



OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR

717 14TH STREET N.W., SUITE 900

WASHINGTON, D.C. 20005

TEL. 202-727-3600 • FAX: 202-724-8814

Deborah K. Nichols
District of Columbia Auditor

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**Letter Report: Sufficiency Review of the
District of Columbia Water and Sewer Authority's
(DC Water) Fiscal Year 2011 Revenue Estimate in
Support of the Issuance of \$300,000,000 in
Public Utility Subordinate Lien Revenue
Bonds (Series 2010A and Series 2010B)**

April 14, 2011



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The Honorable Kwame R. Brown, Chairman
Council of the District of Columbia
1350 Pennsylvania Ave., NW, Suite 504
Washington, D.C. 20004

Letter Report: Sufficiency Review of the District of Columbia Water and Sewer Authority's (DC Water) ¹ Fiscal Year 2011 Revenue Estimate in Support of the Issuance of \$300,000,000 in Public Utility Subordinate Lien Revenue Bonds (Series 2010A and Series 2010B) ²

Dear Chairman Brown:

Pursuant to D.C. Official Code, § 34-2202.09 (h) and a request from the General Manager of DC Water, the District of Columbia Auditor (Auditor) conducted a sufficiency review of DC Water's fiscal year (FY) 2011 revenue estimate in support of a \$300,000,000 Public Utility Subordinate Lien Revenue Bond issuance.

The purposes of the bond issuance are to provide financing for certain capital improvements and to pay capitalized interest on a portion of the bonds related to the Digester project³ and bond issuance costs. Additionally, a portion of the Series 2010B proceeds will be used to refinance a portion of DC Water's outstanding commercial paper notes. This report sets forth the results of the Auditor's analysis of DC Water's FY 2011 revenue estimate of \$397,052,591 in support of the proposed bond issuance.

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

² According to a draft copy of the Preliminary Official Statement (POS) the Public Utility Subordinate Lien Revenue Bonds, Series 2010A (Federally Taxable – Issuer Subsidy – Build America Bonds), and Public Utility Subordinate Lien Revenue Bonds, Series 2010B (Tax-Exempt) are being issued pursuant to the Master Indenture of Trust dated as of April 1, 1998 as amended and supplemented to the date of delivery of the Series 2010 Bonds. Further, according to the draft POS, DC Water "...intends to elect to treat the Series 2010A Bonds as "Build America Bonds or Direct Payment BABs), for purposes of the American Recovery and Reinvestment Act of 2009 (the "Recovery Act") and to receive a cash subsidy from the United States Treasury in connection therewith (the "Direct Payment")." The Direct Payment which will rebate a portion of the interest will not constitute revenues for purposes of the Indenture but DC Water has agreed to deposit such payments in the Series 2010A Interest Account to pay interest when due on the Series 2010 A Bonds.

³ In Fiscal Year 2010, the Authority commenced implementation of a digester project, which involves the design and installation of a thermal hydrolysis solids digestion process (the "Digester Project"). According to DC Water officials, once operational, the digestion process is expected to: (i) reduce hauling and recycling costs; (ii) increase beneficial reuse options; (iii) generate up to 30% of energy used for operations at Blue Plains, thereby reducing overall electricity costs; and (iv) substantially reduce the Authority's carbon footprint. The Digester Project is expected to be completed in 2014.

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

D.C. Official Code § 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 § 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 DC Water's management, information provided by DC Water personnel, and other independent sources of information in support of the proposed bond issuance, it appeared that the revenue estimate of \$397,052,591 would be sufficient to cover DC Water's FY 2011 costs, debt service requirements, and other obligations. Therefore, with regard to DC Water's \$300,000,000 Public Utility Subordinate Lien Revenue Bonds (Series 2010A Federally Taxable-Build America Bonds and Series 2010B Tax Exempt Bonds respectively) the Auditor determined that, at the time of the Auditor's review, DC Water's FY 2011 revenue estimate appeared sufficiently supported and achievable. Further, DC Water officials certified to the reasonable satisfaction of the Auditor the sufficiency of their revenue estimate of \$397,052,591 to pay their FY 2011 costs,⁴ the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by DC Water, and amounts equal to 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.

⁴ According to DC Water's Revised FY 2010 and Approved FY 2011 Operating Budgets, adopted February 4, 2010, page III-12

Information upon which DC Water'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 DC Water's economic outlook and result in significant changes to their certified revenue estimate. The sufficiency review was especially challenging in light of unprecedented economic factors, ongoing turmoil in the financial markets, and other relevant factors.

The validity and accuracy of the Auditor's sufficiency review are predicated upon the extent to which DC Water officials have provided sound revenue estimates for FY 2011 and have fully disclosed and provided reliable and accurate information to the Auditor regarding DC Water's operating expenditures, debt service and contract costs, and any other expenses relevant to the Auditor's sufficiency certification review.

This sufficiency review 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 assessing the sufficiency of DC Water's FY 2011 revenue estimate.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to determine whether DC Water's FY 2011 revenue estimate of \$397,052,591, as certified by DC Water's Chief Financial Officer (CFO) in a signed certificate dated October 7, 2010, was sufficient to pay DC Water's FY 2011 costs, the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by DC Water, 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 (WASUA) capital projects, as such bonds and transfers become due and payable.

In preparing this sufficiency review, the Auditor reviewed DC Water's FY 2011 operating and capital budgets, DC Water's Comprehensive Annual Financial Reports for FY 2007 through FY 2009, and additional supporting documentation provided by DC Water as deemed necessary by the Auditor. Discussions were held with DC Water officials, including its General Manager, CFO, General Counsel, Internal Auditor,⁵ and others including DC Water's co-financial advisors, Public Financial Management Group and P.G. Corbin and Company, Inc. The Auditor reviewed

(Cash Flow Summary), operating disbursements (costs) are projected to be \$394,790,000 for FY 2011.

⁵ The Internal Auditors are not employees of DC Water but these services are contracted out to a firm.

information, provided by DC Water, from the following rating agencies: Fitch and Standard & Poor's.⁶

The Auditor also reviewed the expert study and analysis conducted by Amawalk Consulting Group LLC (Amawalk),⁷ an outside consultant retained by DC Water, and held discussions with representatives from Amawalk. In its opinion letter and accompanying expert study and analysis, Amawalk noted it analyzed the reasonableness of DC Water's projections by assessing whether DC Water met the following:

- (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 DC Water's FY 2011 revenue projection was reasonable. 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 DC Water's management in support of the FY 2011 revenue estimate.

BACKGROUND

The District of Columbia 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 relationship with the District government and provided for the Auditor's analysis of revenues certified by WASA. On June 15, 2010, WASA unveiled a new name and now goes by DC Water.

According to published information, DC Water 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.

⁶ 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.

⁷ See Preliminary Official Statement Certificate, District of Columbia Water and Sewer Authority, dated September 10, 2010, issued by Amawalk Consulting Group LLC.

DC Water 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 DC Water.

Impervious Surface Area Charge (IAC)

In FY 2009, DC Water changed the way it calculated sewer charges to customers. According to information published by DC Water, 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).”⁸ Impervious surfaces include rooftops, paved driveways, patios, parking lots and other paved areas. According to information contained in DC Water’s FY 2010 revised and FY 2011 approved operating budgets, the purpose of the IAC is to assist DC Water with meeting costs associated with implementation of a federally mandated combined sewer overflow long term control plan.⁹

⁸ See DC Water and Sewer Authority – IAC website information at <http://www.dcwasa.com/customercare/iab.cfm>

⁹ 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 DC WATER MANAGEMENT DETERMINED THAT DC WATER'S FY 2011 REVENUE PROJECTION IS REASONABLE AND SUFFICIENT TO COVER ITS FY 2011 COSTS, DEBT SERVICE REQUIREMENTS, AND OTHER OBLIGATIONS

DC Water's FY 2011 revenue estimate of \$397,052,591 is supported by Amawalk's expert study and analysis which is required by D.C. Official Code § 34-2202.09(h). Amawalk assessed the following in determining the reasonableness of DC Water's revenue projections:

1. Adequacy of supporting documentation - In addition to interviews and timely responses to requests for information, the Authority [DC Water] 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.

Amawalk further reported in its expert study and analysis that DC Water's revenue projections were "reasonably developed and attainable." Amawalk's analysis indicated that the FY 2011 revenue projection was based on a 12.5% increase in DC Water's water and sewer rates, an increase in the fixed charge, and an increase in IAC rates approved by DC Water's Board of Directors, effective October 1, 2010.¹⁰ According to Amawalk officials, "FY 2011 consumption is assumed to be relatively consistent with customer usage in FY 2010."¹¹

¹⁰ See Resolutions of the Board of Directors of the District of Columbia Water and Sewer Authority #10-87 and #10-89. Both resolutions were presented and adopted: September 2, 2010, Subject: Final Water and Sewer Service Rates, Customer Metering Fee, Right of Way/PILOT Fee and Impervious Area Surface Charge (IAC) For Fiscal Year 2011.

¹¹ See Preliminary Official Statement Certificate, District of Columbia Water and Sewer Authority (DC Water), dated September 10, 2010, issued by Amawalk Consulting Group LLC. Amawalk noted in its analysis "There is the risk that water consumption could be lower than projected for this period, resulting in lower revenues if rates were implemented as projected. The risk of lower revenues due to lower than projected water usage is mitigated to a significant extent by the Authority's track record of reducing its revenue needs in each year through lower than budgeted expenditures."

DC Water Reserves

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

TABLE I
DC Water Reserve Account Balances
as of July 31, 2010

Reserve Account	Account Balance
Operating Fund Reserve	\$39,004,000
Renewal and Replacement Reserve	35,000,000
Undesignated Reserve	51,312,800
D.C. GO Debt Service Reserve	137,700
Total	\$125,454,500

Source: DC Water's Treasury Manager

As of July 31, 2010, the balance in DC Water's reserve accounts, excluding the rate stabilization fund,¹² totaled \$125,454,500. In addition to the reserves presented in Table I, as of July 31, 2010, DC Water maintained \$28,600,000 in its rate stabilization fund and a \$1,000,000 insurance reserve.

According to DC Water's statement of financial policies, DC Water 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 \$125.5 million in operating reserves.

Table II presents DC Water's sufficiency calculation of projected revenues to cover costs, debt service requirements, and other obligations for FY 2011.

¹² According to DC Water's Treasury Manager, the purpose of the rate stabilization fund is to mitigate large annual rate increases.

Table II¹³
DC Water Sufficiency Calculation of Projected Revenues to Cover Costs,
Debt Service Requirements and Other Obligations for FY 2011
(Dollars in 000's)

Operating Receipts:		
Residential, Commercial & Multi- Family	\$189,039	
Federal	42,311	
Municipal	8,407	
D.C. Housing Authority	6,456	
Groundwater	5	
Metering Fee	10,776	
Right of Way Fee	22,365	
IAB CSO Revenue	<u>13,589</u>	
Subtotal	292,948	
Wholesale revenues	70,634	
Other operating revenues	32,768 ¹⁴	
Interest Earned from Bond Reserves	<u>703¹⁵</u>	
Total Operating Receipts and Interest		\$397,053
Operating Disbursements:		
Personnel Services	94,422	
Contractual Services	76,801	
Water Purchases	33,872	
Chemicals & Supplies	30,080	
Utilities & Rent	36,225	
Small Equipment	<u>974</u>	
Subtotal	272,374	
Debt Service	100,051	
Payment in Lieu of Taxes /Right of Way Fee	<u>22,365</u>	
Total Operating Disbursements		<u>\$394,790</u>
Operating Surplus		<u><u>\$2,263</u></u>

Source: DC Water Revised FY 2010 and Approved FY 2011 Operating Budgets, adopted February 4, 2010, page III-12 (Cash Flow Summary).

¹³ Table may contain minor differences due to rounding.

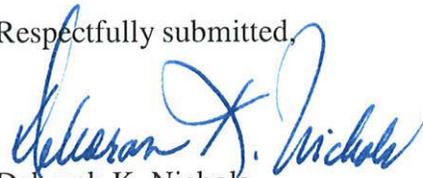
¹⁴ The FY 2011 other operating revenues include a \$13.1 million transfer from the Rate Stabilization Fund. As previously mentioned the Rate Stabilization Fund is used by DC Water to assist in mitigating annual rate increases.

¹⁵ Interest Earned from Bond Reserve is included in the Cash Reserves section of the Cash Flow Summary presented in the Revised FY 2010 and Approved FY 2011 Operating Budgets, Adopted February 4, 2010.

CONCLUSION

Based on the analysis of information presented by DC Water, and other relevant information, including the expert study and analysis completed by Amawalk, DC Water certified to the reasonable satisfaction of the Auditor the sufficiency of DC Water's FY 2011 revenue estimate of \$397,052,591 to pay its FY 2011 costs, the principal of and interest on and other requirements pertaining to the proposed bonds and outstanding revenue bonds issued by DC Water, 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, on October 7, 2010, the Auditor signed a Certificate of the Auditor in support of DC Water's \$300,000,000 Public Utility Subordinate Lien Revenue Bonds Series 2010A and 2010B.

Respectfully submitted,



Deborah K. Nichols
District of Columbia Auditor