

Detroit Water & Sewerage Department and Great Lakes Water Authority
Reconciliation Committee
October 19, 2018 at 10 am

Meeting Notes

1. Inaugural Meeting – Review of Scope and Purpose of Committee
 - a. Purpose of the Committee
 - i. CFO Bateson handed out agenda item #1 – excerpts of agreements and MOU
 - ii. GLWA General Counsel Brown walking through the excerpts
 1. Pulled from the foundation documents to form the relationship was from the water and sewer services agreement
 2. Defines reconciliation committee – perform such duties as out lined in section 5.3
 - a. Financial issues of the reconciliation committee to address
 - b. Goal is to resolve any difference of opinions between the two entities
 3. Moving to the 2018 MOU
 - a. Important for parties to meet on a regular cadence vs when there was just a problem
 - b. Section 9
 - i. Added a few more people to the party
 1. CFO
 2. CEO/Director
 3. General Counsels
 4. Anyone else to attend – bond counsel
 - c. Covers many issues not just financial issues
 - d. Meeting on a quarterly meeting
 - i. Next meeting will occur in January, April, July and next October
 2. Status Report: Cash Held for the Benefit (CHFBO) of DWSD
 - a. CFO Naughton and CFO Bateson talked briefly yesterday afternoon
 - b. Handing out a document used to describe the arrangement as recently going through the financial transaction
 - i. Support of CFO Naughton was appreciated for the questions from the rating agencies and other individuals
 - c. CFO Bateson handed out a Local System Trust Receipts and Disbursements and Local System Budget Transparency
 - i. Local System Budget Transparency
 1. Preparing and sharing with rating agencies when trying to understand relationship between DWSD and GLWA
 2. Page 2 – describe what cash held for the benefit of DWSD is
 - a. Talking about how the retail receipts come into a trust account and how it goes through the flow of funds

- i. Begins with cash receipts and then what comes out of it – presented as a math equation (see page 2)
 - ii. Bottom line is the cash held for the benefit of DWSD
- 3. How it works for the water system CHFBO DWSD is on page 3
 - a. Used on figures through May 31st
 - b. DWSD's cash inflows and outflows are listed in table on page 3
 - i. Outflows are money going into outside accounts for O&M
 - ii. There would be a net positive and this would be used to pay for improvements to the system
 - c. If positive – money GLWA is holding for benefit of DWSD pending direction of how to use funds
 - d. If negative – functions like an AR from DWSD
 - i. Described on page 4 – as it relates to the sewer system
 - ii. Focus on life to date – acknowledge the anomalies that were worked through earlier this year
 - 1. Negative outflow of \$54M
- 4. A lot of people – financial analysts – focus on worst thing that can happen. But GLWA and DWSD have ways to deal with it.
- 5. Director Daddow – Does DWSD – CFO Naughton- agree with the amounts?
 - a. CFO Naughton – DWSD has booked to the same numbers. An issue came up with the allocation of cash. But if there is a change it will be a small amount (de minimus).
- 6. What is the worst that can happen?
 - a. Page 5 – prepared for the eyes of rating agencies. Must point out ultimate backstops that no one wants to execute from the leases.
 - b. Transition of the legal agreements to the page 6
 - i. 100% of the actual budget amount for the O&M account
 - ii. The MOU agreement there was a final sewer bad debt lookback agreement that was to implement in 2019
 - 1. \$6.5M was lookback
 - 2. GLWA owed to DWSD – book entry to reduce negative balance to CHFBO and offset charges
 - 3. This number is not reflected in the page 5 table.
 - a. This is a 2019 activity
 - iii. DWSD also has positive cash balances
 - 1. Positive budget variance – local system is functioning.
 - iv. If there is a shortfall – adjust OM budget
 - 1. Example – regional service charge was at 2% increase, but ultimate was 1% increase

- a. Apply \$1.8M more than what the budget reflects
 - v. CFO Naughton and CFO Bateson compared notes and the lease payment were adjusted for prior fiscal year – brought it down to \$54M
 - 1. What was the amount of the adjustment?
 - a. Effective in March
 - b. Between \$6 – 8M – exact amount will be given.
 - c. \$2.3M per month redirected to offset MBO commitments
 - vi. Budget stabilization fund – this is fully funded
 - vii. Improved collections are anticipated for DWSD
 - 1. DWSD team has continued to pursue and expand collection methods
 - viii. No transfers to the local system I&E – beyond the lease payments
 - ix. MOU also provides a conversion of amount owed after one fiscal year to a three-year payment plan with interest
 - x. 6.30.18 – updated cash numbers were also publicly available
 - 7. Page 7 – to drive things home there are resources available
 - a. This was the most conversations and questions came from this item
 - b. There were other remedies that were listed below. Trying to apply numbers to concepts from page 6.
 - 8. Page 8 – going to work through to detect and prevent future increases in shortfalls
 - a. They knew we have been in standup mode
 - b. When detected a meeting was done right away
 - 9. Last pages – again provided the Excerpts as already provided in agenda item #1
- ii. One rating agency said it appears that GLWA has it covered. Another one was not as positive.
 - 1. Are we getting these financial reports on page 9?
 - a. In process – there is a daily reconciliation being done
 - b. The quarterly reports will be prepared and provided to GLWA
 - c. Revamping the investment report to the finance committee
 - i. Going to add additional schedules – will probably be provided monthly
 - ii. They will become routine and will be a public document
 - 2. One rating agency went through the audited statements for DWSD in detail and it was a rush on information to get the analysis done

- a. The rating agencies are viewing both of the websites at all time
 - b. Want to make sure all the reports are publicly available
- d. Schedule of Local System
 - i. This is a synopsis
 - ii. Moving to Finance Committee report from DWSD (dated 10.3.18)
 - 1. Cash is swept into a trust account
 - 2. Out of that account there are disbursements
 - a. Today these transfers are now predictable – budgets are aligned, and cash flows are understood
 - b. Direct expenses on DWSD books – O&M – transferred direction to DWSD – this is amounts that they manage.
 - c. Indirect expenses – GLWA will make transfers out of the account to make payments on wholesale charges to pay debt service – pre-bifurcation and post bifurcation amounts – GLWA issued bonds on DWSD behalf
 - i. WRAP and all the other MBO commitments
 - 3. Page 3 – no variances if always budget correctly
 - a. Accrual basis – budgeted revenues and what was billed for that period
 - b. For expense side – what was actually paid
 - c. Inflows and outflows that CFO Bateson just went through, but they are aligned with DWSD budget
 - d. The top part the retail revenues is the ones that go to DWSD
 - i. Retail revenues and direct and indirect expenses are the big parts
 - ii. Shared services not settled through cash accounts
 - e. Funding of working capital portion
 - i. Collections in January – March 2016 all went to GLWA as cash
 - ii. Part of the cash variance is going to be this 2016 amount
 - iii. Other part of the variance could be estimated bad debt and actual bad debt
 - 4. Did not go through water analysis.
 - 5. Page 6 – sewer fund – operating budget to cash variances
 - a. For two years what is the total budget and total accruals and what was the actual cash flows
 - b. Overestimated the budget and did not bill enough
 - c. Negative variance of \$24M
 - d. Total indirect expense is another negative variance
 - i. Another expense that is transferred by GLWA on DWSD behalf
 - ii. Had budget of \$514M and accrual expenses was \$536M so there was another \$22M negative variance

- e. Part is the initial funding requirement that was not contemplated but later corrected
- 6. Page 7 pulls it all together
 - a. Drew down \$119M combined
 - b. Total cash advance was \$78M
 - c. Settlement of claims – effectively paid back for the settlement came off as \$9M – reduced the cash held at GLWA
 - d. Sewer fund – owed \$53.6M and net \$45.3M
 - i. On the revenue side with the budget variances – there was a lot going on – rollout of impervious acreage – total uncertainty of what could be collected.
 - ii. There were also several different lawsuits going on
 - iii. New to world credits were also going on at the same time
 - 1. This all effected the budget variance
- 7. Indirect expenses also contributed to the negative variances.
- 8. This is how we got to where we got
- e. Forecast from DWSD
 - i. Water Forecast 2019 – current budget in a different format
 - 1. Net retail receipts – apply debt service – post bifurcation debt service on water – using lease payments to do this.
 - 2. Transfers according the DWSD budget – will be transferred out of account by GLWA – net draw on cash held at GLWA at \$924,000
 - 3. Factor in over time – conservative consumptions – on revenue expectations
 - 4. Cash held at GLWA – try to maintain a balance of \$5M
 - a. In later years transfers to the I&E fund will begin
 - b. Shortfall will go into I&E fund
 - 5. Non-bond funded amounts will be paid out of I&E
 - 6. Same concept – balance of \$43M out of I&E – any excess over \$10M gets transferred to construction fund
 - 7. Bond issue in 2020 – debt service was factored into 2020 debt service – coming out of the lease payment
 - 8. Construction – significant water replacement program
 - 9. Water at end of 2023 will be a positive amount
 - ii. Sewer – more difficult
 - 1. Most growth comes from the impervious charges
 - 2. Only time will tell on the collection rate for these drainage charges
 - 3. Red shaded areas are negative areas
 - a. Over time DWSD will be able to get out from underneath the negative variance by 2022
 - b. I&E will be able to maintain the \$10M balance
 - c. Under construction – factored in the \$93M bond fund – this debt was factored in

- d. There are significant cash deposits right now. There are sources of funding available- even currently.
 - e. Another item not reflected – there is \$5M that came out of City collections. This amount will flow into the trust accounts.
 - i. All would be sewer CFO Naughton believes
- f. CFO Bateson -- Revenue growth – improve in collections or growth?
 - i. A little bit of both. Assuming 2% rate increase and the remainder is the drainage charges.
 - ii. Is this the way of representing the three-year term?
 - 1. Execute in terms of the MOU – to use the three-year term
 - 2. Payment is coming through the increased cash deposits in lockbox vs some other means.
 - a. CFO Naughton - Amend budget and put in portion for payment
 - i. If revenues are hit, then the transfers will occur
 - ii. Formally it would make sense to amend budget to reflect the payments and reduce the lease offset in the budget
 - 1. Amanda VanDusen – maintain some flexibility in budget
 - 3. CFO Naughton – a large part of the increase in drainage charges is on parcels that have never been charged before
 - a. Assuming 40% collections
 - b. First billings were in August 2018 – no collections have been seen yet
 - 4. July 1st – full transfers were resumed
 - a. The previous lease payments were not stopped – instead it was redirected
 - b. For these three-year payments plan – reduce monthly transfer by the amount that is agreed to
 - 5. Under MOU – balance accrued through June 30, 2017 – need to discuss this amount now. (\$30M?)
 - a. Need to discuss this now
 - 6. CFO Naughton’s other concern – is the significant capital improvement plan that the City is expecting
 - a. Director Brown – wild card is the Lead Service Lines – some portion of the budget is being redirected for the lead service lines already
 - i. This will be on the water side impact
 - 7. In a couple months there should be a positive variance out of sewer due to the drainage charges
 - iii. CEO McCormick – outstanding negative balance be converted to three year note and be paid current for the first year by the end of this current year.
 - 1. CFO Naughton – not that far. Will need to pay it off over three fiscal years.

2. CEO McCormick – what about the Additional negative balance accrued through end of 2018?
 - a. Put dent in it?
 - i. CFO Naughton – hope is to start seeing positive cash flows. The amount will be moved to budget stabilization and it will hopefully not be needed. And if not needed GLWA would keep the amount.
 - iv. Director Daddow – good start and will need to come up with 4 – 5 action steps.
 1. \$30M -- June 30th – paid off over 3-year period with interest
 - a. If paid off sooner, then less interest
 2. On the \$24M – from 2018 – paid off as the \$6.5M credit
 3. CFO Naughton – cannot make a commitment at this time but it appears that they are trending in the right direction
 - v. CEO McCormick – part of this is to see if the performance is really looking at the end of the year.
 1. CFO Naughton – this all depends on the collection and revenue growth
 - a. Outflows are set in stone
 - b. It is entirely about managing the budget
 - vi. CFO Bateson – in 2022 Water bond it would be nice to be able to tell this story of the amount being paid off. Bonding agencies look at both sides.
 - vii. CFO Naughton – no billing of residential drainage until August.
 - viii. Director Daddow – first cut point is November 15th
 1. First set of financial statements
 2. This is the 45-day period
 - a. CFO Naughton – would like to get the reports to Director Daddow and GLWA by end of this month.
 3. Would like to see list and worksheet of amounts. Also, a list of items and actions to be made.
 - a. Will track this against September 30th for December statements. If it does not work out, then additional discussions will be needed.
 4. We need to get the numbers closer to each other, still about \$1.5M off. Will work together to get the numbers to be the same. There are two different dates being used on reports. They will bring the dates closer together.
 - g. CFO Naughton – going forward it will be easy to stay in sync.
 - i. Now there is no allocation. All cash receipts that go into that account are DWSD. No need to back into any numbers.
3. Status Report: Watermain Arbitration
 - a. General Counsel Brown – need to get the party started on this issue. Arbitration notice to start the timeline.
 - i. Related to the initial separation of water lines within the system

- ii. Historically we used the method of 24-inch water mains and larger would be responsible by GLWA
 - 1. Smaller within COD would be DWSD responsibility
 - iii. There have been many water main breaks in the last three years.
 - iv. Notice of arbitration – will be an expedited process
 - 1. Engineering firms will be selected within 15 days. Decision for firm will be done within 10 days unless extension requested.
 - v. Issue is the cost of the repairs going back to the bifurcation
 - b. Director Brown – are all 24-inch lines being submitted or are there select lines that will be identified
 - i. General Counsel Brown – attempts to narrow issue but no progress made
 - c. Director Brown – needs help with definition of transmission line
 - i. CEO McCormick – every community has transmission lines and local distribution lines
 - 1. Trying to distinguish regional vs local lines
 - 2. If it is something that generally supports, the regional system. But if it only is a main that provides support to local system it is up to the arbitration group to make that determination.
 - d. Amanda VanDusen – the other customers that GLWA has are wholesale customers. She can imagine where a wholesale customer has transmission lines. All the wholesale functions were leased to GLWA.
 - i. There is no wholesale customer in the city of Detroit.
 - ii. General Counsel Brown – at this stage there needs to be an arbitration for this discussion.
4. Status Report: Water Billing Matter
- a. Facilities within the COD- they have been billed for water and sewer charges after bifurcation.
 - b. September there was a meeting, and this was the power point presentation
 - i. Text of water and sewer services agreement
 - 1. Text states that on the water side the leased facilities can be included in the regional water revenue requirement. There is an intent for the upcoming fiscal year to remove the GLWA water usage for DWSD revenue requirement. This would be for 2020.
 - 2. Happening now so that both sides can set the budget accurately.
 - 3. Declor and chlor facility – this is part of the DWSD revenue requirement – using substantial water for the facility. Part of the analysis done was that it is not being serviced off of a DWSD water line.
 - 4. The usage will be pulled out. As it relates to local charges, there is a requirement for the water to be going through a DWSD line for the charges to occur.
 - ii. Authority’s usage should not be included in the sewer charges
 - 1. Not to say that there cannot be a charge to GLWA but
 - iii. Some accounts listed were for non-existing facilities

1. Parties have worked together to remove those accounts for further billing but there has not been a credit for the past billings
 - iv. There is also a group of accounts that we need to double check that GLWA is receiving a service
 1. WRRF receives a bill for the drainage charge
 2. Impervious areas include the clarifiers that are open and do not drain into the local sewer system
 - c. This is an issue that needs to be resolved because there are significant dollars involved.
 - d. Waiting for Palencia to return from her trip. Next meeting will be in November.
 - e. DWSD Request -- Bart Foster will model the financial impact
 - i. CFO Naughton - This might be premature until decisions are made regarding what facilities will be included or removed.
 - ii. General Counsel Brown – there has been a request to put some meters in place to assist with this analysis
 - f. GLWA -- The request has been to go back to the effective date. \$10.9 M – possibly going back to the effective date.
 - i. Next meeting will be November and at that meeting (or before) there will be financial numbers to determine the impact of the budget and revenue requirement.
 - ii. Need to determine how the billings will work going forward.
 - iii. Commissioner Forte – this is a priority item because of the possible financial impact
5. Establish Annual Calendar
 - a. Next meetings
 - i. January 18, 2019
 - ii. April 5, 2019
 - iii. July 19, 2019
 - iv. October 18, 2019
 - b. Third Friday of the month
 - i. All for 10:30 to noon.
6. Commissioner Forte and Director Daddow to report back out to the Boards about what has transpired from these meetings.
 - a. Alicia Haskin to send out notes from meeting to all committee participants.

Reconciliation Committee

Linda D. Forte, Board of Water Commissioners

Robert J. Daddow, Great Lakes Water Authority Board of Directors

Reconciliation Committee Participants

Gary Brown, Director, Detroit Water & Sewerage Department

Sue McCormick, Chief Executive Officer, Great Lakes Water Authority

Tom Naughton, Chief Financial Officer, Detroit Water & Sewerage Department

Nickie Bateson, Chief Financial Officer & Treasurer, Great Lakes Water Authority

Debra Pospiech, Chief Administrative Officer and General Counsel – Not in attendance

Randal Brown, General Counsel, Great Lakes Water Authority

Terry Donnelly, Bond Counsel, Great Lakes Water Authority

Amanda VanDusen, Bond Counsel, Detroit Water & Sewerage Department

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