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District of Columbia Water and Sewer Authority; Water/Sewer

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Credit Profile		
US\$300. mil pub util sub lien rev bnds (Build America Bonds) ser 2010A&B due 10/01/2044		
<i>Long Term Rating</i>	AA-/Stable	New
District of Columbia Wtr & Swr Auth pub util sr ln rev bnds ser 2009A		
<i>Long Term Rating</i>	AA/Stable	Affirmed
District of Columbia Wtr & Swr Auth pub util subord ln (ASSURED GTY)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
District of Colu Wtr & Swr Auth pub util		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
District of Colu Wtr & Swr Auth pub util subord ln		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to the District of Columbia Water and Sewer Authority's (DCWASA) public utility subordinate-lien revenue taxable Build America series 2010A bonds and tax-exempt series 2010B bonds. At the same time, Standard and Poor's affirmed its 'AA' rating on the DCWASA's senior-lien debt and 'AA-' rating on the authority's subordinate-lien bonds. Ratings on the DCWASA debt were upgraded in April 2008 based on a demonstrated track record of sound financial operations over time, a strong service area economy and greater certainty regarding future cost of regulatory compliance. The affirmation reflects a continuation of these trends.

The 'AA' and 'AA-' ratings reflect our view of the district's:

- Strong service area economy, which includes the District of Columbia (A+/Stable) and four neighboring suburban counties in Maryland and Virginia, all of which are rated 'AAA';
- Management's aggressive and successful efforts to establish and implement sound operating and financial policies and guidelines;
- Strong financial performance, exhibiting both good coverage and liquidity that exceed internal guidelines;
- Competitive rates that are projected to increase between 5% and 12.5% annually over the next five years, with adopted rates typically falling below previous projections; and
- Sizable, 10-year, \$3.8 billion capital improvement plan (CIP), 61% of which will be debt funded, which addresses new regulatory requirements.

The distinction in ratings between the senior and subordinate debt reflects the difference in lien priority between the two as well as differences in legal provisions. The series 2010A and 2010B bonds are being issued to finance capital improvements as part of the district's long-term capital improvement plan, including \$75 million for its digester

project. Bond proceeds will also fund \$11 million in capitalized interest. There will be no debt service reserve associated with these two series of bonds.

DCWASA was created in 1996 as an independent, regional authority to operate the District of Columbia's water and sewer system. Previously, the district operated the system through the department of public works. Under the control of the authority and management team, several significant operational improvements have occurred. DCWASA's management has implemented planning tools not typically found in water and sewer enterprises. Along with a 10-year CIP, multiyear operating forecasts are performed; in addition, coverage, liquidity, pay-as-you-go capital, and rate stabilization reserve fund goals have been established and met.

DCWASA's finances are sound. In fiscal 2009, senior debt service coverage (DSC) was 2.97x and all DSC, including senior and subordinate debt, was roughly 1.34x. Although these levels are lower than their 4.68x senior-lien coverage and 1.57x coverage for all debt in 2008, the levels remain very strong in our view. For fiscal 2010, management projects senior-lien coverage to decline to what we consider to be a still-strong 2.53x and total coverage to be 1.2x. Senior-lien coverage is expected to range between 2.38x and 1.73x from fiscal years 2010 through 2014. Combined DSC is expected to hover around 1.2x through 2014. These projections assume \$1.01 billion in additional senior-lien debt. Liquidity at fiscal year-end 2009 remained very strong with 259 days' unrestricted cash on hand, compared with 308 days in 2008. This amount includes DCWASA's rate stabilization fund and remains above the authority's six-month liquidity policy. In 2008, the authority reduced its rate-stabilization fund by \$15 million to \$28.6 million at the end of fiscal 2009 but expects to replenish that amount in 2010 based on a projected surplus. The CIP is large and estimated at \$3.8 billion through 2018; roughly 45% of the plan is mandate driven. Pay-as-you-go capital, wholesale customer capital payments, and grants will account for the remainder of funding. The capital improvement plan, however, does not anticipate potential additional federal funding or even greater contributions from its wholesale customers, which if they materialize, could result in lower-than-anticipated rate increases.

DCWASA provides retail water and wastewater service to roughly 123,000 customers in the District of Columbia (A+/Stable), as well as wholesale wastewater service to Montgomery (GO rated AAA/Stable) and Prince George's (AAA/Stable) counties in Maryland and Fairfax (AAA/Stable) and Loudoun (AAA/Stable) counties in Virginia. The system has good capacity and has contracted to purchase water from the Washington Aqueduct. The aggregate service area's population is nearly 2.2 million and wealth and income levels are above average.

Outlook

The stable outlook reflects the underlying economic strength of the service area. It also reflects management's continued efforts to improve its operations and its sound financial and planning policies. While the authority's capital improvement plan remains sizeable, it incorporates the additional cost of new regulatory requirements. Standard and Poor's expects management to meet regulatory requirements and address its capital improvement needs while maintaining affordable rates, healthy coverage, and adequate reserves.

Legal Provisions

Net revenues of the water and sewer system secure the bonds. Rates must be maintained to generate revenues equal to 1.2x annual DSC of all revenue debt and 1.0x DSC of all subordinate debt, including GO debt. The additional

bonds test is weak in our view. Additional bonds may be issued if:

- Net revenues collected in the 12 consecutive months out of the past 18 months provide 1.2x DSC of existing and proposed annual debt service, or
- Financial projections by a consultant show 1.2x annual DSC for five succeeding years.

The subordinate bonds are special and limited obligations of the authority, payable on a subordinate basis to all senior debt. The flow of funds establishes separate subordinate accounts for both associated debt service and required debt service reserve funds. Although the series 1998 senior-lien bonds and the series 2003 subordinate-lien bonds all have debt service reserves associated with them, series 2008A, 2009A, 2010A, and 2010B will not have debt service reserves. The reserves are specific to each series of bonds and are not available for any shortfalls on other series. Given the authority's current cash levels and debt service reserves available to the other series of bonds, the issuance of the series 2010A and 2010B bonds without a reserve is not currently a credit concern. Standard & Poor's will continue to monitor reserves and evaluate the effect of issuing additional debt without funding debt service reserves on a case-by-case basis.

Finances

DCWASA's financial performance has been strong, with strong coverage of senior debt and all debt achieved. Coverage of senior debt was over 2.97x in fiscal 2009. Total debt service coverage (DSC) remains a strong 1.34x and is considered high relative to other systems that include a substantial wholesale component. The marked difference between senior and subordinate coverage levels reflects substantially greater subordinate debt issuance compared with senior-lien debt. Including this issuance, the system has roughly \$548 million in senior-lien debt, compared with \$1.05 billion in subordinate revenue and GO debt. Coverage levels are expected to decline over the next five years as additional debt is brought on. Senior-lien DSC is expected to decline to what we view as a still-strong 1.7x to 2.5x range. Total DSC is projected to hover around the 1.20x-1.25x range over the forecast period, which extends through 2014. Management assumes all additional debt will be issued as senior-lien debt. Projected coverage could vary based on management's decision to issue subordinate instead of senior-lien debt.

Operations

DCWASA has been an independent authority since 1996. An 11-member regional board of directors governs the authority:

- Six appointed by the District of Columbia mayor with consent of the city council and
- Five appointed by the District of Columbia mayor with recommendations from represented user jurisdictions.

The authority has made significant strides in operating as an independent entity although some hurdles remain. Operating budgets must be submitted to the district for review and included in its submission to the U.S. Congress for approval. While the District of Columbia cannot make any budgetary changes, it can review and make recommendations. Questions about the role and responsibility of the District of Columbia's CFO in selecting the authority's CFO have been resolved with the authority maintaining its ability to select its own CFO independent of the District of Columbia's CFO.

Planning and budgeting are more detailed and extensive than most other water and sewer enterprises. In addition,

significant operational improvements have been achieved in plant, fleet, and customer service. Management's financial goals and policies have been exceeded, including the maintenance of cash reserves equal to the greater of four months of operations or \$125 million and coverage of at least 1.4x, despite the lower tests required by bond covenants. Additional DCWASA policies include requirements that retail rates be based on annually updated and adopted 10-year operating and capital plans and that rate increases are implemented in a gradual and predictable manner.

Among other items, the board has approved a 10-year operating plan and a 10-year CIP, which were both fully supported by regional members. The authority has the power to set rates and issue debt.

Rates

The authority's financial management policies require gradual rate increases to avoid spikes in fees. The rate stabilization fund, which stood at \$48.6 million at fiscal year-end 2008, declined to \$28.6 million in fiscal 2009, and will be used to smooth out rate increases over the next few years.

Retail rates are affordable, but forecasts indicate continued rate increases in the near future. The average residential rate is affordable, in our view, at \$61.20, up 9% from its previous level. Newly proposed rate increases range from 12.5% in 2011 to 8.0% and 8.5% in 2012 and 2013. After 2013, rate increases are projected to decline to 6.5% in 2014 and 5.0% in 2015. In April 2009, the authority will begin imposing an impervious area charge to recover costs of its Combined Sewer Overflow (CSO) Long-Term Control Projects.. The CIP, which is reflective of new federal regulations, is driving rate increases. The current average residential bill for combined water and wastewater is in the mid-range compared with other Eastern U.S. metropolitan areas.

The System

DCWASA provides retail water and sewer service to about 123,000 customers in the District of Columbia as well as wholesale wastewater treatment to Montgomery and Prince George's counties in Maryland and Fairfax and Loudoun counties in Virginia, under long-term agreements. These long-term agreements expire in 2010, and the authority has already begun to work with its members to renew this agreement.

Wastewater

Wastewater is treated at the DCWASA-operated Blue Plains wastewater facility. The plant provides advanced treatment and has an average flow capacity of 370 mgd, a peak four-hour flow capacity of 740 mgd, and a peak daily flow capacity of 1,076 mgd. The collection system includes:

- 1,800 miles of sanitary and combined sewers,
- 22 flow-metering stations,
- 16 storm water pumping stations, and
- Nine off-site pumping stations.

About a third of the sewers are combined storm-sanitary collectors.

Under the provisions of the inter-municipal agreement (IMA) between DCWASA and Montgomery, Prince George's,

Fairfax, and Loudoun counties, the plant is expected to meet all its members' needs until 2018. The IMA allocates the plant's capacity and establishes cost-sharing provisions. Under the IMA, all members pay their proportional share of operating and capital costs.

Water

DCWASA purchases treated water from the Washington Aqueduct, which is owned by the federal government and operated by the Army Corps of Engineers, pursuant to the water sales agreement. Currently, the aqueduct produces about 180 mgd, with peak production at nearly 245 mgd. The board continues with its line replacement program but continues to evaluate it as other capital needs gain higher priority. EPA-mandated replacements ended in January 2006.

CIP/Combined Sewer

The 10-year CIP through 2018 is \$3.8 billion, an increase of \$600 million from the previous CIP and is expected to be 61% funded by bonds. About \$555 million, or 14% of the plan, will be used for water facilities; \$1.6 billion, or 41%, for wastewater facilities, including facilities to meet new discharge requirements; and \$1.1 billion, or 29%, for the authority's Combined Sewer Overflow Long Term Control Program. The balance will be used for storm water, sanitary sewer, equipment, and Washington Aqueduct improvements. The CIP's size will require annual rate increases to cover debt service costs and is the main driver of the authority's budget growth, a trend consistent with other large regional water and sewer authorities.

The authority received a modification to their consent decree that will require them to meet these National Pollution Discharge Elimination System limits between 2014 and 2018.

The authority reached an agreement with the federal government on a 20-year long CSO Long Term Control Plan (CSO LTCP). A judicial consent decree was entered by the U.S. District court in March 2005, which formalized the agreement and called for WASA to complete the CSO LTCP in 20 years at a cost totaling \$2.2 billion (including inflation). The plan calls for:

- Three large storage tunnels that will store the CSO;
- Pumping station improvements;
- Targeted separation of combined sewer in several sections of the authority's service area;
- Consolidation and elimination of 14 of 59 existing outfalls, including four outfalls on the river; and
- Low-impact development projects at WASA facilities.

The authority continues to make progress on the CSO nine minimum control projects that were included in the CSO LTCP in 2004. These projects have a total cost of \$170 million and are expected to reduce CSO overflows by 40%.

A recent U.S. Courts of Appeals decision ruled that total maximum daily pollutant loads developed by the EPA for the Anacostia River should be implemented on a daily basis and not longer. The short-term impact of this decision is a possible delay in the implementation of the CSO LTCP. Management does not expect this ruling to increase the costs.

Related Criteria And Research

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept.15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

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