MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

PRELIMINARY

September 28, 1993

To: Board of Directors (Special Committee on Financial Policy--Information) (Finance and Insurance Committee--Information) (Water Problems Committee--Information)

From: General Manager

Subject: Financial Structure Study Alternatives

The goal of the Financial Structure Study is to develop recommendations for changes or modifications to Metropolitan's water rate structure and additional revenue sources to achieve the Board's broad objectives established in the February 23, 1993 board letter and summarized in Attachment 1. These objectives include issues of growth paying its fair share, enhanced operating flexibility, and water resource management incentives. Staff has been working with the Special Committee on Financial Policy and a Working Team of Member Agency Managers and/or their assistants to refine options for full Board consideration in December 1993 and implementation in fiscal year 1994-95.

A set of eleven revenue alternatives has been developed for consideration by the Special Committee and the Working Team. Attachment 2 describes the revenue methods and Table 1 lists the revenues generated by each alternative. These alternatives assume that Metropolitan continues with the current basic and seasonal storage rate structure. The seasonal storage rate structure will be further analyzed after completion of the Financial Structure Study.

The first alternative represents no change in Metropolitan's methods of collecting the revenue requirements. The other ten methods offer a variety of alternative revenue methods with resulting effects in the base rate and treatment surcharge for fiscal year 1994-95.

The alternatives are permutations of the following six charges:

- Taxes--Maintain the current level or increase to the maximum allowed under the Metropolitan Act.
- Standby Charge--Maintain the standby charge at its present level or eliminate the standby charge and incorporate the foregone revenue into the

Readiness-to-Serve charge. Counsel has indicated that Metropolitan cannot have both a standby charge and a Readiness-to-Serve charge.

- Treated Peaking Charge--Provide a treated water peaking charge to reflect the cost of peaking on Metropolitan's system. These revenues would help offset required increases in the treatment surcharge.

- Connection Maintenance Charge--Implement a charge per connection to cover maintenance costs. This revenue would be used to reduce necessary increases in the water rate.

- Readiness-to-Serve Charge--Implement this charge to substitute for a standby charge and to recover enough revenue to eliminate a water base rate increase.

- Capacity Acquisition (or growth) Charge--Provide a charge to generate revenues to fund the costs associated with the portion of the capital improvement program designed to accommodate new users. This charge is recommended for all alternatives to address the objective of growth paying its fair share. But, the amount generated through such a charge is unknown at this time, since it is dependent on new growth.

It is estimated that a base rate increase of $27 per acre-foot (AF) and a treatment surcharge increase of $10 per AF would be necessary in fiscal year 1994-95, if no new additional revenue alternatives were implemented. If revenue alternatives such as a treated peaking charge, connection maintenance charge, readiness-to-serve charge, and a capacity acquisition charge were in place (Alternative K), then water rate increases would be avoided, although payments to Metropolitan will still be increased by about 8 percent. The specific impacts of these charges on each member agency is currently being determined.

It is envisioned that the Special Committee will narrow these eleven alternatives to about four or five scenarios at their October 5 meeting. A green draft Board letter with the recommended scenarios will be submitted to your Board in November. Chart 1 shows a schedule of the Financial Structure Study Work Plan.

Board Committee Assignments

This letter is referred for information to:

The Special Committee on Financial Policy pursuant to its authority to study and make recommendations with regard to alternative rate structures and revenue sources;

The Finance and Insurance Committee pursuant to its authority to determine revenues to be obtained through sales of water, water standby or availability of service charges, and the levying of taxes; and

The Water Problems Committee pursuant to its authority to study, revise, and make recommendations with regard to the selling prices of water and conditions governing sales and exchanges of water.

Recommendation

For information only.

John R. Wodraska

JMB:vb

Attachment

ATTACHMENT 1

Financial Structure Study Objectives

The following set of objectives were adopted for the Financial Structure Study. These objectives are not listed in order of importance.

- Reliably generate needed revenue requirements. The water rate should generate total revenue requirements less receipts from interest, power recovery, taxes, and other revenue including revenue from parcel charges or service charges.

- Provide revenue stability from year to year. The water rate structure must provide a substantial base amount of assured revenue each year.

- Incorporate in revenue requirement determinations provisions for growth to pay its fair share. The water revenue determinations should recognize the additional costs of growth on Metropolitan's system.

- Maintain Metropolitan's and member agencies' strong financial ratings. The water rate structure should not negatively impact the borrowing capability of Metropolitan and its member agencies.

- Minimize rate shock. The water rate structure and reserves should be set up so that the amount of change in water rates each year follows a relatively even progression.

- Simple to administer, easy to implement. It should take a minimum amount of administration to calculate and bill water deliveries. The transition from the current rate structure to the new rate structure should take a minimum amount of effort.

- Provide equity in rates for classes of service to member public agencies. The water rate structure should provide equal rates for the same class of service to all agencies.

- Provide system operating flexibility. The rate structure should encourage efficient use of the

distribution system so that peaking on Metropolitan is discouraged and the capture of available water is maximized.

- Provide regional water resource management incentives.
  The water rate structure should stimulate member and local agencies to increase the use of regional water resources particularly during droughts.

- Lend itself to a conservation plan if necessary.
  The water rate structure should be easily convertible to a conservation plan and not conflict in any way with that plan.

- Encourage water conservation. Rates should be structured in such a way that they encourage the conservation of water.

ATTACHMENT 2

DEFINITION OF REVENUE ALTERNATIVES

Water Revenue - Base - Amount of money projected to be received from water sales net of treatment surcharge revenue.

Treatment Surcharge Revenue - Amount of money projected to be received from the water treatment surcharge.

Taxes - Amount of money projected to be received from ad valorem property taxes.

Interest - Revenues received from investments.

Standby Charge - Revenues received from a charge placed on an individual parcel of land in Metropolitan's service area, calculated per acre or per parcel, if less than one acre.

Power & Miscellaneous - Revenues received by the generation and sale of hydropower and other sources such as lease income and sales of surplus property.

Treated Peaking - Revenues received from a charge placed on peak week treated flow in the summer (May through September) in excess of annual average week treated flow by agency. Seasonal deliveries are not included in the flows. The

charge is based on the cost of facilities needed to meet the peak.

In equation form:

Summer Peak Week Flow - Annual Average Week Flow = CFS of Peaking

CFS of Peaking * Rate/CFS = Treated Peaking Revenues

Connection Maintenance Charge - Revenues received from a charge placed on a connection to pay for the costs of operating and maintaining that connection, irrespective of the size and use of the connection. In equation form:

$$\frac{\text{Total O\&M Costs to Maintain Connections}}{\text{Number of Connections}} = \text{Charge per Connection}$$

Readiness-to-Serve Charge - Revenues received from a charge placed on historical water usage less seasonal storage service (SSS) deliveries. The revenues generated would be allocated to a portion of the revenue debt service that is needed to provide for the existing user's reliability. The water usage would be calculated by averaging the total water sales by agency less SSS for the four years beginning fiscal year 1989-90. Short-Term

Seasonal Storage would ultimately be included in the water usage. In equation form:

(FY 1989-90 Sales less SSS + FY 1990-91 Sales less SSS + FY 1991-92 Sales less SSS + FY 1992-93 Sales less SSS)/4 = Annual Average Water Deliveries

$$\frac{\text{RTS Revenue Requirements}}{\text{Annual Average Water Deliveries}} = \text{RTS per AF}$$

RTS Per AF * Agency's Annual Average Water Deliveries = Agency's Total RTS Charge

The charge is levied by agency based on the average prior four year water sales.

Capacity Acquisition Charge - Revenues received from a charge placed on water usage above historical water usage. The revenues generated would be used to pay for the growth portion of the CIP. The water usage for the base comparison would be calculated by averaging the total water sales less SSS for the four years beginning fiscal year 1989-90. A rolling historic four year average would be compared to the base amount. Any volume of water from the rolling average that is above the base amount would pay a Capacity Acquisition Charge. Short-Term Seasonal Storage would ultimately be included in the water usage. The amount to be charged for each acre-foot of water used above the highest historic four year average (base amount)

would equal the dollar amount to develop an extra foot of water for household consumption. This amount in equation form:

(FY 1989-90 Sales less SSS + FY 1990-91 Sales less SSS + FY 1991-92 Sales less SSS + FY 1992-93 Sales less SSS)/4 = Annual Average Water Deliveries in AF

((FY 1990-91 Sales less SSS + FY 1991-92 Sales less SSS + FY 1992-93 Sales less SSS + FY 1993-94)/4 - Base Annual Average Water Deliveries) * CAC/AF = CAC Revenues

Once an agency exceeds its highest historic four year average, then that new four year average becomes its base.

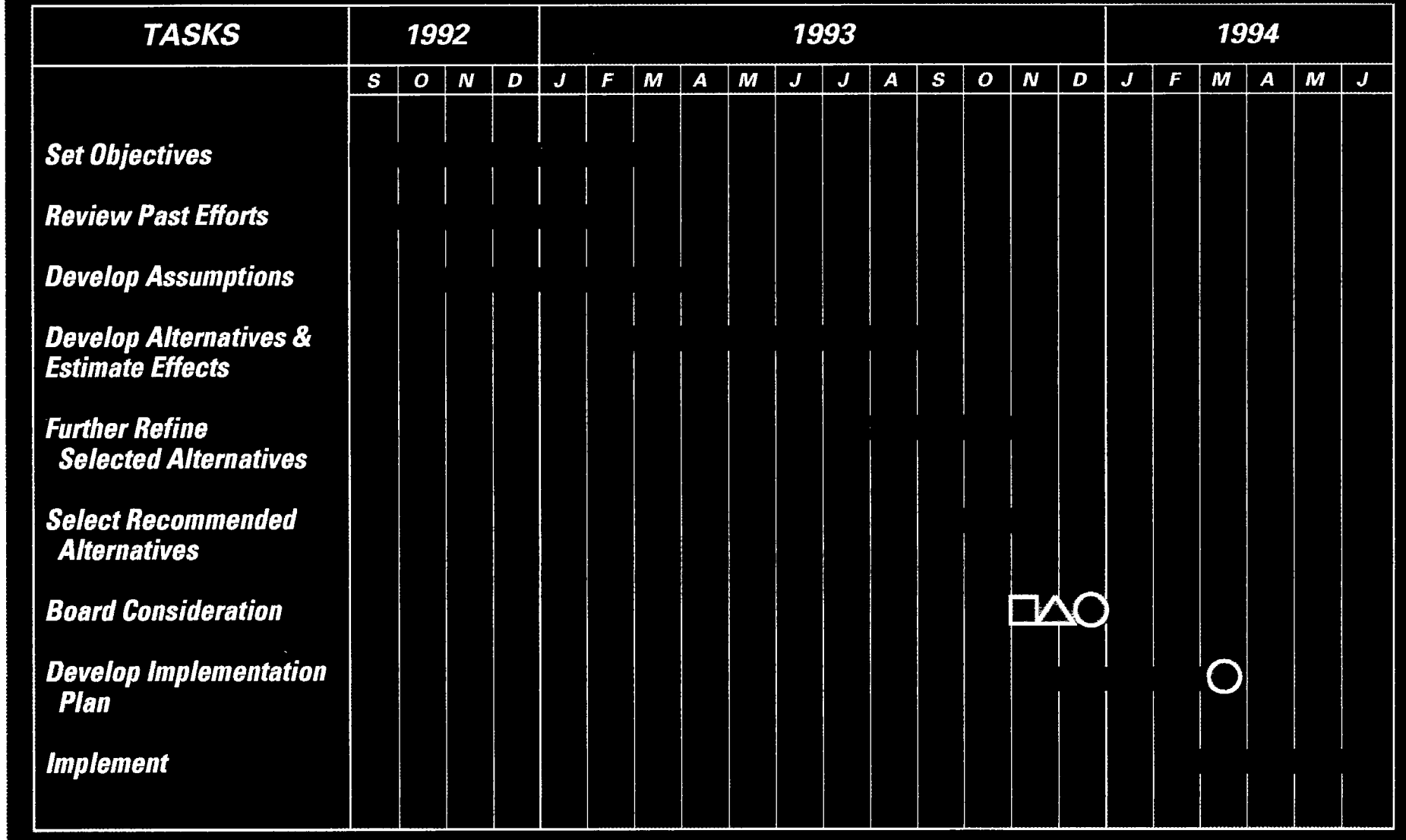
TABLE 1
1994-95 REVENUE ALTERNATIVES
(In $Millions)

	A	B	C	D	E	F	G	H	I	J	K
Water Revenue - Base	631	614	585	625	616	585	677	610	597	601	581
Treatment Surcharge Revenue	84	85	85	75	85	85	75	75	75	85	75
Taxes	91	91	91	91	105	91	105	91	105	105	91
Standby Charge	50	50	-	50	50	-	-	50	50	50	-
Interest	22	22	22	22	22	22	22	22	22	22	22
Power & Misc.	22	22	22	22	22	22	22	22	22	22	22
Treated Peaking Charge	-	-	-	15	-	-	-	15	15	-	15
Connection Maint. Charge	-	15	-	-	-	15	-	15	15	15	15
Readiness-to-Serve Charge *	-	-	94	-	-	79	-	-	-	-	79
Capacity Acquisition Charge **	-	0	0	0	0	0	0	0	0	0	0
Total	900	900	900	900	900	900	900	900	900	900	900
Rate Effects:											
Base Rate Increase	+ $27	+ $18	0	+ $27	+ $19	0	+ $50	+ $18	+ $6	+ $9	0
Treatment Surcharge Increase	+ $10	+ $10	+ $10	0	+ $10	+ $10	+ $10	0	0	+ $10	0

* Allocated on 4-year average water purchases from MWD (excluding seasonal storage). Short-term seasonal storage would ultimately be included.

** Adopted in all alternatives except alternative A. Allocated on 4-year average water purchases from MWD (excluding seasonal storage). Short-term seasonal storage would ultimately be included. Charge would not be collected until FY 1995-96.

CHART 1
FINANCIAL STRUCTURE WORK PLAN



□ SPECIAL COMMITTEE CONSIDERATION ○ BOARD ACTION

△ GREEN DRAFT