OFFICE OF INSPECTOR GENERAL

MEMORANDUM
March 11, 2011

TO: Hon. Valerie Ervin, President, County Council
    Hon. Isiah Leggett, County Executive

FROM: Thomas J. Dagley
       Inspector General

SUBJECT: Final Interim Report: Review of Allegations of Questionable Payments to Developers for the Hoyles Mill Wastewater Pumping Station and Force Main CIP Projects (West Germantown Development District)

Attached please find the Office of Inspector General’s (OIG) February 14, 2011 final interim report prepared by Christopher Giusti, Deputy Inspector General, and the March 9, 2011 management response of Jerry N. Johnson, General Manager, Washington Suburban Sanitary Commission (WSSC). This report and response will be released by the OIG no earlier than March 14, 2011. A response to our report from the Chief Administrative Officer (CAO), Montgomery County Government (MCG), has not been received. A management request was received to extend the original due date of March 2 to March 9 and again to March 18. Upon receipt, we will provide you with a copy.

The Hoyles Mill Wastewater Pumping Station (HMWPS) and Force Main (FM) capital improvements program (CIP) projects were part of Council Resolution No. 13-1135 dated January 13, 1998 that created the West Germantown Development District (WGDD). The OIG's ongoing examination of these projects is an outgrowth of a planned review to examine WSSC policies, procedures, and payment practices for selected CIP projects including a 20" water main project (No. 964860) included in Resolution No. 15-87 that created the Clarksburg Town Center Development District (CTCDD) on March 4, 2003. The objectives, scope and methodology of the planned review were communicated to Mr. Johnson in a letter dated October 7, 2010.

However, on October 27, 2010, the day after the Council adopted Resolution No. 16-1544 that terminated the CTCDD, the OIG began receiving allegations of questionable payments to the HMWPS/FM developers. Specifically, we received multiple reports that
developers were reimbursed by both WSSC and MCG for the same or similar design and construction costs for these projects. In addition, there were concerns reported to us that senior MCG officials were aware that developers were paid twice and a lack of transparency and disclosure prevented these matters from being properly examined for several years.

Our examination to date has found that the HMWPS/FM developers or their representative were reimbursed a total of $6,655,600.50, with $3,715,602.50 paid by MCG’s Executive Branch and $2,939,998 paid by WSSC. MCG’s reimbursements were paid in 2002 and 2003 to the Woodcliffe Development District and WSSC’s reimbursements, a combination of cash payments and system development charge (SDC) credits, were paid in 2005 and 2006 to Arcola Investment Associates and Artery Hoyles Mill, LLC.

Our fieldwork to date has not been able to determine the reason(s) for payments by both government agencies to the developers or their representative for the same or similar HMWPS/FM projects costs. Our ongoing fieldwork includes the referral of certain matters to law enforcement and other officials to help determine if any criminal violations, conflicts of interest, or professional misconduct exist in the implementation of the WGDD. I believe attention by the Council and/or Executive will be necessary to ensure the public interest is served in this and other development district matters.

With regard to Mr. Johnson’s March 9 response, I agree that developers did not submit subcontractor invoices to WSSC for direct reimbursement of specific eligible costs. I want to clarify that the first four examples included in our report on pages 4 and 5 represent cost components that were included in larger payments by MCG and WSSC on April 11, 2002 and March 7, 2006, respectively. The larger payments are outlined in Exhibit 1 on page 8 of our report. These examples were included in our report to show that our analysis of the documents provided to us by WSSC and MCG found that the same subcontractor costs were reimbursed by both WSSC and MCG.

Attachments

cc: County Council Members
   Jerry N. Johnson, General Manager, WSSC
   Maxene Bardwell, Manager, Office of Internal Audit, WSSC
   Timothy L. Firestone, Chief Administrative Officer, MCG
   Kathleen Boucher, ACAO, MCG
OFFICE OF INSPECTOR GENERAL

MEMORANDUM

February 14, 2011 (CORRECTED)

TO: Thomas J. Dagley
Inspector General

FROM: Christopher Giusti
Deputy Inspector General

SUBJECT: Final Interim Report: Review of Allegations of Questionable Payments to Developers for the Hoyles Mill Wastewater Pumping Station and Force Main CIP Projects (West Germantown Development District)

Background
On March 9, 2010, the Montgomery County Government (MCG) Office of Inspector General (OIG) sent a letter to Mr. Jerry N. Johnson, General Manager, Washington Suburban Sanitary Commission (WSSC), requesting an introductory meeting to discuss the “WSSC – Financial Oversight Act, MC/PG 101-09,” as signed into law by the Governor of Maryland Martin J. O’Malley on May 7, 2009. This law gives the Montgomery County Council (MCC) authorization to audit and examine the books and records of WSSC under certain circumstances, and generally relates to audits and financial statements of the WSSC. Since that time, the OIG has had several productive meetings with Mr. Johnson and his staff.

In a letter to Mr. Johnson dated October 7, 2010, the OIG identified the objectives, scope and methodology of a planned OIG review to examine WSSC policies, procedures and payment practices for selected capital improvements program (CIP) projects including the “Clarksburg Town Center Development District (CTCDD) Water Main Project” (WSSC Number W-46.13)\(^1\). On October 8, 2010, Mr. Johnson designated WSSC’s Internal Audit Manager as the OIG point of contact for the review.

\(^1\) The CTCDD was created by the MCC on March 4, 2003 with the adoption of Resolution 15-87. Resolution 15-87 authorized the MCC to impose on all properties located within the CTCDD special assessments and taxes sufficient to pay the principal of, interest on, and any redemption premium on, bonds issued by or for the CTCDD by MCG. In August 2007, the OIG issued an audit report, “Review of Selected Capital Improvements Program (CIP) Projects with Development District Funding,” which examined selected CTCDD road construction projects included in the MCG FY07-12 CIP budget. The audit report, the Executive Branch management response, and a related County Attorney memorandum dated September 7, 2007 can be found at [http://montgomerycountymd.gov/ig](http://montgomerycountymd.gov/ig) under “IG Activity.”

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240/777-8240, FAX 240/777/8254, E-mail: IG@montgomerycountymd.gov
Allegations of Questionable Payments - West Germantown Development District
On October 26, 2010, the MCC passed Resolution No. 16-1544 that terminated the CTCDD. The next day, October 27, 2010, prior to beginning the fieldwork for the review of the CTCDD Water Main Project, the OIG began receiving allegations regarding questionable payments to the developers who designed and constructed the Hoyles Mill Wastewater Pumping Station/Force Main (HMWPS/FM) CIP projects that were part of the MCG West Germantown Development District (WGDD) and the WSSC infrastructure projects approved for reimbursement to the developers by WSSC\(^2\). There was concern that senior officials from both MCG and WSSC were aware that developers were improperly reimbursed by MCG and WSSC for similar design and construction costs and that there was a lack of transparency and disclosure by MCG officials.

The concerns regarding questionable payments were reinforced when documents related to the CTCDD were provided to the OIG in November 2010. These documents disclosed that the CTCDD developer advised the MCC and the Executive Branch in December 2007 to remove $827,000 in developer district funds from a 20" water main CIP project because the developer “is being reimbursed for the construction cost by WSSC. There is no reason to include this in other financing programs.”

Expanded Objectives, Scope and Methodology of OIG Review
Based on the allegations received, the OIG expanded the objectives, scope and methodology of the planned review, to include acquisition/procurement policies and procedures, and management practices used to make payments for the HMWPS/FM CIP projects. In addition to the information requested in the October 7, 2010 letter to Mr. Johnson, the OIG requested WSSC internal audit work papers and financial records related to the WGDD and related infrastructure projects. On November 19, 2010, the OIG also requested specific development district information from the MCG Department of Finance regarding the WGDD HMWPS/FM projects.

MCG/WSSC Documentation
A review of documentation by the OIG disclosed the following:

- In June 1998, there were discussions and a verbal agreement between the MCG Department of Finance representative and WSSC operations personnel that “neither the

\(^2\) The MCC adopted Resolution No. 13-1135 on January 13, 1998 that created the WGDD in an area of 670.71 acres in Germantown that included properties owned by Artery Hoyles Mill, LLC, Bethesda, MD and Arcola Investment Associates, Hyattsville, MD. The Resolution identified certain infrastructure improvements (e.g. roads, water, and sewer) including the HMWPS/FM projects that were to be funded through bonds to be issued through MCG Department of Finance as part of the MCC approved CIP budget. The Resolution also authorized the imposition on all properties in the WGDD special assessments and taxes to pay the principal of, interest on, and any redemption premium on, bonds issued under a separate resolution.

During the same period that the MCC passed Resolution No. 13-1135, the WSSC had standard procedure CUS 94-03, System Development Charge (SDC) Developer Credits and Reimbursements, in place. A SDC is a fee paid to WSSC at the time of application for a plumbing permit intended to cover the cost of building a CIP project needed to accommodate growth. WSSC’s standard procedure allowed a developer to be eligible for SDC credits after WSSC authorized the design and construction of a qualified project. The WGDD HMWPS/FM projects were approved as separate qualified projects by WSSC and eligible for SDC credits. WSSC policies allowed developers to submit a request to WSSC’s Office of Internal Audit to audit developers design and construction costs prior to WSSC reimbursing developers for costs.
County nor WSSC wish to double pay the developers. Thus, both agencies will collaborate to coordinate their respective agreement with the developers’;

- In October 2005, WSSC’s Office of Internal Audit was advised that WSSC’s former General Counsel agreed at the very beginning of the WGDD project that WSSC would reimburse the two developers the SDC credits even though the project was going to be paid by the bond proceeds from Montgomery County;

- In October 2005, WSSC officials confirmed with a MCG Department of Finance representative that MCG had already reimbursed the developers with development district bond proceeds for the cost of the HMWPS project, and that the same or a similar set of costs had been submitted by the developers to WSSC for reimbursement; and

- In October 2005, WSSC officials discussed with the MCG Department of Finance representative that the developers of the HMWPS project would be improperly paid twice (once by MCG and again by WSSC) for the same costs unless WSSC and MCG officials worked to prevent a double payment. In addition, the Department of Finance’s representative was not willing to provide documentation to WSSC that assigned the SDC credits to either MCG or the developers.

WSSC documents furnished to the OIG indicated in 2005, prior to any WSSC payments, WSSC officials believed that since MCG had already reimbursed the developers, MCG should receive the SDC credits and, thereby, prevent payments by both WSSC and MCG to the developers. According to the documents, the MCG Department of Finance representative disagreed, stating the developers incurred the costs twice and, therefore, should be paid twice. The documentation revealed the MCG Department of Finance representative was unwilling to provide an assignment letter from MCG Department of Finance to WSSC stating MCG would agree to assign the SDC credits to the developers. WSSC was familiar with the use of the letter because in November 2004 the Prince George’s County Executive provided such a letter to WSSC for an unrelated CIP development district project. As a result of this disagreement, the WSSC internal auditor performed the required review and approval of the HMWPS/FM CIP costs. WSSC Permit Services Unit authorized a combination of cash payments and SCD credits to the developers totaling almost $3 million for the HMWPS/FM projects.

A review of documents maintained by MCC staff identified MCC concerns in August 2007 about double payments to developers for development district infrastructure improvements, one month prior to the MCC Office of Legislative Oversight (OLO) release of its report titled, An Analysis of Issues Raised by the Clarksburg Town Center Advisory Committee. The OIG was advised that when MCC staff learned that the developers of the HMWPS submitted the same or a similar set of costs for reimbursement to MCG and WSSC, MCC staff briefed the MCG Chief Administrative Officer (CAO) (former Director of Finance) and Director of Finance (former Finance manager responsible for administering the WGDD and CTCDD) on August 23, 2007 about the project and double payment concerns. In addition, the OIG was advised that MCC staff were sufficiently concerned about the risk of double payments to developers for development district CIP projects that the following statement was included in Chapter 9 of the OLO report released on September 11, 2007: “In particular, the Council should consider amending the development district law to expressly preclude the possibility of development district funding of any water or sewer infrastructure item if that item could also be funded through WSSC’s System
Development Charge (SDC), including developer credits against the SDC, as it appears that the Clarksburg Town Center 20" water main could be.”

Payments – HMWPS/FM CIP Projects
OIG analysis of records provided by the MCG Department of Finance found that the Department of Finance approved four cash payments totaling $3,715,602.50 that were made between April 11, 2002 and April 21, 2003 to Woodcliff Development District, c/o (name omitted by OIG), Linowes and Blocher (escrow agent) for the HMWPS/FM projects.

An analysis of records provided by WSSC found that WSSC approved four cash payments totaling $1,869,691.78 that were made between December 9, 2005 and March 7, 2006 for the HMWPS/FM projects. In addition, WSSC issued SDC credits totaling $1,070,306.22 to one of the developers between December 9, 2005 and March 7, 2006.

Exhibit 1 of this report, prepared by the OIG using information provided by both MCG and WSSC, shows that the combined MCG/WSSC cash payments and SDC credits to the developers and their representative for the HMWPS/FM projects totaled $6,655,600.50.

The OIG found that the developers’ design and construction costs submitted to WSSC for reimbursement for the HMWPS/FM projects were reviewed and approved by the WSSC internal auditor, as required by WSSC laws and policies, prior to any payments. MCG payments made to the HMWPS/FM developers or their representative were approved by the Department of Finance representative who was responsible for administering the WGDD. OIG was not provided any purchase orders, invoices, or other detailed financial records by MCG Department of Finance that supported the developers' requests for reimbursement as required by MCG procedures.

A review of the limited supporting documentation provided by the MCG Department of Finance and a review of WSSC’s internal audit files disclosed the following examples of the developer’s costs for the HMWPS (WSSC Contract No. 94CR9880A) that were reimbursed twice (once by MCG and again by WSSC):

<table>
<thead>
<tr>
<th>Various Construction Costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MCG payment on April 11, 2002 to Woodcliff Development District for Subcontractor A</td>
<td>$ 980,000.00</td>
</tr>
<tr>
<td>WSSC payment on March 7, 2006 to Arcola for Subcontractor A</td>
<td>$ 980,000.00</td>
</tr>
</tbody>
</table>

3 MCG policies and procedures used to reimburse developers for development district infrastructure improvements were discussed in the OIG August 2007 audit report regarding the CTCDD, and a related September 7, 2007 memorandum issued by the County Attorney to the MCG CAO. The County Attorney identified the need for the Executive Branch to enter into an implementation agreement with a developer, and stated such an agreement should set the amount of reimbursement which should not exceed the lesser of: 1) the appropriation; 2) the actual cost of the construction; or 3) a fair and reasonable price for the infrastructure.

4 The terms and conditions of the payment requests to MCG Department of Finance for WGDD contained the following language: “Attached AIA form G702, together with all purchase orders, invoices, and other appropriate documentation supporting the payments or reimbursements herein requested must be delivered to the County representative (name omitted by OIG) with this payment request.”
Paving Costs
MCG payment on April 11, 2002 to Woodcliffe for Subcontractor B $ 53,852.50
WSSC payment on March 7, 2006 to Arcola for Subcontractor B $ 53,852.50

Parking Lot Costs
MCG payment on April 11, 2002 to Woodcliffe for Subcontractor C $ 37,176.23
WSSC payment on March 7, 2006 to Arcola for Subcontractor C $ 37,176.23

Water/Fire Hydrants Costs
MCG payment on April 11, 2002 to Woodcliffe for Subcontractor D $ 55,115.00
WSSC payment on March 7, 2006 to Arcola for Subcontractor D $ 55,115.00

WSSC MOU Fee5
MCG payment on April 11, 2002 to Woodcliffe for WSSC MOU Fee $ 218,136.00
WSSC payment on March 7, 2006 to Arcola for WSSC MOU Fee $ 218,136.00

WSSC - Memorandum of Understanding and Amendments
On May 17, 2000, a Memorandum of Understanding (MOU) between WSSC and Arcola was signed that authorized Arcola to construct the HMWPS (a separate MOU was signed between WSSC and Arcola to build the Force Main). According to WSSC, the MCG Department of Finance was working with Arcola on WGDD and requested that WSSC grant each house an equal SDC credit. The MOU stated SDC credits shall be allocated on a pro-rata basis across all units developed by Arcola. The SDC credit was determined to be $2,297.73 for each single family house. The allocation of SDC credits on a pro-rata basis across all units was not a standard practice for WSSC, and after interviews with WSSC and MCG officials involved in the process, the OIG found that this practice was not well understood by MCG personnel.

From July 17, 2001 through October 4, 2004, the following three amendments were made to the original May 17, 2000 WSSC MOU:

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5 According to the WSSC MOU dated May 17, 2000, WSSC estimated its direct costs and overhead associated with the HMWPS to be $218,136. Prior to construction of the HMWPS, Arcola was required to deposit $218,136, in cash, to cover WSSC’s estimated direct and overhead costs for the construction. The WSSC Office of Internal Audit concluded in its internal audit report dated November 22, 2005 that the $218,136 was an eligible qualified project cost for the HMWPS and reimbursable to Arcola.
(a) On July 17, 2001, Arcola and WSSC amended the existing MOU in order that Arcola could receive SDC credits in accordance with WSSC’s approved SDC credit policy (CUS 94-03) rather than provide the $2,297.73 SDC credit allocation for each single family house.

(b) On May 23, 2003, Arcola and WSSC amended the existing MOU for a second time and increased the design and construction costs from $1,640,581 to $2,184,544;

(c) On October 4, 2004, the MOU was amended by Arcola and WSSC for a third time, and Artery Hoyles Mill, LLC was added to the MOU so Arcola and Artery could receive SDC credits in accordance with WSSC’s approved SDC policy. The total design and construction costs of the HMWPS remained at $2,184,544.

The original WSSC MOU and amendments can be found on the OIG webpage under “IG Activity” at http://montgomerycountymd.gov/ig.

MCG - Implementation Agreement
On April 1, 2002, the WGDD Implementation Agreement was signed between MCG and the developers (Woodcliffe, Arcola, and Artery). MCG estimated the infrastructure improvements (roads, water, and sewer) would cost approximately $12,831,177 of which $3,838,020 (approximately 30 percent of the total cost) was for the HMWPS/FM CIP projects. MCG financed these infrastructure improvements through the issuance of tax-exempt bonds.  

On page 14 of the WGDD Implementation Agreement, Article VI, WSSC System Development Charge Credits, Section 6.01, Agreement Regarding Allocation of System Development Charge Credits, Artery and Arcola agreed with WSSC through separate agreements relating to the construction of the HMWPS/FM infrastructure that: “any credits on the WSSC SDC accruing to Artery and Arcola or any builders or developers purchasing properties located within the district from Artery and Arcola will be allocated in accordance with the following percentages: 30.10% to the units within the Artery development until the Artery units receive $1,000,000 in the aggregate and, 69.90% to the units within the Arcola development and all of the SDC credits after the Artery units receive $1,000,000 in the aggregate. The SDC credits shall be allocated by the developers on a pro-rata basis across all of the units developed by Artery and Arcola. Each unit will receive an SDC credit allocation, irrespective of the date when the application for such allocation of SDC credit is made, provided that the allocation does not cause the actual amount of the SDC credit to be exceeded.”

The language regarding the allocation of SDC credits on page 14 of the Implementation Agreement was contained in the original WSSC MOU signed May 17, 2000. However, it was deleted in its entirety from the MOU on July 17, 2001 when WSSC and Arcola amended the MOU. As a result, the SDC credit language contained in the MCG Implementation Agreement signed on April 1, 2002 was different than the process WSSC used to reimburse the developers.

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6 Montgomery County issued an aggregate of $15,915,000 in Special Obligation Bonds, $11,600,000 principal amount of 2002 Series A Bonds and $4,315,000 principal amount of 2002 Series B Bonds. The Bonds are payable solely from special taxes and special assessments levied by the County on taxable property within the WGDD.
The MCG WGDD Implementation Agreement described above can be found on the OIG webpage under “IG Activity” at http://montgomerycountymd.gov/ig.

Interviews of WSSC/MCG Officials
The OIG conducted interviews with numerous WSSC and Montgomery County officials and the developers or their attorney who were involved in WSSC and Montgomery County activities related to the HMWPS/FM CIP projects. Our interviews included:

- WSSC: General Manager, operations personnel, internal auditors, former general counsel staff;
- MCG: CAO, Assistant Chief Administrative Officer, County Attorney and Department of Finance personnel to include the Director of Finance;
- MCC: Legislative attorneys, legislative analysts, and other MCC staff.

These interviews, which were designed to clarify the WSSC and MCG policies, procedures and payment practices applied to the HMWPS/FM CIP projects, have not to date clarified why the developers were reimbursed the same or similar costs by both WSSC and MCG.

County Taxpayer’s Liability
Property owners and WSSC customers who reside in the WGDD are levied a special development district tax by Montgomery County as part of the financing mechanism used to repay the County for the issuance of bonds that were used to reimburse the developers for the infrastructure improvements (roads, water and sewer) in the development district. There are approximately 1,300 property owners who are responsible for paying the annual development district tax. For example, a property owner’s Real Property Consolidated Tax Bill for July 1, 2010 – June 30, 2011, listed the WGDD Special Tax at $825.27. Beginning in tax levy year 2002, for individuals who owned property in WGDD, the special tax was charged and is scheduled to continue to be charged for approximately 23 more years.

Recommendation: It is recommended that the WSSC General Manager and the MCG CAO use the information in this report to conduct a thorough review of all fiscal, ethical, and legal accountability issues associated with the WGDD HMWPS/FM CIP projects to ensure accountability in government and developer actions, and to ensure that County taxpayers who reside in the WGDD and pay the annual special tax are protected from any unnecessary or unreasonable payments. It is also recommended that WSSC and MCG jointly assess and seek recovery of the full amount of all questionable payments or reimbursements made to the developers or their representative.
<table>
<thead>
<tr>
<th>Date of Payment</th>
<th>Payee</th>
<th>Payment From</th>
<th>Dollar Amount</th>
<th>SDC Credits</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>4/11/2002</td>
<td>Woodcliffe Development District c/o (name omitted by OIG) Linowes and Blocher (escrow agent)</td>
<td>MCG</td>
<td>$2,684,033.70</td>
<td></td>
<td>HMWPS/FM</td>
</tr>
<tr>
<td>4/11/2002</td>
<td>Woodcliffe Development District c/o (name omitted by OIG) Linowes and Blocher (escrow agent)</td>
<td>MCG</td>
<td>$893,607.08</td>
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<td>FM</td>
</tr>
<tr>
<td>4/21/2003</td>
<td>Woodcliffe Development District c/o (name omitted by OIG) Linowes and Blocher (escrow agent)</td>
<td>MCG</td>
<td>$126,877.14</td>
<td></td>
<td>HMWPS/FM</td>
</tr>
<tr>
<td>4/21/2003</td>
<td>Woodcliffe Development District c/o (name omitted by OIG) Linowes and Blocher (escrow agent)</td>
<td>MCG</td>
<td>$11,084.58</td>
<td></td>
<td>FM</td>
</tr>
<tr>
<td></td>
<td><strong>Total MCG Payments</strong></td>
<td></td>
<td><strong>$3,715,602.50</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12/9/2005</td>
<td>Artery Hoyles Mill, LLC Bethesda, MD</td>
<td>WSSC</td>
<td>$32,102.00</td>
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<td>FM</td>
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<td>12/9/2005</td>
<td>Arcola Investment Associates Hyattsville, MD ($948,543 less $343,017 SDC Credits)</td>
<td>WSSC</td>
<td>$605,526.00</td>
<td>$343,017.00</td>
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<td>3/7/2006</td>
<td>Arcola Investment Associates Hyattsville, MD ($1,916,636 less $727,289.22 SDC Credits)</td>
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<td>$1,189,346.78</td>
<td>$727,289.22</td>
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<td>3/7/2006</td>
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<td>WSSC</td>
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<td>HMWPS</td>
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<tr>
<td></td>
<td><strong>Total WSSC Payments/SDC Credits</strong></td>
<td></td>
<td><strong>$1,869,691.78</strong></td>
<td><strong>$1,070,306.22</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Total HMWPS/FM Costs:</strong></td>
<td></td>
<td><strong>$3,715,602.50</strong></td>
<td></td>
<td>(MCG Payments)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td><strong>$1,869,691.78</strong></td>
<td></td>
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<td>(WSSC SDC Credits)</td>
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<td></td>
<td></td>
<td><strong>$6,655,600.50</strong></td>
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*Source: MCG Department of Finance

**Source: Washington Suburban Sanitary Commission

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7In the MCG Implementation Agreement, the cost estimate for the design and construction of the pumping station and force main by the developers was $3,838,020. In the WSSC MOU amendments, the final cost estimate for design and construction of the HMWPS by the developers was $2,184,544 and $1,064,949 for the FM for a total of $3,249,493.
March 9, 2011

Mr. Thomas J. Dagley
Inspector General
Montgomery County Government
51 Monroe Street, Suite 802
Rockville, MD 20850

Re: West Germantown Development District draft interim report – WSSC Management Response

Dear Mr. Dagley,

The Hoyles Mill Wastewater Pumping Station and Force Main are but one component of the entire West Germantown Development District. That District was established by Montgomery County, and WSSC has no in-depth knowledge of the other components, nor of the totality of the value the District provided to the citizens of Montgomery County. As such, we are confining our response to the items associated with the WSSC facilities. Our silence on the other issues should not be construed as agreement or consent as to their validity. Based on our review of the above mentioned report we have the following comments and observations:

- On page 3, the report appears to place a significant relevance to the fact that the County was unwilling to provide an assignment letter stating that the County would agree to assign the System Development Charge (SDC) credits to the developers. The agreements between WSSC and the developers were required by State law (Section 25-405 of the Public Utilities Article, WSSD Laws, Annotated Code of Maryland; previously Section 6-113 of Article 29, Annotated Code of Maryland). In accordance with the law, those agreements addressed, among other things, how SDC credits were to be granted. In this case, the agreements specified that the developers were entitled to the SDC credits. WSSC’s request for the assignment letter was to document for our files that the County was aware that the Commission was going to continue to treat the developers as the entity to receive the credits. The WSSC documentation provided to your office stated outright that from conversations with County personnel, WSSC knew the County was aware that the SDC credits were granted to the developers. Not obtaining an assignment letter did not modify the terms of the agreements with the developers, nor did its absence change WSSC’s obligations to the developers with regards to the SDC credits.

- On pages 4 and 5, the report erroneously identifies the SDC credit reimbursement payments made by WSSC to the developers as being directly associated with payments made by the developers to their subcontractors. This identification is incorrect and could lead a reader to misinterpret how WSSC reimburses any developer for SDC credits. In fact, that misinterpretation has apparently already occurred based on the Washington Examiner editorial of February 28, 2011. In accordance with the (then) approved Commission policy on SDC Developer Credits and Reimbursements (CUS 94-03), the credits are determined based on total eligible costs, and are returned to the developer as they apply for eligible plumbing permits (for that served area’s SDC fee), or are paid to the developer from SDC collections WSSC obtains from other applicants in the area served by the WSSC facilities. At no time
does any developer submit an invoice from a subcontractor to the WSSC for direct reimbursement of specific eligible costs. The developer identifies the cost components and presents all invoices in support of their total costs at the completion of the project, when WSSC audits those costs. As you are aware, the developer submits their initial estimate of total eligible costs, WSSC reviews the costs for conformance to CUS 94-03 (or ENG 04-01 for agreements entered into after March 10, 2004), and, once included in the agreement between WSSC and the developer, the WSSC grants to the developer an amount equal to 50% of the total eligible costs as a credit which may be used for the SDC portion of their plumbing permits until such time as the project is completed and the developer’s total costs are audited by WSSC’s Internal Audit Office. Once the audit is complete, the total eligible costs are finalized. At that time, and no time prior, is the developer entitled to receive from WSSC the difference between the audited total eligible costs and the amount of SDC credits previously used (if any) in their permit applications via a properly executed credit voucher. The payments made by WSSC to the developers in 2005 and 2006 represented those differences. Therefore, to avoid further misinterpretation, we request that the WSSC “payments” identified on pages 4 and 5 be removed. Your Exhibit 1 correctly identifies the WSSC SDC credits and payments, and should be sufficient for the reader to properly understand the SDC activity between WSSC and the developers.

I would like to thank you for the extension of time for us to review and comment on the draft report and look forward to seeing our concerns addressed in the final report.

Sincerely,

[Signature]

Jerry N. Johnson
General Manager/CEO

cc: Maxene Bardwell, WSSC Internal Auditor