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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

7-6

October 27, 1997

To: Board of Directors (Budget and Finance Committee--Action)
(Water Planning and Resources Committee--Action)

From: *For* General Manager

Submitted by: Robert J. Gomperz, Acting Director
of Public Affairs and Conservation

Subject: Advances to Member Agencies to Operate Conservation Programs

Robert J. Gomperz

RECOMMENDATION(S)

It is recommended that:

- Your Board approve a policy which allows funds to be advanced to Metropolitan's member agencies to assist in establishing and running Conservation programs.
- The General Manager be authorized to provide up to 25 percent (to an agreement maximum of \$250,000 and for a maximum period of one year) of the proposed total value of Metropolitan funding upon execution of an agreement with a member agency, with ongoing recovery of the advanced funds through the term of the agreement.
- That funds advanced for Conservation programs be subject to interest at a rate equal to Metropolitan's yield on O&M funds.

EXECUTIVE SUMMARY

Metropolitan's staff has been participating with its member agencies' Conservation staffs to produce a wide variety of Conservation programs since your Board initially authorized the Conservation Credits Program in 1988 (Board Letter 8-1 dated August 8, 1988). Occasionally, a participating member agency may ask for advance funding for a portion of the expected Metropolitan share of total cost of a Conservation project in order to have the funds available to start up the project and/or to meet the increased cash flow requirements of larger programs.

The purpose of this letter is to clarify your Board's intention regarding the practice of advancing funds to member agencies to assist them in the performance of Conservation programs.

DETAILED REPORT

Format

Please note that this letter is a revision of last month's letter regarding advance funding. The revisions address issues raised at last month's meeting of your Board's Budget and Finance Committee. Subsequent to that meeting, staff from Metropolitan and your member agencies worked together to refine the advance funding policy. In this letter, a strike-through represents a deletion and underlining represents an addition when compared to last month's letter.

Background on the Conservation Credits Program

When your Board approved the Conservation Credits Program (CCP) in 1988 (Board letter 8-1 dated August 8, 1988), Metropolitan's staff began working with its member agencies' Conservation coordinators to develop water efficiency programs that would provide a broad range of Conservation opportunities. Programs have been developed to appeal to residential customers, large turf irrigators, and business and industrial customers. Many of the programs have involved replacement of inefficient equipment, fixtures and sanitary facilities at low or no cost to the customer. By offering financial incentives to customers, the installation of water efficient devices has resulted where there would have not otherwise been a retrofit.

Drought-Period Advances

In the early 90s, when Southern California was in the middle of a severe drought, Metropolitan used "up front" financing (by means of a Conservation Credit on the member agencies' water bills) of as much as 100 percent of the project costs in order to assist the fledgling Conservation movement in Southern California. This was done on an as-needed basis, as some member agencies did not have operating revenue necessary for their Conservation programs and would have been unable to participate in the CCP. As of last year, staff believed that Conservation programs had reached a level of maturity where it was no longer necessary to issue advance funding and all new CCP agreements allowed for payment of Conservation Credits only upon verification of completed retrofits.

1997 Conservation Summit

At the Conservation Summit held in August, some member agencies requested that Metropolitan again provide advance funding, because these agencies still require advance funds to fuel startup and continuing operating needs of their programs. Providing advances will allow member agencies to participate in water conservation projects that will help them achieve their Integrated Resources Plan (IRP) goals. In fiscal 1995-96, the amount of water saved through active water conservation programs was estimated to be 37,000 acre-feet per year, and by the year 2010 IRP targets for conservation are 343,000 acre-feet per year. Metropolitan's CCP is designed to help the member agencies achieve these very important regional goals. Through advances, member agencies will be better able to undertake large projects that they otherwise may not have implemented due to local fiscal constraints.

Proposed Advance and Recovery Policy

~~Providing advances to the member agencies will cost Metropolitan lost interest on the amount advanced. However, the potential cost of lost interest earnings is small. If Metropolitan provides \$500,000 in advances in any one fiscal year, and the participating member agencies pay back the advanced amount throughout the fiscal year, it is estimated that the interest earnings losses will be less than \$20,000 per year.~~

Typically, Metropolitan is being asked to advance a Conservation credit of up to 25 percent of Metropolitan's expected contribution to the member agencies' Conservation program upon the execution of an agreement between the member agency and Metropolitan. The advance is provided by means of a Conservation Credit on the participating member agencies' water service billing. After the participating member agency commences the program operations, it will submit quarterly invoices to Metropolitan for Conservation work completed up to that point. Metropolitan will then pay the member agency through a Conservation Credit in the agency's next water bill, based on the terms of the agreement. Metropolitan will recover the amount of its 25 percent advance by deducting 25 percent from each participating member agency's invoice paying \$.75 on every \$1.00 that it is invoiced until the amount of the advance is returned.

Interest on the advanced funds would be computed at the average interest rate earned by Metropolitan on O&M funds (in the last fiscal year, this rate was approximately 5.9 percent). The rate would be charged against the average of advanced funds expected to be outstanding during the one-year term of the advance.

At the conclusion of the program there will be a reconciliation of all costs and invoices according to the terms of the agreement. All money paid by Metropolitan as advances, ongoing payments for Conservation retrofits, or money to be returned to Metropolitan is accomplished through credits or debits on the participating agencies water service billing.

Policy Implementation Guidelines and Limitations

Based on the suggestions and concerns from your Board requiring that the process be simple to administer, available to all member agencies, and financially equitable, staff recommends the following policy guidelines and limitations be applied to all agreements:

- Advances shall be for a maximum period of one year. Funds remaining unrecovered after the one-year period shall be debited by Metropolitan on the member agency's next regular water billing.
- No more than 25 percent of Metropolitan's contribution during that year, as defined in a CCP agreement between Metropolitan and a member agency, may be advanced to the member agency.
- The maximum amount that may be advanced on any single CCP agreement is \$250,000.

- To compensate for interest foregone by Metropolitan, each advance shall be subject to interest at a rate equal to Metropolitan's average yield on O&M funds for the fiscal year immediately preceding the effective date of the CCP agreement. Interest shall be computed on the average outstanding balance over the term of the advance; interest shall be collected at the end of the term of the advance.

Based on experience with recent CCP projects, it appears that funds outstanding as a result of advances during any 12-month period will not exceed \$500,000. In such an instance, the interest cost borne by the participating member agencies would be less than \$15,000, since agencies would generally pay back their advances in less than the year maximum. In the unlikely event that all member agencies participating in Metropolitan's CCP requested advances, then as much as \$2.4 million could be outstanding at the beginning of the fiscal year (based upon a gross budget amount of \$9.6 million). Interest on the outstanding balance of these advanced funds during the year would be less than \$70,000.

In reviewing the several Conservation-related letters that have been submitted to your Board since the inception of the CCP, there has never been a specific discussion about the policy of advances. It is the General Counsel's opinion and the staff's recommendation that this practice be specifically authorized by your Board.

RJW:adb
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