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**Letter Report: Sufficiency Review of the
Water and Sewer Authority's Fiscal Year 2007
Revenue Estimate in Support of the Issuance of
\$300,000,000 in Public Utility Subordinated Lien
Revenue Bonds (Series 2007)**

April 20, 2007



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The Honorable Vincent C. Gray, Chairman
and Members of the Council of the District of Columbia
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 2007 Revenue Estimate in Support of the Issuance of \$300,000,000 in Public Utility Subordinated Lien Revenue Bonds (Series 2007)

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 February 15, 2007 letter, the General Manager of the District of Columbia Water and Sewer Authority (WASA) requested the District of Columbia Auditor (Auditor) to certify the sufficiency of WASA's fiscal year (FY) 2007 revenue estimate in support of a proposed \$300,000,000 issuance of Public Utility Subordinated Lien Revenue Bonds, Series 2007.¹ The purpose of the bonds was to provide financing for some of WASA's FY 2007 and FY 2008 capital improvements and retire outstanding debt under the commercial paper program.² This report sets forth the results of the Auditor's analysis of WASA's FY 2007 revenue estimate of \$305,010,000 in support of its proposed bond issuance.

¹Simultaneously with the issuance of the Public Utility Subordinated Lien Revenue Bonds, WASA planned to issue \$75,000,000 in Public Utility Subordinated Lien Taxable Revenue Bonds. Proceeds from these bonds will be used to finance certain costs of the system, including costs of improvements to the Washington Aqueduct which WASA is contractually obligated to pay. System is defined as all plants, systems, facilities, equipment, real and personal property and tangible and intangible property...and the supply, treatment, storage, and distribution of water.

²On April 12, 2007, WASA issued \$7,500,000 in commercial paper notes which are due and payable by June 7, 2007, and \$22,500,000 in commercial paper notes, which are due and payable by June 8, 2007. The interest rate on the commercial paper notes is 3.75%. The Auditor issued a separate report relating to this commercial paper issuance entitled, "Letter Report: Sufficiency Review of the Water and Sewer Authority's Fiscal Year 2007 Revenue Estimate in Support of \$50,000,000 in Commercial Paper Notes," dated April 3, 2007.

Auditor's Responsibilities Regarding WASA's Borrowing of Money and Incurring of Debt

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 and other information provided by WASA personnel in support of the proposed bond issuance, it appeared that the revenue estimate of \$305,010,000 would be sufficient to cover WASA's FY 2007 costs, debt service requirements, and other obligations. Therefore, with regard to WASA's planned \$300,000,000 issuance of Public Utility Subordinated Lien Revenue Bonds, Series 2007, the Auditor determined that, at the time of the examination, WASA's revenue estimate appeared sufficiently supported and achievable. Based on this determination, the Auditor certified WASA's revenue estimate of \$305,010,000.

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.

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 examination provided a reasonable basis for certifying WASA's FY 2007 revenue estimate.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine whether WASA's FY 2007 revenue estimate of \$305,010,000, as certified by WASA's Chief Financial Officer (CFO) in a signed certificate dated April 10, 2007, was reasonably sufficient to cover WASA's FY 2007 costs,³ the principal of and interest on the proposed bonds and other requirements, outstanding revenue bonds, and the debt service payments on 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.

In preparing this certification, the Auditor reviewed WASA's FY 2007 operating and capital budgets, the Comprehensive Annual Financial Reports for FY 2004 through FY 2006, and an expert study and analysis conducted by PB Consult, an outside consultant retained by WASA.⁴ WASA also provided additional supporting documentation as deemed necessary by the Auditor. Discussions were held with WASA officials, including its CFO, as well as PB Consult representatives.

In its expert study, PB Consult 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. PB Consult concluded that WASA's FY 2007 revenue estimate had been reasonably developed and was attainable. The Auditor relied, in part, on representations contained in PB Consult's expert study and analysis as well as additional information obtained directly from WASA 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, the Water and Sewer Utility Administration (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

³According to WASA's FY 2007 Revised Budget, operating expenses are projected to be \$303,150,000 for FY 2007.

⁴See Review of Projected FY 2007 and FY 2008 Revenues for the District of Columbia Water and Sewer Authority, dated February 15, 2007, issued by PB Consult, Inc.

relationship with the District government and provided for the Auditor's analysis of revenues certified by WASA.

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 Prince George's and Montgomery Counties in Maryland, and Fairfax County in Virginia. A General Manager provides day-to-day management of WASA with the assistance of a management team consisting of one Deputy General Manager and two Assistant General Managers.

RESULTS OF ANALYSIS

WASA OFFICIALS AND PB CONSULT DETERMINED THAT WASA'S ESTIMATED FY 2007 REVENUES WILL BE SUFFICIENT TO COVER ITS FY 2007 COSTS, DEBT SERVICE REQUIREMENTS, AND OTHER OBLIGATIONS

WASA's FY 2007 revenue estimate of \$305,010,000 is supported by PB Consult's expert study and analysis which is required by D.C. Code, Section 34-2202.09(h).⁵ PB Consult made the following observations:

1. Adequacy of supporting documentation - In addition to interviews and timely response 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.

PB Consult further reported that: (1) WASA's revenue projections were "reasonably developed and attainable," and (2) WASA's year-to-date revenues were substantially on target.

The Auditor found that WASA's FY 2007 revenue estimate reflects a 5% water and sewer rate increase that was effective October 1, 2006. The Auditor also found that the FY 2007 revenue estimate of \$305,010,000 was \$4,614,000, or 1.5%, below WASA's actual revenue of \$309,624,000 for FY 2006.

⁵See Review of Projected FY 2007 and FY 2008 Revenues for the D.C. Water and Sewer Authority, dated February 15, 2007, issued by PB Consult, Inc.

WASA Established Reserve Accounts

WASA's financial position is strengthened by several reserve accounts including:

1. an operating reserve equal to six months of operating and maintenance expenses (the Master Indenture of Trust only required WASA to maintain a balance equal to 60 days operating and maintenance expenses);
2. a rate stabilization reserve fund which consists of WASA's excess operating cash after funding the operating reserve at its required level; and
3. a reserve established to address contingencies.

As of February 28, 2007, the balances in these reserve accounts were: (a) Operating and Maintenance Reserve, \$118,131,974.79; and (b) Rate Stabilization Reserve, \$58,500,000. The Operating and Maintenance Reserve included \$6,815,975 for other contingencies.

In connection with the issuance of the Series 2007 Bonds, WASA is to establish two Subordinate Debt Service Reserve Accounts.⁶ WASA is to deposit and maintain in these debt service reserve accounts amounts equal to the average annual debt service costs relating to the bonds.

WASA's Automated Meter Reading Project

In FY 2002, WASA implemented its Automated Meter Reading (AMR) Project whereby all water meters within the District were to be changed to an electronic network. At the close of FY 2006, WASA had completed 96% of the AMR project with approximately 119,000 electronic meters having been installed throughout the District. AMR allows WASA to read all water meters via electronic transmission in an effort to reduce operating expenses. In addition, using AMR, WASA is able to bill customers for exact water usage based on accurate meters that transmit daily readings. Revenues are thus based on actual rather than estimated meter readings, which minimizes the need for periodic revenue adjustments.

⁶See the Sixth Supplemental Indenture of Trust Between the District of Columbia Water and Sewer Authority and Wells Fargo Bank Minnesota, N.A., As Trustee, Section 503, Series 2007A Subordinate Debt Service Reserve Account [relating to the Public Utility Subordinated Lien Revenue Bonds]. See also the Seventh Supplemental Indenture of Trust Between the District of Columbia Water and Sewer Authority and Wells Fargo Bank, N.A., As Trustee, Section 503, Series 2007B Subordinate Debt Service Reserve Account [relating to the Public Utility Subordinated Lien Taxable Revenue Bonds].

Based upon the Auditor's review of information contained in the expert study and analysis, the established reserves, and other information submitted by WASA, the Auditor was reasonably satisfied that WASA's FY 2007 revenue estimate of \$305,010,000 was sufficient to cover WASA's FY 2007 costs, the principal and interest on the proposed bonds and other requirements, outstanding revenue bonds, and the debt service payments on general obligation bonds issued by the District on behalf of WASUA prior to October 1, 1996. Table I presents WASA's FY 2007 revenue estimate.

Table I⁷
Water and Sewer Authority's
Fiscal Year 2007 Revenue Estimate
(Dollars in 000s)

Account Type	
Residential	\$44,274
Commercial	71,888
Multi-family	<u>46,009</u>
Subtotal Residential, Commercial, and Multi-family	162,171
Federal Government	29,246
District of Columbia Government	7,167
D.C. Housing Authority	6,607
Transfer from Rate Stabilization Fund ⁸	2,500
Metering Fee ⁹	<u>5,300</u>
Total Retail	\$212,991
IMA Wastewater Charges	50,851
Potomac Interceptor Wastewater Charges	<u>4,927</u>
Total Wholesale	55,778
District Stormwater Revenue	1,712
Miscellaneous Revenue (e.g. water tap installation, fire hydrant usage, etc.)	8,924
Washington Aqueduct Debt Service Revenue	787
Interest Income	7,304
Right of Way Fee/Payment in Lieu of Taxes Fee	<u>17,514</u>
Total Other	<u>36,241</u>
WASA's FY 2007 Revenue Estimate	<u>\$305,010</u>

Source: D.C. Water and Sewer Authority Revised FY 2007 and Proposed FY 2008 Operating Budgets, dated October 26, 2006.

⁷Table may contain minor differences due to rounding.

⁸WASA periodically transfers monies from the Rate Stabilization Fund to reduce the impact of required rate increases on its customers. Consistent with Board policy, such transfers are made when needed rate increases are not gradual and predictable.

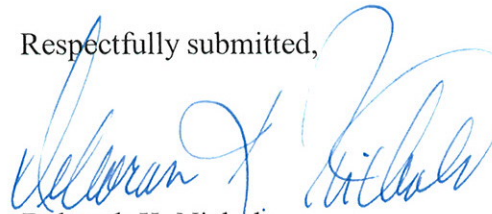
⁹WASA assesses metering fees to cover the costs of installing, operating, and maintaining meters and installing the Automated Meter Reading (AMR) system. Metering fees range from \$2.01 to \$181.76 per month depending upon the type of meter at the customer's location.

CONCLUSION

Based on the analysis of all information presented by WASA, and other sources of relevant information, the Auditor was reasonably satisfied that WASA's FY 2007 revenue estimate of \$305,010,000 would be sufficient to support its FY 2007 costs, the principal of and interest on the proposed bonds and outstanding revenue bonds, and other debt service payments.

Should you have any questions or need additional information regarding this matter, please do not hesitate to contact me at (202) 727-3600.

Respectfully submitted,



Deborah K. Nichols

District of Columbia Auditor