Amawalk Consulting Group LLC.

Impervious Surface Area Charge (IAC)

In fiscal year 2009, WASA changed the way it calculated sewer charges to customers. According to information published by WASA, they “lowered the rate for sewer service and are now including a special charge for properties that include surfaces water can’t penetrate (impervious surfaces).”⁶ Impervious surfaces include rooftops, paved driveways, patios, parking lots and other paved areas. According to information contained in WASA’s FY 2010 revised and FY 2011 approved operating budgets, the purpose of the IAC is to assist WASA with meeting costs associated with implementation of a federally mandated combined sewer overflow long term control plan.⁷

⁶ See DC Water and Sewer Authority – IAC website information at <http://www.dcwasa.com/customer-care/iab.cfm>

⁷ See District of Columbia Water and Sewer Authority Operating Budgets, Revised FY 2010 and Approved FY 2011, Adopted February 4, 2010, budget overview and performance section II-16.

RESULTS OF ANALYSIS

AMAWALK CONSULTING LLC AND WASA MANAGEMENT DETERMINED THAT WASA'S ESTIMATED FY 2010 REVENUES WILL BE SUFFICIENT TO COVER ITS FY 2010 COSTS, DEBT SERVICE REQUIREMENTS, AND OTHER OBLIGATIONS

WASA's FY 2010 revenue estimate of \$378,181,106 is supported by Amawalk's expert study and analysis which is required by D.C. Code, Section 34-2202.09(h).⁸ Amawalk made the following observations:

1. Adequacy of supporting documentation - In addition to interviews and timely responses to requests for information, the Authority [WASA] provided sufficient documentation from which to verify their projections.
2. Best available information - The Authority used the most current information available to prepare its forecasts.
3. Accurate computation - All projections were accurately computed in all material respects.
4. Reasonableness of assumptions - The Authority gave appropriate consideration to the risks that would affect forecast values.

⁸ See Preliminary Official Statement Certificate, District of Columbia Water and Sewer Authority, dated March 8, 2010, issued by Amawalk Consulting Group LLC.

Amawalk further reported in its expert study and analysis that WASA's revenue projections were "reasonably developed and attainable." Amawalk's analysis indicated that the FY 2010 revenue projection was based on a 9% increase in WASA's water and sewer rates and an increase in IAC rates approved by WASA's Board of Directors which became effective October 1, 2009.⁹ According to Amawalk officials, the FY 2010 revenue projection assumes "that water consumption in FY 2010 will be relatively consistent with customer usage in FY 2009."¹⁰

WASA Reserves

WASA's financial position is strengthened by several reserves which are presented in Table I.

TABLE I
WASA Reserve Balances
as of February 28, 2010

Reserve	Amount
Operating Reserve	\$39,004,000
Renewal & Replacement Reserve	35,000,000
Undesignated Reserve	51,312,800
D.C. Insurance Reserve	1,000,000
D.C. GO Debt Service Reserve	137,700
Total	\$126,454,500

Source: WASA's Treasury Manager

⁹ See Resolution of the Board of Directors of the District of Columbia Water and Sewer Authority #09-103, Presented and Adopted: September 3, 2009, Subject: Final Water and Sewer Service Rates, Right of Way and PILOT Fee and Impervious Area Surface Charge (IAC) For Fiscal Year 2010.

¹⁰ See Preliminary Official Statement Certificate, page 3 (opinions and conclusions).

As of February 28, 2010, the balance in WASA's reserve accounts, excluding the rate stabilization fund,¹¹ totaled \$126,454,500. In addition to the reserves presented in Table I, as of February 28, 2010, WASA maintained \$28,600,000 in its rate stabilization fund.

According to WASA's statement of financial policies, WASA will maintain strong levels of operating cash reserves, equivalent to 120 days of budgeted operations and maintenance costs calculated on an average daily balance basis with the objective of maintaining at least \$125,500,000 in operating reserves.

Table II presents WASA's sufficiency calculation of projected revenues to cover costs, debt service requirements, and other obligations for FY 2010.

¹¹ According to WASA's Treasury Manager, the purpose of the rate stabilization fund is to mitigate large annual rate increases.

Table II¹²
Water and Sewer Authority's Sufficiency Calculation of Projected Revenues to Cover Costs,
Debt Service Requirements and Other Obligations for FY 2010
(Dollars in 000s)

Operating Receipts:		
Residential, Commercial & Multi- Family	\$172,971	
Federal	36,453	
Municipal	7,693	
D.C. Housing Authority	6,499	
Groundwater	5	
Metering Fee	5,500	
Right of Way Fee	20,446	
IAB CSO Revenue	<u>11,336</u>	
Subtotal Retail	260,903	
Wholesale revenues	68,577	
Other operating revenues	48,378 ¹³	
Interest Earned from Bond Reserves	<u>323¹⁴</u>	
Total Operating Receipts and Interest		\$378,181
Operating Disbursements:		
Personnel Services	89,158	
Contractual Services	77,896	
Water Purchases	30,295	
Chemicals & Supplies	29,132	
Utilities & Rent	38,307	
Small Equipment	<u>899</u>	
Subtotal Operations & Maintenance		265,687
Debt Service	88,494	
Payment in Lieu of Taxes /Right of Way Fee	22,794	
Total Operating Disbursements		<u>\$376,975</u>
Operating Surplus		<u>\$1,206</u>

Source: D.C. Water and Sewer Authority Revised FY 2010 and Approved FY 2011 Operating Budgets, Adopted February 4, 2010, page III-12 (Cash Flow Summary).

¹² Table may contain minor differences due to rounding.

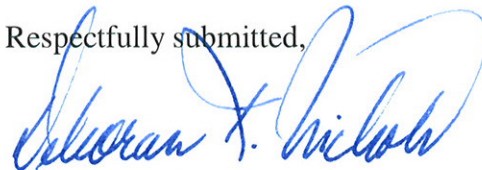
¹³ The FY 2010 other operating receipts include a \$28 million transfer from the Rate Stabilization Fund. As previously mentioned the Rate Stabilization Fund is used by WASA to assist in mitigating annual rate increases.

¹⁴ Interest Earned from Bond Reserve is included in the Cash Reserves section of the Cash Flow Summary.

CONCLUSION

Based on the analysis of all information presented by WASA, and other sources of relevant information, including the expert study and analysis completed by Amawalk, the Auditor was reasonably satisfied that WASA's FY 2010 revenue estimate of \$378,181,106 would be sufficient to support its FY 2010 costs, the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by WASA, and the debt service payments on District general obligation bonds issued by the District on behalf of the Department of Public Works, Water and Sewer Utility Administration (WASUA) prior to October 1, 1996. Therefore, the Auditor signed a Certificate of the Auditor on May 5, 2010, in support of WASA's \$225,000,000 Commercial Paper (Taxable and Tax Exempt) issuance.

Respectfully submitted,



Deborah K. Nichols
District of Columbia Auditor