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**Certification of the Water and Sewer Authority's
Fiscal Year 1998 Revenue Estimate in Support of the
\$266,120,000 Series 1998 Public Utility Revenue Bond Issue**

June 22, 1998



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The Honorable Linda Cropp, Chairman
and Members of the Council of the
District of Columbia
441 4th Street, N.W. Room 704
Washington, D.C. 20001

Letter Report: Certification of the Water and Sewer
Authority's Fiscal Year 1998 Revenue
Estimate in Support of the \$266,120,000
Series 1998 Public Utility Revenue Bond
Issue

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

Pursuant to D.C. Code, Section 43-1679(h), this letter report represents the District of Columbia Auditor's analysis of the Water and Sewer Authority's certification of its fiscal year 1998 revenue estimate in support of the \$266,120,000 Series 1998 Public Utility Revenue Bond issue. D.C. Code, Section 43-1679(h) states:

"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 43-1677(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, 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."

The Chairman of the Authority's Board of Directors certified to the fiscal year 1998 revenue estimate of \$228,818,000. Based upon the Office of the Auditor's review and analysis of the Authority's fiscal year 1998 certified revenue estimate, the D.C. Auditor certified to the reasonableness of the \$228,818,000 revenue estimate provided by the Authority.

OBJECTIVES, SCOPE AND METHODOLOGY

The objective of this analysis was to determine whether the revenue estimate certified by the Chairman of the Authority's Board of Directors, in a signed certificate dated March 11, 1998, was reasonably sufficient to cover the Authority's fiscal year 1998 costs included in the Authority's cash flow analysis and revenue requirements.

The Auditor interviewed Authority officials and its financial advisor and bond counsel concerning issues related to the Series 1998 Public Utility Revenue Bond issue, the underlying assumptions contained in the preliminary official statement, and the legally required expert study and analysis, which was prepared by Black and Veatch, a consulting firm retained by the Authority. Also, the Auditor interviewed officials in the Office of the Corporation Counsel concerning the collection of the Authority's delinquent accounts receivable.

The Auditor's review of the Authority's fiscal year 1998 revenue estimate was limited and made difficult by the Authority's late submission of final information necessary for a thorough analysis of projected revenue and costs related to the mission of the Authority. As a result, the Auditor was not allowed ample time within which to perform a detailed analysis of the assumptions and estimates for each category of revenue and cost reflected in the Authority's fiscal year 1998 cash flow analysis of projected revenue and revenue requirements.

BACKGROUND

The Water and Sewer Authority was established pursuant to D.C. Law 11-111, effective April 18, 1996. Prior to the establishment of the Authority, the Water and Sewer Utility Administration, which was under the organizational umbrella of the District's Department of Public Works, managed the District's water and sewer utility operations. In accordance with D.C. Law 11-111, the Water and Sewer Utility Administration was abolished and its functions were transferred from the Department of Public Works to the Water and Sewer Authority.

D.C. Law 11-111 was amended by D.C. Law 11-184 to clarify the Authority's relationship with the District government and provided for the Office of the D.C. Auditor's analysis of revenues as first certified by the Authority.

The Authority is governed by an eleven 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. Five members from Prince George's and Montgomery Counties in Maryland, and Fairfax County in Virginia are appointed to represent the surrounding jurisdictions. A general manager performs day-to-day management of the Authority with the assistance of a management team consisting of two deputy general managers and an assistant general manager.

The Authority has implemented several measures to correct significant operating deficiencies that were identified by the independent auditor in previous water and sewer management letters. The Authority also adopted new policies to enhance billing and revenue collections. According to information reviewed by the Auditor, the Authority devised an 11-point Collections Plan to improve the collection of revenues. This collection plan included the following:

1. a new 1 percent per month interest charge on delinquent accounts (in addition to the current one-time 10 percent delinquent account charge);
2. after proper notification, termination of service to all single and multi-family owners who do not pay their bills;
3. court appointed receiver to collect rents from landlords and apply those rents to unpaid water and sewer bills;
4. property liens against properties with delinquent accounts;
5. publication of names of delinquent customers in local newspapers;
6. negotiation of payment agreements;
7. installment agreements;
8. incentive program to offer a payment to employees who report situations where a customer has bypassed a meter and where water is being used but is not being metered or billed;
9. enforcement of legal provisions for theft of service;
10. conversion to universal monthly billing; and
11. delivery of accurate bills.

Also, the Authority has instituted changes affecting its customer base. For example, consumers of water and sewer services not previously identified as paying customers have been included in the Authority's billing and collection system. These consumers of water and sewer services are now required to pay for utility services at the same rate as all other customers. Consumers of water and sewer services that were added to the customer base included the District government, non-profit organizations, educational institutions, and churches.

To further strengthen its revenue base, the Authority's Board of Directors adopted a resolution on December 5, 1996 to establish a policy regarding the collection of delinquent water and sewer payments from District customers. The resolution included the following provision:

"WASA will initiate a discontinuation of services as a last resort. Prior to a cut-off of service, a petition for receivership must be pending on large apartment buildings with four or more units. The Department of Consumer and Regulatory Affairs and the Police and Fire Department will be notified prior to service cut-offs."

Although the Board adopted this policy over a year ago, at the time of our review, the Authority's general manager had not implemented the policy for residential buildings with four or more units. Authority officials indicated that they were in the process of establishing procedures to fully implement this policy and, at the same time, considering ways to minimize the impact to residents residing in units eligible for service cut-off.

Negotiated Sale Used for Authority's First Bond Issue

The Authority's fiscal year 1998 bond series was sold under negotiated procedures rather than competitive bidding procedures. According to information provided by the Authority's bond counsel and financial advisor, negotiated procedures were used primarily because:

- the Authority had not established a bond issue track record;
- the Authority had not established a history with regard to the management and repayment of a debt issue; and
- since this was the Authority's first bond issue, the bonds had to be marketed to potential investors.

Additionally, the Authority's financial advisor indicated that this bond issue would: (1) raise funds to finance capital project expansion and improvements; (2) refund approximately \$17 million of outstanding old general obligation and District Treasury debt of varying maturity dates and interest rates; (3) repay a \$12 million outstanding balance from a line of credit established during fiscal year 1997; (4) fund the Debt Service Reserve Fund for the Series 1998 bonds; and (5) pay the issuance costs of the Series 1998 bonds.

FINDINGS

THE WATER AND SEWER AUTHORITY'S CERTIFICATION OF THE FISCAL YEAR 1998 REVENUE ESTIMATE WAS BASED UPON AN EXPERT STUDY AND ANALYSIS

In accordance with D.C. Code, Section 43-1679(h), 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, that..." its revenues are sufficient to pay its costs. Section 43-1679(h) further requires that the Authority's certification be supported by expert study and analysis.

The expert study and analysis was provided by Black and Veatch, an engineering consulting firm hired by the Authority. The Auditor analyzed Black and Veatch's expert study and analysis to determine and support the reasonableness of the Authority's fiscal year 1998 revenue estimate. The analysis provided by Black and Veatch included engineering and financial feasibility studies in support of the Authority's Series 1998 bond issue. Based upon the Office of the Auditor's evaluation of the findings and information contained in the Black and Veatch analysis, the Authority's fiscal year 1998 revenue estimate of \$228,818,000 appeared to be sufficient to cover the costs identified in the Authority's fiscal year 1998 cash flow analysis of projected revenues and revenue requirements.

A PORTION OF THE BOND PROCEEDS WILL BE USED TO REPAY APPROXIMATELY \$12 MILLION FROM AN OUTSTANDING BANK LOAN ESTABLISHED DURING FISCAL YEAR 1997

The Authority, as documented in the preliminary official statement, indicated that approximately \$12 million in bond proceeds would be used to repay the \$12 million outstanding balance borrowed against a \$25 million line of credit that was established during fiscal year 1997.

In discussions with one of the Authority's financial managers and its financial advisor, the Auditor found that, while the preliminary official statement reflected repayment of approximately \$12 million borrowed against the \$25 million line of credit established during fiscal year 1997, no final decision had been made concerning the feasibility of maintaining the existing line of credit (after payment in full) or renegotiating a new line of credit for future purposes. However, according to Authority officials and its financial advisor, the Authority had no plans to use the line of credit in the future except in extreme emergencies and only after utilizing cash reserve resources.

The Auditor notes that the Authority's fiscal year 1998 revenue requirements did not provide for principal or interest payments in connection with the line of credit. Should the Authority decide to borrow against the existing line of credit or establish and use a new line of credit during fiscal year 1998, the Authority's revenue estimate should be reevaluated to determine its sufficiency to cover any additional costs associated with the line of credit that were not previously included in the cash flow analysis and revenue requirements.

ESTIMATE OF REVENUE COLLECTIONS FOR LONG TERM DELINQUENT ACCOUNTS NOT INCLUDED IN CASH FLOW PROJECTIONS

According to Black and Veatch, the Authority's fiscal year 1998 cash flow projections did not include a revenue estimate for collection of any long-term delinquent accounts receivable. As of September 19, 1997, approximately 52 percent of the Authority's \$36,889,708 accounts receivable balance was over 366 days old. In recent years, the Corporation Counsel of the District of Columbia has been instrumental in collecting the Authority's long-term delinquent accounts receivable. According to a representative of the Corporation Counsel, collections for fiscal years 1996 and 1997 totaled approximately \$3,796,489 and \$2,170,587, respectively. However, according to this official, the trend in collecting delinquent water and sewer accounts appears to be moving

Collections for fiscal year 1998 through February 1998 totaled approximately \$453,000—a rate of less than one-half of the collection rate for the same period in fiscal year 1997. During fiscal year 1998, the Corporation Counsel expects to resolve a delinquent account totaling approximately \$1,000,000. If revenue is collected from this case and other delinquent water and sewer accounts, collections of delinquent water and sewer receivables will increase, at minimum, \$1,000,000 and provide the Authority with cash resources above the fiscal year 1998 revenue estimate.

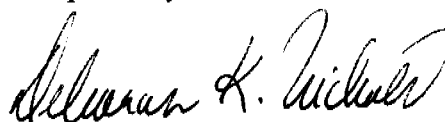
CONCLUSION

The Auditor certified to the reasonableness of the fiscal year 1998 revenue estimate, as first certified by the Chairman of the Authority's Board of Directors, in support of the proposed \$266,120,000 District of Columbia Water and Sewer Authority Public Utility Revenue Bond, Series 1998. The Authority estimated revenues of \$228,818,000 for the fiscal year ending September 30, 1998. The Auditor was reasonably satisfied that the fiscal year 1998 revenue estimate certified by the Chairman of the Authority's Board of Directors was achievable and sufficient to meet revenue requirements.

The D.C. Auditor's certification of the Authority's revenue estimate was based in part on the expert study and analysis required by D.C. Code, Section 43-1679(h) and the Auditor's review and analysis of the Authority's fiscal year 1998 projected revenues and costs. Additionally, the Auditor's certification was based, in part, on the Authority's plan to repay, and thereby eliminate, approximately \$12 million in outstanding debt from a line of credit established during fiscal year 1997. Notwithstanding, the Auditor was informed that the Authority was in the process of determining the feasibility of maintaining the existing line of credit or establishing a new line of credit for future purposes. Should this materialize, the Authority's revenue estimate must be reevaluated to determine whether it is sufficient to cover any additional costs associated with the line of credit that were not previously identified for fiscal year 1998.

Based upon the revenue certification of the Authority, and barring any unforeseen contingencies, the Auditor determined that the Authority should have sufficient revenue to cover fiscal year 1998 costs identified in its fiscal year 1998 cash flow analysis of projected revenues and revenue requirements.

Respectfully,



Deborah K. Nichols

Interim District of Columbia Auditor