# FY 2007 - 2016 FINANCIAL PLAN

### *Overview*

WASA's strong financial performance and its success in achieving and maintaining strong "Aa / AA" category bond ratings has been in large part due to the annual development of and adherence to a ten-year strategic financial plan. This plan serves as one of management's key tools to monitor progress in meeting financial goals and to proactively address future financial and operational issues. During FY 2007, WASA met or exceeded the goals set by Board policy and the FY 2006 - 2015 ten-year plan. This budget includes WASA's eleventh comprehensive ten-year financial plan, covering FY 2007 – 2016.

The necessity of a ten-year financial plan is clear:

1. WASA operates under a regulatory and capital project-driven environment that requires a longer term ten-year planning horizon. In order to provide our customers with the best service possible and with gradual and predictable rate increases, WASA must plan for all projects on a long-term and integrated basis, including both capital and operating requirements. A five year, capital-only financial plan would insufficiently prepare WASA to address the major regulatory and capital project issues that will impact service, operations, and rates over the next five to ten years.

2. In accordance with Board policy, WASA will set rates so that each customer will be charged for the actual cost to provide each service, and rate increases will be gradual and predictable. Since proposed future rate increases are due primarily to WASA's capital program and the Combined Sewer Overflow Long-Term Control Plan, the development of a ten-year financial plan allows WASA to meet these key goals of full cost recovery and predictability.

3. The Board has directed WASA management to undertake internal improvements that will significantly lower operating costs over a ten-year period. A ten-year plan is required to bridge current operations and related capital and operating budgets with these longer term cost reduction goals.

Board policies, priorities and guidance in several key financial areas drive the development of the FY 2007 - 2016 financial plan. Given WASA's substantial borrowing needs over the next ten years, adherence to these Board policies is crucial in order to cost-effectively access the capital markets and retain our credibility with customers and regulators. Key Board policies are summarized below.

*Financing and Reserve Policies*

In FY 2004, the Board completed a review of its existing financing policies, reaffirming the core policies. Two modifications were made to the reserves policy, both in accordance with WASA's master trust indenture: 1) Changing the timing of when WASA is required to meet its overall operations and maintenance reserve requirement from September 1 to an average daily balance basis, resulting in a more conservative calculation that also more realistically reflects WASA's annual reserve levels; and 2) revising the indenture-required renewal and replacement reserve requirement from two percent of original plant in service to $35 million, with a requirement to revisit this reserve level every five years in conjunction with the indenture-required system assessment prepared by WASA's independent rate consultants. These changes were reviewed and endorsed by WASA's bond counsel, financial advisors, and rate consultants.

WASA's financing policies are as follows:

1. WASA will maintain financial practices and policies that result in high quality investment grade bond ratings so as to ensure the lowest practical cost of debt necessary to finance WASA's long-term capital program.
2. WASA will maintain strong levels of operating cash reserves, equivalent to approximately six months of budgeted operations and maintenance costs, calculated on an average daily balance basis. The annual reserve amount will be formally approved by the Board as part of its annual approval of the operating and capital budgets and ten-year plan. The operating reserve will, at a minimum, include any reserve requirements contained in WASA's master trust indenture as follows, excluding any debt service reserve funds and the rate stabilization fund:
   - *Operating Reserve* – equivalent to sixty days' operating costs
   - *Renewal & Replacement Reserve* - $35 million. This reserve requirement will be evaluated every five years by WASA's independent rate consultant in conjunction with the indenture-required system assessment. The next assessment will be performed in 2008.
   - *District of Columbia General Obligation Debt Reserve* – equivalent to ten percent of WASA's share of subsequent year's District general obligation bond debt service
3. WASA will maintain senior debt service coverage of 140 percent, in excess of WASA's indenture requirement of 120 percent. Senior debt service coverage will be calculated in accordance with WASA's indenture.
4. In general, WASA will utilize operating cash in excess of the Board's reserve requirement and any other significant one-time cash infusions for capital financing or for repayment of higher cost debt.
5. WASA will whenever possible use the least costly type of financing for capital projects, based on a careful evaluation of WASA's capital and operating requirements and financial position for each year.
6. WASA will attempt to match the period of debt repayment, in total, with the lives of the assets financed by any such debt.

*Rate Setting and Budgetary Policies*

WASA's rate-setting policies are based on the following principles:

1. Rates and fees will be based on the actual cost to deliver each service.
2. Current rates must be sufficient to cover current costs and to meet all bond covenants.
3. Rates will be based on an annually updated ten-year financial plan (both operating and capital).
4. Rate increases will be implemented in a gradual and predictable manner, avoiding large one-time rate increases.
5. Contributions to and usage of a rate stabilization fund as needed to avoid "rate shock." Each year, after reviewing pay-go financing and any other non-recurring financing uses of excess operating cash, the annual rate stabilization fund deposit, if any, is determined. This fund was established in FY 2000 and its balance at the end of FY 2007 was $68.5 million.

*Cash Management and Investment Policies*

In September 2007, the board adopted a new "Statement of Investment Policy". This policy is designed to ensure the prudent management of Authority funds, the availability of operating and capital funds when needed, and an investment return competitive with comparable funds and financial market indices. The investment portfolio shall be managed to accomplish the following hierarchy of objectives:

1. Safety
2. Liquidity
3. Return on investment
4. Diversity

## ***Major Accomplishments***

The FY 2006 - 2015 financial plan and Board policy set out several financial and organizational goals to be accomplished in FY 2007. During FY 2007, WASA met or exceeded the financial goals set out by the Board and the FY 2006 - 2015 financial plan. Senior debt service coverage, reserve levels, and budget performance all met or surpassed Board policies, as discussed in more detail below.

✶ Implementation of the CSO Long-Term Control Plan (CSO LTCP) began in earnest in 2006 with the Retail Rates Committee endorsement of a new rate structure (impervious rate structure) to fund the LTCP as well as the selection of a program manager and the start of facilities planning and geotechnical work. The twenty-year plan, whose terms are outlined in a consent decree executed in March 2005, is projected to cost $1.9 billion. See "Combined Sewer Overflow Long-Term Control Plan" for additional details on the projected rate impact of the plan.

- ✶ In FY 2007, WASA started the implementation of an impervious rate structure for CSO and Stormwater cost recovery to be effective in FY 2009. An impervious area rate offers the following advantages:

  - Provides a better allocation of cost responsibility than a water/sewer consumption rate relating to managing surface runoff.
  - Applying an impervious area rate structure for both programs in the same way on a citywide basis will improve understanding and sharpen incentives for low impact development.

- ✶ WASA Board policy requires senior debt service coverage of at least 140 percent, greater than the indenture requirement of 120 percent. ***WASA's senior debt service coverage in FY 2007 was at 343 percent***, reflecting implementation of the Board's policy of gradual and predictable rate increases and lower than projected capital spending. Senior debt service coverage will decline to the Board's 140 percent policy level as capital spending and related debt issuance increase. Subordinate debt service coverage (subordinate debt service includes WASA's subordinated lien revenue bonds, WASA's share of the District of Columbia general obligation debt, Little Seneca Reservoir debt, and Jennings Randolph Reservoir debt) in FY 2007 was at 211 percent. WASA is required to have 100 percent coverage of subordinate debt service. Combined debt service coverage was at 160 percent (in FY 2007).

- ✶ ***WASA contributed an additional $10.0 million to the rate stabilization fund in FY 2007***, raising the balance in this fund to $68.5 million.

- ✶ WASA Board policy calls for cash reserves (excluding the rate stabilization fund) equivalent to 180 days' operating and maintenance expenses, or approximately $111.3 million in FY 2007, based on the Board-revised budget. ***WASA consistently met this goal during FY 2007, with an average daily balance during the year of $120.5 million, $9.2 million greater than the Board's policy.*** This year's plan provides for an increase in this reserve to $118.6 million in FY 2008, in line with the revised FY 2008 operations and maintenance budget.

- ✶ ***WASA continued its strong operating budget performance in FY 2007.*** Operating cash receipts surpassed budget by $6.4 million, or 2.2 percent; operating expenditures are projected at $22.1 million, or 7.1 percent, less than the Board-revised budget. Although in FY 2006 WASA experienced higher than anticipated (budgeted) costs for electricity and chemicals used for operations driven by rising fuel costs and other market factors, WASA also had significant savings in debt service costs related to lower than anticipated financing cost on the variable rate debt and also a delay of planned debt issuance in FY 2007.

- ✶ Overtime spending was reduced from a high of $8.7 million in FY 1997 to a projected $5.6 million in FY 2007, or 7.7 percent of payroll. This reduction continues a trend of significant reductions in overtime costs, from a rate of 23 percent of payroll in the months before WASA was formed.

- ✶ WASA implemented a water and sewer rate increase of 5 percent in FY 2007. In addition, the Board approved a retail rate increase of 5.5 percent effective October 1, 2007 as well as an increase in the Right of Way / PILOT fee to recover the full costs of this fee charged to WASA by the District of Columbia government.

- ✶ For the fifth consecutive year, WASA received the Government Finance Officers' Award for Distinguished Budget Presentation for its FY 2007 budget submission. WASA also received its ninth unqualified audit opinion for the fiscal year ended September 30, 2006 and anticipates receiving GFOA's Certificate of Achievement for Excellence in Financial Reporting.

- ✶ Implementation of the lead service line replacement program continues, with over 14,000 public lines replaced to date out of an estimated 33,000 – 35,000 total. The ten-year plan includes capital costs for this program, estimated at $438 million.

- ✶ In FY 2008, we successfully renewed all of our insurance policies at essentially the same coverage and terms at a net cost reduction of 7 percent from the previous year. There were improvements in coverage amid increases in property values, payroll and revenue.

- ✶ WASA completed its third year of the rolling owner-controlled insurance program (ROCIP), under which WASA procures most insurance coverage for the majority of our construction contractors. The result is substantially higher insurance coverage levels for all contracts and significant cost savings. At the end of FY 2007, 49 construction contracts, and 92 contractors had been enrolled in the ROCIP program (including most of the lead service line replacement contracts), and preliminary savings estimates exceed $900,000. Over the five year program, WASA anticipates enrolling a total of 120 projects, with estimated savings in the $4 to $5 million range. A major reason for the cost savings is the implementation of a uniformly strong safety program for all contractors.

- ✶ WASA continued to build on the significant improvements made in the Department of Customer Service over the last few years, which have resulted in greatly improved service to WASA customers. Major accomplishments over the last year include:

  - Improved collections efforts, which have resulted in a reduction of delinquent retail accounts receivable over 90 days from $26.5 million in September 2001 to $7.1 million in September 2007.

  - Implementation of the meter replacement/automated meter reading (AMR) program. The meter installation/Automated Meter Reading Program is 98.9% complete, representing approximately 122,000 customer locations under the original contract. The Authority will continue to aggressively attempt to complete the remaining installations utilizing a combination of contractors and WASA staff. Over 89% of FY 2007 billings were billed via AMR meters.

- In FY 2007, we expanded our Process Notification Program to include commercial customers. Process Notification is an automated outbound collections calls service that notifies delinquent customers when bills are past due. This program directly contributed to the achievement of an all-time low greater than 90 days accounts receivables delinquency of $7.1 million.

- IMA renegotiation - 1985, the District signed the Blue Plains Intermunicipal Agreement (the IMA) with the "Users" of the Blue Plains Wastewater Treatment Plant facilities. The User group consists of WASA, District of Columbia, Fairfax County in Virginia, and Montgomery and Prince George's Counties in Maryland. The IMA outlines terms relating to facility location, sizing, capacity allocations and funding, long-term management of the wastewater treatment and disposal process; the Agreement also establishes a uniform payment basis for facilities and future improvements. IMA signatories share the cost of operations, maintenance and the capital program at the Blue Plains facility; the three surrounding counties comprise approximately 60 percent of the Blue Plains capacity. Some of the terms in the 1985 IMA expires in 2010; for example, the Agreement states that capacity allocations at 370 mgd (peak capacity) remain in effect until 2010. In order to allow ample time to renegotiate any User issues, the Users began negotiations during FY 2006 and will continue discussions until all parties reach a new agreement.

- Potomac Interceptors Users Rate Update (PI) – In FY 2007, as stipulated in the Intermunicipal Agreement (the IMA), a PI rate study was conducted. The new rates for the PI users are effective from October 1, 2007 and go through September 30, 2010. The previous rate study was completed in FY 2004. The FY 2007 rate study analyzes WASA's cost and determines the cost allocation of WASA's current capital and O&M costs for PI users. It is necessary to update rates to ensure that they reflect the Authority's current capital and O&M costs.

- Water Audit Program - During the latter part of FY 2007, we implemented a water audit program. This program is to help establish a new methodology for tracking and reporting water losses consistent with the American Water Works Association (AWWA) standards. It will also enable us to better measure and compare DCWASA to other like entities.

### *Future Goals*

The proposed FY 2007 - 2016 financial plan includes the resources necessary to accomplish critical financial and operational goals over the coming years, as summarized below.

- Continue adherence to the Board's financial, investment, rate-setting and long-term planning policies.

- Continue implementation of the Board-approved lead service line replacement program.

- Update water system facility master plan.

- ✶ Continue implementation of the ten-year $3.1 billion capital improvement program.

- ✶ Continue implementation of the twenty-year, $1.9 billion CSO Long-Term Control Plan, including rate structure changes.

- ✶ Continue implementation of internal improvement plan across WASA

- ✶ Continue implementation of major improvements in customer service, including:
  - Complete AMR/meter replacement program.
  - Expand bill payment options by offering e-check via telephone and the web. This will allow customers to make one-time payments via check.
  - Offer blind or vision-impaired customers the option of receiving bills in either Braille or large print.
  - Provide customers with the opportunity to communicate with customer care associates via on-line chat.

- ✶ Successfully implement key information technology initiatives, including:

  - Implementation of the *process computer control system* (PCCS) which will automate a substantial number of plant processes and is critical to achieving Blue Plains internal improvement goals. Initial planning and design for this system began in FY 2002.
  - Implementation of a new *asset management system*. By integrating WASA's existing customer information, maintenance management, PCCS/SCADA and other systems, it will help us better track specific asset performance and perform more preventive maintenance, particularly in the water and sewer systems.
  - Successive phases and upgrades of the *financial, payroll and human resources information, and customer information and billing systems*
  - Evaluation and development of *data redundancy* and related systems to ensure that WASA's mission-critical systems can operate on an uninterrupted basis in the event of an emergency

- ✶ Negotiate new collective bargaining agreement to cover period beginning in FY 2008.

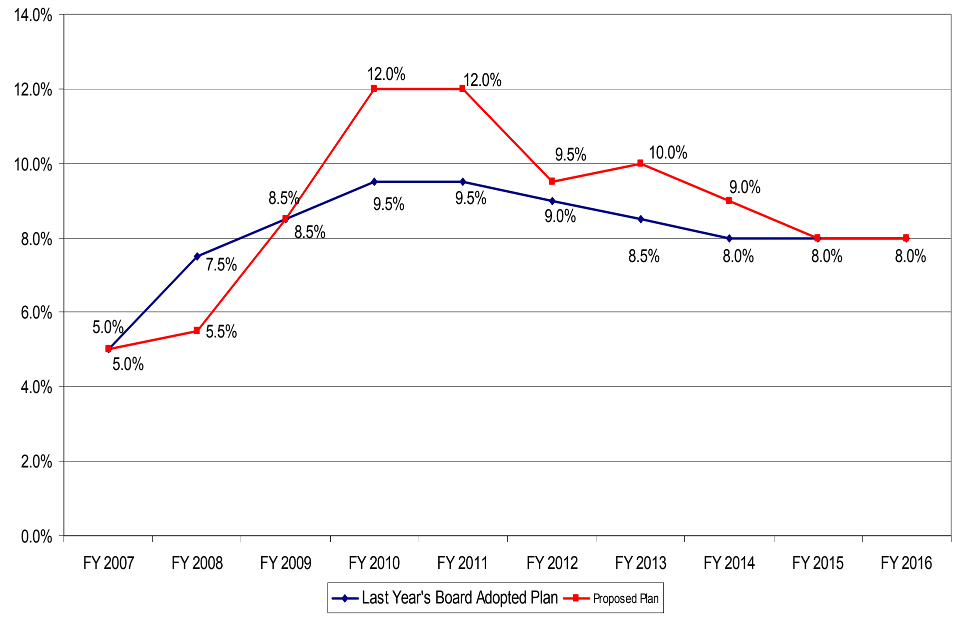
### *Rates*

The proposed rate increases included in the FY 2007 – 2016 financial plan are driven by the following initiatives:

- *Increasing debt service expenditures, driven by WASA's $3.1 billion capital improvement program (cash disbursements basis)*, which is approximately 15% higher as compared to last year's plan.
- *Internal improvement programs* – These plans, currently being implemented at Blue Plains and the Departments of Water and Sewer Services, are projected to result in operating savings, in part due to capital improvements and in part due to management and operational changes. The largest of these plans is at Blue Plains and was originally adopted in 2000. In FY 2006, WASA undertook a study to update the Blue Plains IIP, taking into account progress under the CIP and management changes to date, and the results of this analysis will be factored into next year's ten-year plan**.**
- The initial phases of WASA's twenty-year *CSO Long-Term Control Plan*, totaling $502 million (which is included in WASA CIP).
- *Continued compliance with Board policies on debt service coverage and reserve levels* -- Projected senior debt service coverage ranges from 156 percent (FY 2016) to 395 percent (FY 2008), above the policy requirement of 140 percent. In addition, cash reserves are maintained at six months' operations and maintenance expenses, growing from $120.5 million in FY 2007 to $146.2 million in FY 2016.

Due to these ongoing and new initiatives, from FY 2007 – FY 2016, WASA's water and sewer rates are projected to increase by 5.0 percent to 12 percent annually, with cumulative rate increases totaling 87.5 percent, as shown in the chart below. Projected retail rate increases are higher by 0.5 to 2.5 percent annually over last year's plan due to increases in District ratepayer-funded projects in the CIP and a higher base level of operations and maintenance expenditures, particularly in chemicals and electricity due to the recent trend of rising oil prices. As a result of the capital improvement program, debt service is projected to increase on average by 13.9 percent per year, while operations and maintenance expenditures are only projected to increase by 3.9 percent.

**Projected Retail Rate Increases**
**FY 2007 – FY 2016**




*Proposed FY 2009 Rate & Fee Increase & Structure Changes*

The proposed retail water and sewer rate increase for FY 2009 is 8.5 percent, which allows for gradual and predictable rate increases in future years. In addition, the proposed increase in the Right-of-Way / PILOT fee is 10.6 percent, to recover the full amount charged to WASA by the District.

In FY 2006, WASA completed a cost of service study (the last study was completed in FY 2002.) The study was conducted by WASA's independent rate consultants, and concluded that WASA's current rate structure sufficiently recovered WASA's costs, tracked the Board-approved ten-year plan, and met the Board's rate-setting policies. Near-term recommended changes included potentially increasing the metering fee to recover all customer service related costs and to evaluate the private fire protection fee. (WASA's current retail rate structure is a commodity or usage-based structure, with the exception of the metering fee which is a flat monthly fee set to recover costs associated with metering.)

In addition to the cost of service study, WASA has been evaluating different cost recovery options for the CSO LTCP, which are described in more detail below.

*Rate Comparisons to Other Utilities*

WASA's current and proposed rates and fees remain very competitive with other water and wastewater providers in the mid-Atlantic and the eastern United States. As shown in the charts in Section IV, WASA's proposed monthly residential bill (including the District's stormwater rate and the PILOT / ROW fee) is slightly less than the average of other utilities in WASA's benchmark group. Without the stormwater and the PILOT / ROW fees, WASA's proposed average monthly residential bill is $4.95 or 9.8 percent less. The proposed future rate increases over the ten-year planning period are also consistent with those being contemplated by regional and national providers.

*Customer Assistance Programs*

In June 2000, the Board adopted a customer assistance program that assists low-income customers in paying their water bills. The program is comprised of two components: a component funded by voluntary contributions from ratepayers (the S.P.L.A.S.H. program); and a component funded by WASA and based on a bill credit for 400 cubic feet of water consumption per month (the Customer Assistance Program, or "CAP"). In 2004, the Board approved expanding the CAP program to single family tenants that meet certain federal income guidelines; previously, the program was limited to homeowners. The ten-year plan assumes a total impact of $500,000 annually for the expanded program, or 0.2 percent of projected FY 2007 receipts.

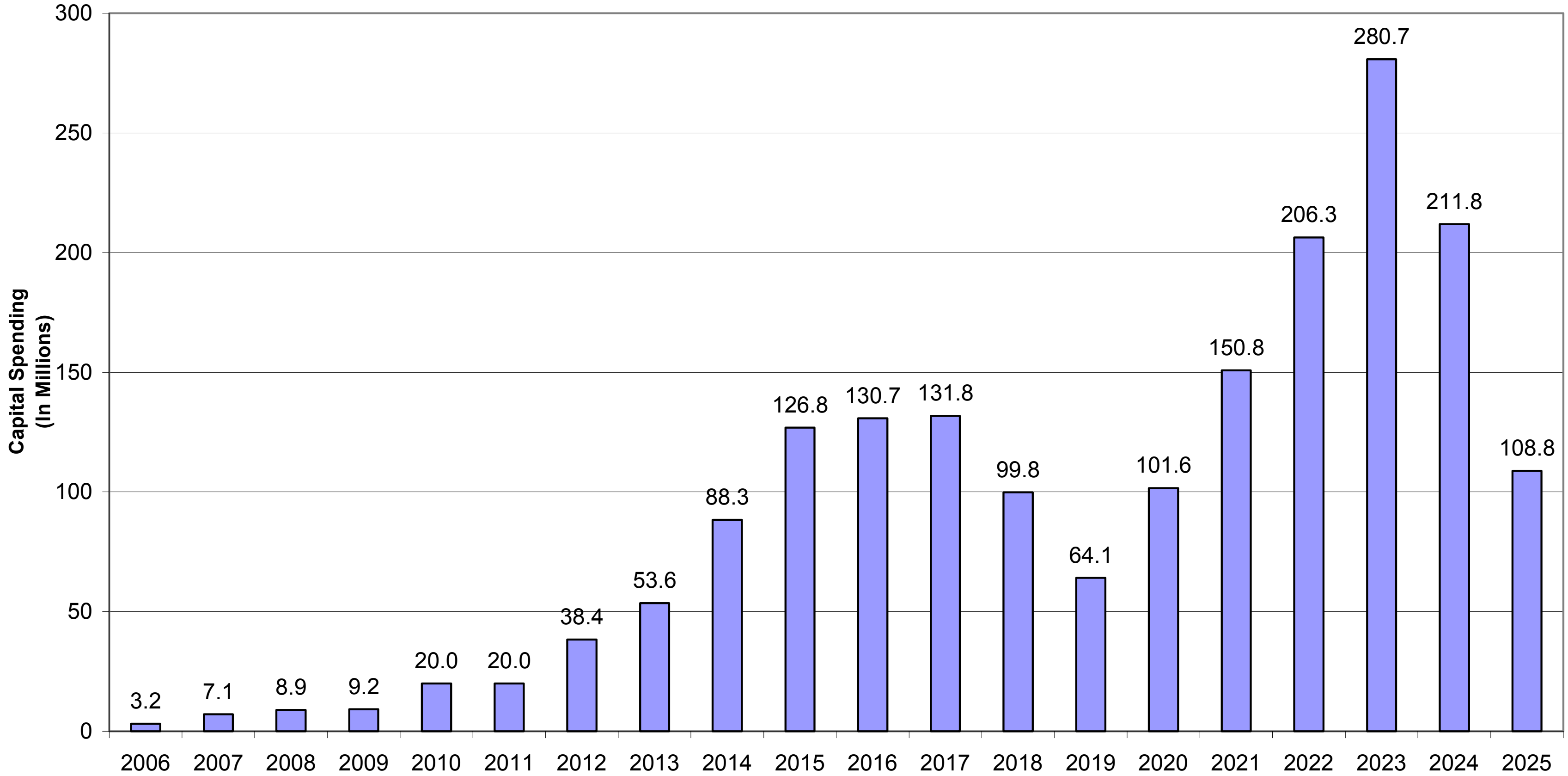
*Rate Stabilization Fund*

This year's plan reflects continued funding of the rate stabilization fund, including a contribution of $10.0 million in FY 2007. The total balance in the fund is currently $68.5 million. The fund is projected to be fully utilized in FY 2008 through FY 2016 to help level out proposed rate increases in those years. Additional contributions to the rate stabilization fund are determined each year based on actual financial performance and the latest ten-year plan. No deposits to the rate stabilization fund will be made unless the Board's six month operating and maintenance reserve policy and all other bond indenture requirements are met.

*Combined Sewer Overflow Long-Term Control Plan*

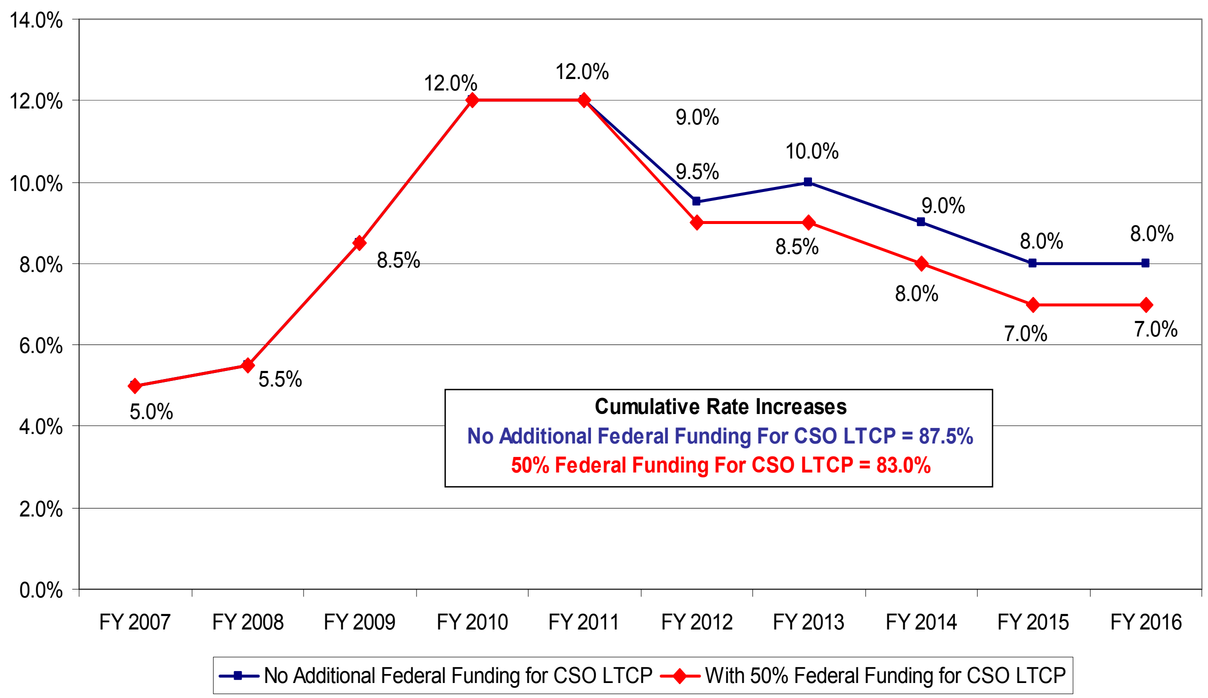
In December 2004, the Board reached agreement with the federal government on the proposed CSO LTCP and entered into a related consent decree. Capital costs for this twenty-year plan total approximately $1.9 billion with inflation, and this year's plan includes $502 million of projected CSO LTCP disbursements. Spending in the early years of the plan is significantly less than the latter years, allowing for a gradual rate increase implementation schedule. Projected spending by fiscal year is shown in the chart below.

**CSO LTCP Spending by Year**
**Excludes NMC Projects**



Since projected spending under the CSO LTCP is somewhat back-loaded, the near-term impact on rates is mitigated. Additionally, if significant federal assistance is provided, rate increases would be lower, as shown in the chart below; the ten-year plan assumes no external funding beyond the special Congressional appropriations WASA has already received, totaling $98 million. Assuming no additional federal assistance, and based on current rate structure assumptions, at the end of the twenty-year implementation period, the typical residential customer's monthly wastewater bill is projected to be $110, an increase of approx. 300 percent over the current monthly wastewater bill of $28.

**Impact of Federal Assistance for CSO LTCP**
**On Projected Rate Increases through FY 2016**



In September, WASA contracted with a consulting firm to assist in developing an impervious area database that would be used for developing an impervious rate structure. A communications strategy is being developed to include all stakeholders. Also, data gathering and policy review has begun on the IAB (Impervious Area Billing). WASA has begun the more detailed data collection process, in particular through DC OCTO (Office of the Chief Technology Officer), with the goal of implementation in FY 2009. Compared to a water consumption-based structure, an impervious area structure will cause a shift in the cost allocation between customer classes due to differences in their water use and their land use as shown in the table below.

**Current vs. Impervious Rate Structure**
**Impact by Customer Class [1]**

| Rate Structure | Single Family Residential | Multi- Family Residential | Commercial | DC Govt | Fed Govt |
|---|---|---|---|---|---|
| Current | 21% | 27% | 33% | 4% | 15% |
| Impervious Rate | 24% | 13% | 22% | 6% | 35% |

1. Based on preliminary data.

### *Revenues*

The revised FY 2008 receipts projection totals $338.4 million, an increase of $34.7 million, or 11.4 percent over actual FY 2007 receipts:

- *Residential, commercial and multi-family receipts* are projected to increase by approximately $3.5 million, or 2.2 percent, due to the Board-approved 5.5 percent rate increase and small increases in consumption due to the projected completion of the AMR project. These increases are offset by one-time collections in FY 2007 that will not be repeated in FY 2008.
- *Federal revenues* are projected to increase by $2.4 million.
- *Wholesale receipts* are projected to increase by $5.2 million reflecting higher budgeted costs at Blue Plains due to electricity and chemicals price increases.
- *Projected utilization of $24.9 million in rate stabilization fund balances.*
- *Other revenues* are projected to increase by $2.1 million, mainly due to WSSC amount of indirect cost reimbursement for capital projects that was not received in FY 2007.

The proposed FY 2009 receipts projection totals $353.4 million, approximately $15.0 million, or 4.4 percent, higher than revised FY 2008 projections. This increase is due primarily to:

- *Proposed water and sewer rate increase of 8.5 percent*
- *Proposed utilization of $22.6 million in rate stabilization fund balances*
- *Proposed increase in the Right of Way / PILOT fee for full recovery of this cost*
- *Projected consumption decline,* conservatively estimated at one percent annually

Additional details on revenue projections for each class of customers are described below.

*Residential, Commercial & Multi-Family* - FY 2008 projections reflect an increase of $3.5 million or 2.2 percent from FY 2007, due primarily to the following reasons.

- In FY 2007, WASA's collections on its retail receivables was very strong, with accounts receivable over 90 days declining from $10.9 million on October 1, 2006 to $7.1 million as of September 30, 2007. While WASA will continue its aggressive collection efforts, we have conservatively assumed no additional increase in cash receipts due to improved collections performance in 2008.
- Board-approved retail rate increase of 5.5 percent effective October 1, 2007.
- Continued implementation of the customer assistance program, which reduces projected revenues by approximately $0.5 million.

Proposed FY 2009 receipt projections reflect an increase of $12.1 million, or 7.4 percent, due to the following reasons:

- Proposed rate increase of 8.5 percent.
- One percent decrease in consumption due to projected conservation.
- Continued implementation of the customer assistance program, which reduces projected revenues by approximately $0.5 million.

*Rate Stabilization Fund Utilization* – The ten-year plan and near-term revenue projections assume utilization of $24.9 million in FY 2008 and $22.6 million in FY 2009 of rate stabilization fund balances. Prior years' plans also assumed the use of these funds which is necessary as WASA reaches its peak years of spending in the CIP. Utilization of RSF monies allows WASA to implement future rate increases on a gradual and predictable basis while still meeting Board and indenture policies on cash reserves and debt service coverage.

*Federal* - Revised FY 2008 federal revenues are projected to total $31.6 million or $2.4 million more than FY 2007. Under existing federal billing legislation, federal billings are prepared on an estimated basis eighteen months in advance of the start of the fiscal year (e.g., the FY 2008 billing was prepared in April 2006), and are based on then-current consumption estimates and projected rate increases as included in the then-current ten year plan. These estimates are then reconciled with actual consumption and rate increases, and an adjustment is made in the subsequent year's billing (e.g., the reconciliation of FY 2008 estimated vs. actual consumption and rate increases will be included in the FY 2011 billing, prepared in April 2009.) Federal revenues in the ten year plan are presented on a revenue basis, net of any adjustments for prior year reconciliations which are accounted for as reserve items. Consistent with this methodology, revised FY 2008 federal revenues reflect the final billing sent to the federal government in April 2006, net of the adjustment for the prior year (FY 2005) reconciliation.

*Municipal & D.C. Housing Authority* – FY 2008 receipts from the District of Columbia government and the District of Columbia Housing Authority are projected at $13.7 million, an increase of $0.7 million. In FY 2009, receipts from these organizations are projected to total $14.7 million, an increase of $1.0 million, or 7.4 percent, due to the proposed retail rate increase of 8.5 percent and continued conservation.

*Metering Fee* – Metering fee collections totaled $5.6 million in FY 2007, and are expected to remain stable in FY 2008 & FY 2009. It recovers the costs associated with installing, operating, and maintaining meters, and is charged to all retail customers (including federal and municipal customers.) The fee varies based on meter size, with monthly fees ranging from $2.01 for a 5/8 inch meter (typical size of a residential customer meter) to $41 to $182 for larger meters (typically used for large commercial customers.)

*Right of Way and Payment In Lieu of Taxes Pass-Through Fees* – Similar to other Washington area utilities, WASA has implemented fees that pass through the costs of the District's Right of Way fee and payment in lieu of taxes as separate line items on its bill. In FY 2008, these fees increases by $1.5 million to $18.2 million due to the Board's approval of an increase to recover the full cost of the payments WASA makes to the District. In FY 2009, the Board will be considering a proposed 10.6 percent increase in these fees, in line with the increase in the PILOT portion of WASA's payment to the District.

*Wholesale* - WASA's wholesale customers are responsible for a proportionate share of operating and maintenance expenses (associated only with shared facilities primarily at Blue Plains) based on their respective share of wastewater volume discharged. In addition, each user is responsible for a proportionate share of related indirect costs. FY 2008 wholesale revenues are projected at $61.0 million. Wholesale revenues are projected to increase by approximately one to three percent annually after FY 2009, consistent with WASA's operating and maintenance expense increase assumption over the ten year period.

*Stormwater* – WASA's FY 2008 and FY 2009 receipts include $0.5 million from the District's stormwater rate that will be used to fund WASA's share of the District's stormwater permit compliance activities. The stormwater rate was implemented in July 2001, and appears as a separate line item on WASA's retail customers' bills. In FY 2004, the District received a new stormwater permit that will significantly increase compliance costs for all participating agencies. There is a planned reduction in FY 2008 and onwards as the District new Department of the Environment takes on more stormwater responsibilities as an administrator. The FY 2007 - 2016 financial plan assumes that all incremental costs borne by WASA for stormwater permit compliance activities will be covered by the stormwater rate approved by City Council, and that no WASA funds will be advanced to pay for these activities.

Other major assumptions underlying the revenue projections contained in the FY 2007 - 2016 financial plan include:

- From FY 2009 – FY 2016, a one percent reduction in water sales is assumed for all customer categories, based on historical trends in consumption levels.

- One to three percent annual increase in revenues from wholesale customers between FY 2009 and 2016, consistent with operating and maintenance expense increase assumptions and the goals of the Blue Plains internal improvement plan.

- Based on the current interest rate environment, interest projections conservatively assume a 3.75 percent earnings rate in FY 2008 and FY 2009 on operating funds. Beyond FY 2009, interest rates are assumed at 5.0 percent.

- The majority of other non-operating revenues, totaling $14.0 million in FY 2008, are projected to remain relatively stable over the ten year plan, and include such items as:

    - Reimbursement from Arlington County and Falls Church for debt service issued for pre-1997 Washington Aqueduct capital improvements - $0.6 million
    - WASA’s share of the District’s stormwater fee - $0.5 million
    - Fire protection fee that was adopted by the Board in January 2000 and is charged to the District of Columbia government - $1.9 million
    - Recovery of indirect costs from WASA’s IMA partners – $5.1 million - this reflects recovery of indirect costs on capital projects (e.g., costs for Finance and Budget, General Counsel, and Human Resources functions). FY 2008 revenues are higher by $2.1 million pertaining to WSSC amount which was not received in FY 2007
    - Other miscellaneous fees and charges, including service line replacements, developer-related fees, etc. - $5.9 million

### *Operating Expenditures*

Debt service continues to be the fastest growing expenditure in the ten-year financial plan as a result of WASA's $3.1 billion capital improvement program, growing at an average annual rate of 13.9 percent, from 18.8 percent of total operating expenditures in FY 2007 to 33 percent in FY 2016. All other operating expenses are projected to grow at an average annual rate of 3.9 percent, due to implementation of internal improvement plans that are projected to result in operating savings.
The following chart provides detail for the FY 2008 and FY 2009 operating budgets.

**COMPARISON OF FY 2008 & FY 2009 OPERATING BUDGETS**
**(In $000's)**

| | FY 2008 APPROVED | FY 2008 REVISED | Percent Change | FY 2009 PROPOSED | Percent Change |
|---|---|---|---|---|---|
| Personnel Services | 88,304 | 88,067 | -0.3% | 92,235 | 4.7% |
| Contractual Services | 65,796 | 70,993 | 7.9% | 69,599 | -2.0% |
| Water Purchases | 23,601 | 23,601 | 0.0% | 23,601 | 0.0% |
| Chemicals & Supplies | 24,499 | 25,016 | 2.1% | 27,183 | 8.7% |
| Utilities | 36,322 | 36,543 | 0.6% | 37,821 | 3.5% |
| Small Equipment | 1,157 | 837 | -27.7% | 873 | 4.3% |
| Lead Abatement | 1,000 | 1,000 | 100.0% | 1,000 | 0.0% |
| Long Term Control Plan | | - | | 370 | |
| **Subtotal Operations & Maintenance** | 240,679 | 246,057 | 2.2% | 252,683 | 2.7% |
| Debt Service | 81,938 | 76,508 | -6.6% | 91,240 | 19.3% |
| PILOT | 13,469 | 13,097 | -2.8% | 14,210 | 8.5% |
| Right of Way Fee | 5,100 | 5,100 | 5,100 | 5,100 | 0.0% |
| **Subtotal Debt Service & PILOT / ROW** | 100,507 | 94,706 | -5.8% | 110,550 | 16.7% |
| **TOTAL OPERATING** | 341,186 | 340,763 | -0.1% | 363,234 | 6.6% |
| **Less Personnel Services Charged to Capital Projects** | (8,400) | (8,400) | 0.0% | (8,400) | 0.0% |
| **TOTAL NET OPERATING** | 332,786 | 332,363 | -0.1% | 354,834 | 6.8% |

The revised FY 2008 budget totals $340.8 million, slightly lower than the Board-approved FY 2008 budget. While operations and maintenance expenditures increases by 2.2 percent, debt service costs were reduced by 6.6 percent, due to a continuing favorable interest rate environment and slightly lower than projected capital spending. A description of the assumptions and major issues in each major expenditure category follows.

- ***Personnel service expenditures*** are $0.2 million, or 0.3 percent less than the approved FY 2008 budget. This decrease is primarily due to more realistic vacancy rates as the number of filled positions has continued to decline in recent years. This budget includes adjustments for a three percent cost of living increase and one to two percent merit increase for union employees included in the last collective bargaining agreement.

- ***Contractual service expenditures*** increase by $5.2 million, or 7.8 percent, over the approved FY 2008 budget due primarily to funding for the Low Impact Development Program (LID) and New Revenue-Producing Products and Services initiatives approved by the Board in FY 2007. Funding was also added to improve water main infrastructure repair/replacement needs and to meet rising litigation costs.

- ***Water purchase expenditures*** this budget remained unchanged at $23.6 million.

- ***Chemicals and supplies expenditures*** increase by $0.5 million, or 2.6 percent, from the approved FY 2008 budget due to higher unit prices for the majority of chemicals used at Blue Plains, in large part due to rising oil and energy prices.

- ***Utilities expenditures*** increase slightly by $0.2 million, or 0.6 percent, primarily due to rising telecommunications costs. Electricity continues to be the largest portion of the utilities budget, representing 12% of the FY 2008 revised O&M budget. In an effort to increase the construction of new generating capacity in congested areas, the Federal Energy Regulatory Commission ("FERC") approved a capacity rate increase from $9.98 per MW-day to $180.58 per MW-day, effective June 1, 2007. The impact of this rate increase is estimated at $2.4 million for FY 2008. The revised FY 2008 budget reflects these market factors with electric generation and transmission prices estimated at an annual average price of $86 per megawatt hour. WASA continues to monitor the wholesale daily electricity market to lock in blocks of power at a fixed price when futures pricing meets budget targets. Prices were extremely volatile in FY 2006 and FY 2007, due to rising oil prices, heavy global demand for power and oil, and the aftereffects of Hurricanes Katrina and Rita in FY 2005.

- ***Lead abatement expenditures –*** budget remained unchanged. The revised FY 2008 budget includes $1.0 million for various administrative and legal costs associated with ongoing lead program activities.

The approved FY 2009 budget totals $363.2 million, a 6.6 percent increase over the revised FY 2008 budget, primarily due to increased debt service for the capital program. The FY 2009 operations and maintenance budget (net of debt service, PILOT/ROW fee) increases by 2.7 percent, with the increase due primarily to projected compensation increases and projected inflationary increases in contractual services, utilities, and chemicals and supplies. Specific information regarding each department is included in Section VII.
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Beginning in FY 2010, the ten year financial plan reflects the following major assumptions:

- One to three percent increase over approved FY 2009 levels in most expense categories, reflecting implementation of the Blue Plains and other departmental internal improvement programs.
  - Beginning in FY 2013, operating expenses are projected to increase by three percent, reflecting completion of the internal improvement programs.

- Three percent increase in water purchase costs, based on projected Washington Aqueduct budget trends.

- Payment in lieu of taxes (PILOT) to the District of Columbia increases at the same rate as WASA retail rate increases, in accordance with the memorandum of understanding with the District.

- The net right of way payment to the District of Columbia stays level at $5.1 million through FY 2013 consistent with the memorandum of understanding with the District.

### *Capital Financing Program, Cash Position, & Long-Term Debt*

The FY 2007 - 2016 financial plan funds total capital disbursements of $3.1 billion. The financing of WASA's capital program comes from four primary sources, as more fully described below. The amount of EPA grant funding is defined by annual federal appropriations, while jurisdictional capital contributions are based on a fixed percentage of Blue Plains and other shared facilities. The remainder of the program is funded with WASA debt and pay-go financing from operations. The amount of pay-go financing is equal to the amount available after fully funding the six months' operating reserve and meeting Board policies on the level and timing of rate increases and debt service coverage.

During FY 1999, WASA developed a comprehensive financing plan with the dual goals of 1) securing the lowest cost of capital possible, and 2) maximizing administrative and operating flexibility. The plan includes the following components:

- *Utilize available pay-as-you-go financing to pay down higher cost, taxable U.S. Treasury notes for the Washington Aqueduct* Rather than permanently funding WASA's share of Aqueduct improvements with higher cost, taxable U.S. Treasury notes, WASA uses available pay-go funds, prepaying all outstanding Treasury notes, totaling $59 million at the end of FY 2004.
- *Establish an interim financing program to finance construction* – In early FY 2002, WASA developed a $100 million commercial paper program for this purpose which has been extremely successful. We expect that remaining Series 2007A proceeds will not be fully spent until the fourth quarter of FY 2008, when we will begin utilizing our commercial paper program again.
- *Issue permanent financing every twelve to 24 months to take out interim financing proceeds*.

Additional details on each financing source are described below.

| | FY2007 - 2016 PLAN TOTAL | Percent of Total |
|---|---|---|
| EPA Grants / CSO Appropriations | $ 258,081,159 | 8.4% |
| Wholesale Capital Payments | 851,878,854 | 27.8% |
| Revenue Bonds / Commercial Paper | 1,877,017,802 | 61.3% |
| Pay-Go Financing | 49,014,334 | 1.6% |
| Interest Income on Bond Proceeds | 24,169,735 | 0.8% |
| **TOTAL SOURCES** | $ 3,060,161,884 | 100.0% |

1. ***EPA Grants*** - WASA currently receives 55 - 80 percent EPA grant funding for certain eligible projects under the Clean Water and Safe Drinking Water Acts. In general, the District of Columbia projects carried out by WASA are supported by approximately one percent of the available annual funding through revolving fund programs associated with the Clean Water and Safe Drinking Water Acts. In addition, WASA has received $91 million in Congressional appropriations for the CSO LTCP.

   This line item also includes an anticipated $32.5 million reimbursement from the District related to planned costs to be incurred by WASA for facilities relocation tied to the stadium construction, as fully described in Section I.

2. ***Wholesale Capital Payments*** - Nearly 60 percent of the capacity of WASA's wastewater treatment facilities are contractually committed to provide wholesale service to suburban jurisdictions under various contracts. Montgomery and Prince George's Counties (through the Washington Suburban Sanitary Commission (WSSC)), Fairfax County, and the Loudoun County Sanitation Authority pay a proportionate share of capital-related costs equal to their share of contracted capacity at Blue Plains.

3. ***Revenue Bonds/ Commercial Paper*** – Debt issuance represents 61 percent of funding for the ten year capital program. A common ratio used by the rating agencies to measure leverage and debt burden is the ratio of debt to net fixed assets (plant). In FY 1999, WASA's debt to plant ratio was 36 percent, and, based on the current capital improvement program, is projected to increase to 60 percent through FY 2016. In addition, debt service as a percentage of total operating expenditures remains at or below 35 percent or less through the ten-year planning period, even with substantial new debt issuance projected during this period.

4. ***Pay-Go (Internal) Financing*** - The amount transferred from operations to the capital program each year is equal to the amount remaining in cash reserves after the six month operating and maintenance reserve and rate stabilization fund goals have been satisfied. Approximately two percent of total funding for the FY 2007 - 2016 plan is projected to come from pay-go financing, which strikes an appropriate balance between maintaining moderate debt levels and financing provided by current ratepayers. Pay-go funds will be used in a manner consistent with our financial policies: 1) to fund items with shorter useful lives where bond financing is less appropriate, such as capital equipment; and 2) to achieve the lowest cost of capital possible, including using pay-go funds to reduce higher cost debt.

*FY 2008 & 2009 Debt Issuance Plans & Debt Service Assumptions*

WASA successfully issued $218.5 million of tax exempt subordinate lien revenue bonds and $59 million of taxable in June 2007. The tax exempt bonds were fixed rate, the taxable bonds were issued as auction rate securities which carry short-term variable rates. In FY 2007, the simple average interest rates on taxable bonds were 5.33 percent. As noted above, based on current capital spending projections, WASA projects that Series 2007A proceeds will last through the fourth quarter of FY 2008, after which the commercial paper program will be utilized. We expect that the next permanent financing, which we anticipate issuing as senior lien, fixed rate revenue bonds, will be issued in late spring / early summer 2009. We expect that the size of this bond issue will be in the $300 million range, covering all of FY 2009 new money needs as well as the first 9 months of FY 2010 needs.

Our interest rate assumption on new bond issues in FY 2009 and beyond is 6.5 percent, in line with historical interest rate trends although substantially higher than current market conditions. On variable rate debt (i.e., the Series 2007A auction rate securities and commercial paper), the ten year plan assumes interest rates of four percent through the life of the plan, plus ongoing fiscal charges for broker-dealers, ratings, etc. This assumption is based on average short-term rates since 1981. For appropriations purposes, we have assumed higher interest rates on variable rate debt than in the ten-year plan in order to provide us with sufficient flexibility to address short-term peaks in interest rates, if required, without going through the Congressional approval process, which can be lengthy.

## *Cash Position & Reserves*

Cash balances totaled $253 million at the end of FY 2007. As described below, this includes $68.5 million for rate stabilization and $67.8 million for the special Congressional appropriation WASA received in FY 2003 through FY 2007 for the CSO LTCP, net of reimbursements to date. Over the next ten years, cash balances are projected to remain close to the Board-required reserve levels, with the operating and maintenance reserve totaling $118.6 million in FY 2008 and growing to approximately $146.1 million in FY 2016, based on projected growth in operations and maintenance expenses.

In FY 2004, the Board completed a review of its existing financing policies, reaffirming the core policies. Two modifications were made to the reserves policy: 1) Changing the timing of when WASA is required to meet its overall operations and maintenance reserve requirement from September 1 to an average daily balance basis, resulting in a more conservative calculation; and 2) revising the indenture-required renewal and replacement reserve requirement from two percent of original plant in service to $35 million, with a requirement to revisit this reserve level every five years in conjunction with the indenture-required system assessment prepared by WASA's independent rate consultants.

WASA's base six month operating reserve includes the following components:

**PROJECTED FY 2008 YEAR-END CASH RESERVES (1)**
**(In 000's)**

| | | |
|---|---|---|
| **BOARD-ADOPTED OPERATING RESERVE (180 Days O&M)** | | |
| 60 Day Operating Reserve (Indenture-Required) | $ | 34,854 |
| Renewal & Replacement Reserve (Indenture-Required) | | 35,000 |
| District of Columbia General Obligation Reserve | | 404 |
| Undesignated Reserve | | 48,320 |
| **TOTAL OPERATING RESERVE** | $ | 118,578 |
| | | |
| Reserve for Rate Stabilization Fund | | 68,500 |
| DC Insurance Reserve | | 1,000 |
| **TOTAL OTHER RESERVES** | $ | 69,500 |
| | | |
| **TOTAL CASH RESERVES** | $ | 188,078 |

(1) Excludes special CSO LTCP funding & debt service reserve funds

*Indenture-Required Operating Reserve* - This reserve is required by WASA's bond indenture and is equivalent to two months' operations and maintenance expenses from the prior year, or approximately $33.0. million in FY 2008 based on the revised FY 2007 budget (audited financial results will not be completed until December 2007.)

*Renewal & Replacement Reserve* - This reserve is funded at $35.0 million based on the revisions approved by the Board to the financing policies in 2004. As noted above, the level of this reserve will be reviewed every five years by WASA’s independent rate consultants in conjunction with the indenture-required assessment of the physical condition of the system.

*District of Columbia General Obligation Bond Reserve* - This reserve is required under WASA's memorandum of understanding with the District of Columbia regarding payment of District general obligation bonds that WASA is responsible for. This reserve is equal to ten percent of the subsequent fiscal year's debt service, or $0.5 million in September 2008.

*Undesignated Reserve* - After allocating portions of the 180 day operating and maintenance reserve to the reserves listed above, the amount that remains (approximately $42.6 million projected for FY 2008) is WASA's undesignated reserve, and is available for other contingencies.

WASA has other reserves that are available to it in very specific circumstances:

*Rate Stabilization Fund* - Consistent with the Board's financial policies and as envisioned in the bond indenture, this fund is to be established to mitigate large annual rate increases. At the end of FY 2007, the balance in this fund totaled $68.5 million. Future deposits to the rate stabilization fund will be determined annually based on financial performance in that fiscal year and updated ten-year capital and operating forecasts.

*Debt Service Reserve Funds* - The supplemental bond indenture associated with each bond issue require WASA to maintain a debt service reserve fund for its Series 1998 senior lien bonds and its Series 2003 and 2004 subordinated lien revenue bonds. The Series 1998 and Series 2004 reserves were funded with bond proceeds; the Series 2003 reserve was funded through the purchase of a surety bond. This reserve which is in addition to the 180 day operating and maintenance reserve, is held by WASA's trustee and can only be used in the event that net revenues are insufficient to meet the next debt service payment. WASA earns interest on this reserve that is included in other operating revenue and is used to offset annual debt service payments. (The amount of interest earnings that WASA can retain on the debt service reserve fund is limited by federal arbitrage restrictions.)

## *Long-Term Operational & Financial Issues*

Over the next ten years, WASA faces a number of significant operational and related financial issues that will impact future financial plans:

***Combined Sewer Overflow Long-Term Control Plan*** – As described earlier in this document, the approval of this twenty-year, $1.9 billion plan marks a significant milestone for WASA and the District. While the retail rate impact in the early years of the plan is mitigated by a somewhat back-loaded schedule, if no additional federal assistance is secured, the long-term impact on retail rates will be substantial.

***Chesapeake Bay Initiative and new NPDES permit*** – The 1987 Chesapeake Bay Agreement called for a 40 percent voluntary nitrogen reduction by its signatories by year 2000. The District of Columbia was the first signatory in the region to meet this voluntary commitment due to significant improvements by DCWASA at Blue Plains. The EPA Chesapeake Bay Program continued to set new nutrient limits for all jurisdictions and began to make these limits mandatory instead of voluntary by including these requirements in NPDES permits. A modification to Blue Plains' NPDES Permit, which became effective on June 4, 2007, included a requirement to operate the wastewater treatment plant to meet a total nitrogen effluent limit of not more than 4,689,000 pounds per year. At an average annual flow of 370 mgd, this is equivalent to 4.2 mg/l. In the fact sheet developed by EPA related to the permit modification, EPA concedes that "the Blue Plains facility is not currently designed to achieve the limit on a consistent basis. In order to do so, it is anticipated that new and/or retrofitted treatment technologies must be installed at the Blue Plains facility. Therefore, EPA intends to establish a schedule for compliance with the nitrogen limit in a separate enforceable document". DCWASA is currently in negotiations with EPA to modify the current CSO consent decree; one of the modifications would be to include the schedule for compliance with the nitrogen limit.

DCWASA developed a BTN program to incorporate the requirements of the Chesapeake Bay Program and the Long Term Control Plan in a coordinated approach. This plan was reviewed by EPA and presented to the public and received favorably by all due to the water quality benefits of the proposed plan. The estimated cost, of this program is $950 million in 2007 dollars.

***Other Issues*** – WASA faces a number of other regulatory issues that could result in significant new capital and operating costs, such as additional nutrient removal requirements as part of the Chesapeake Bay Program. These issues, which are described in more detail in Section 1 of this document, will be closely monitored by WASA over the next year and included in future years' plans, as appropriate.

## *Results*

WASA's adherence to the Board's financial and rate-setting policies by implementing prior ten year plans has been one of the key reasons for WASA's financial success. The consistent support for and implementation of the plan has been commended and acknowledged by the capital markets and broader financial community, as evidenced by WASA's bond ratings of Aa3 / AA- / AA-.

Continued adherence to Board policies and the proposed ten year plan will provide the financial resources to meet our ongoing commitment to 1) provide world-class service to our customers and 2) meet our regulatory and environmental obligations. An essential component of meeting these goals is fully funding the capital program, which the ten year plan accomplishes. Continuing implementation of the plan and its underlying policies will result in maintenance of WASA's already strong bond ratings, producing continuing reductions in WASA's cost of capital which will be passed on to WASA's customers.