

• Budget and Finance Committee

November 13, 2000 Committee Meeting

9a**Subject**

Determination of Water Revenue Requirements for Fiscal Year 2001-02

Description

The first step in Metropolitan's rate setting process is the determination of the annual cost to be paid from water rates (revenue requirements). The revenue requirement will be used to determine the water rates to be effective on January 1, 2002.

Estimates of the total revenues required to fund expenditures not funded from debt proceeds and taxes have been prepared for Fiscal Year 2001-02. The estimates are based on current information and will be updated as part of the annual budget process. The determination of revenue requirements is necessary to set water rates in a timely fashion. Total revenues required to meet Metropolitan's estimated expenditures in 2001-02 are estimated to be \$928.6 million. Of that amount, \$671.0 million will be required from the sale of water.

The revenue estimates are based on the current rate structure, and do not reflect changes that may result from the Board's discussion and consideration of the Strategic Plan. As such, a five-year forecast of revenues and expenditures has not been included in this pending letter. Instead, projected results for the current fiscal year and Fiscal Year 2001-02 are shown in [Attachment 1](#) and [Attachment 2](#).

The total amount of revenue to be recovered from water rates and charges, taxes and other income (interest and miscellaneous), are shown in [Attachment 1](#). The water rates and charges leading to the revenue estimate for Fiscal Year 2001-02 are shown in [Attachment 2](#). For purposes of this analysis, it is assumed that basic untreated water rates would remain unchanged for the fifth consecutive year. In addition, the Readiness-to-Serve Charge is assumed to remain at its current level of \$80 million.

MAJOR ASSUMPTIONS

Water sales are projected to be 2.21 million acre-feet (MAF) in 2000-01, and 2.13 MAF in 2001-02.

Variations in water sales will greatly impact reserve levels and changes in rates and charges. If water sales are less than anticipated, then reserve levels will decrease below expected levels. Higher sales will lead to an increase in reserve levels. For 2001-02, sales are estimated to be 2.13 MAF. However, based on weather conditions, actual sales could range from a low of about 1.66 MAF to a high of about 2.56 MAF. The major assumptions on which the expenditure and revenue requirements for Fiscal Year 2001-02 are based include:

Water Sales	2.13 MAF
Water to Storage, Exchanges, and Losses	0.40 MAF
Colorado River Supplies	1.29 MAF
State Water Project Supplies	1.24 MAF

from the cash defeasance each year through 2006 are projected to be used to defease additional debt. For Fiscal Year 2001-02, revenue bond debt service payments are projected to be reduced by approximately \$19.9 million due to the cash defeasance. The \$19.9 million reduction in debt service payments represents approximately \$9 per acre-foot on Metropolitan's water rate.

Estimates to finance the Capital Investment Program (CIP) for 2001-02 also include \$78.4 million of Pay-As-You-Go (PAYG) expenditures, which is an increase of \$3.4 million of PAYG expenditures from the current fiscal year. Projected PAYG expenditures for 2001-02 are consistent with the PAYG policy approved by the Board through the adoption of the 1999 update to the Long Range Finance Plan. Total 2001-02 capital investment program expenditures for Metropolitan's CIP (which include payments from debt proceeds held in construction funds and payments from the PAYG Fund) are estimated to be \$326.8 million.

Metropolitan O&M and Operating Equipment

\$214.2 million

Projected Operation and Maintenance (O&M) and operating equipment expenditures of \$214.2 million are projected to be approximately \$3.2 million greater than estimates for the current fiscal year. The increase in the O&M estimate for 2001-02 is the result of a \$5.0 million estimate for dry year transfer and storage costs. A detailed breakdown of projected O&M expenditures will be provided during the development of the 2001-02 Annual Budget.

Adjustments in Reserves

(\$24.9) million

During Fiscal Year 2001-02, a decrease in required reserve balances of \$24.9 million has been calculated in accordance with revenue bond covenants and Board policies contained in Metropolitan's Administrative Code. Of the \$24.9 million decrease in reserves, \$12.4 million is due to a decrease in the minimum reserve requirement balance (funds to be transferred from the Revenue Remainder Fund to the Water Rate Stabilization Fund) calculated in accordance with reserve policies outlined in Metropolitan's Administrative Code. The decrease in the minimum reserve requirement is mainly attributable to a decrease in projected fixed obligations to be recovered by water sales after 2002. In addition, there is an \$8.0 million projected reduction in the PAYG Fund at June 30, 2002.

Sufficient funds need to be on hand (on July 1) to make interest and principal payments for outstanding and projected debt obligations due July 1, 2002, and to meet revenue bond covenant requirements for debt payments after July 2002. Other fund requirements for July 1, 2002 include the State Water Contract Fund and the Operations and Maintenance Fund.

PROJECTED REVENUES FOR FISCAL YEAR 2001-02

Total = \$1.056 billion

Total revenues for Fiscal Year 2001-02 are projected to be \$1.056 billion. Revenue from ad valorem property taxes, levied at the reduced tax rate of .0088 percent of assessed valuations and from annexation charges are estimated to be \$102.9 million. Power recoveries, interest on investments, and miscellaneous revenues are projected to produce \$70.2 million during Fiscal Year 2001-02.

Revenues from the Readiness-to-Serve Charge are projected to be \$80.0 million, which is at the same level as the current fiscal year. In addition, approximately \$2.8 million will be collected from the Connection Maintenance Charge.

Based on the projected expenditure estimates described above, total revenues required in 2001-02 are projected to be \$928.6 million. After accounting for the revenues projected from all other sources, required revenues from water sales are projected to be \$671.0 million. Water revenues are projected to be \$798.8 million; therefore, water revenues are projected to exceed water revenue requirements by \$127.8 million. This assumes no increases in basic water rates during Fiscal Year 2001-02. [Attachment 2](#) details projected rates and charges under the current rate structure through January 1, 2002.

It should be noted that regardless of the outcome of the rate structure negotiations currently underway, rates and charges to be in effect January 1, 2002 will need to be sufficient to generate revenues required to be funded from water sales as outlined in this letter.

MINIMUM/MAXIMUM RESERVE POLICY

On June 30, 2001, reserve balances are projected to be greater than the projected maximum reserve level established and approved by the Board during the adoption of the 1999 update to the Long Range Finance Plan (LRFP). The estimated revenue requirement and revenue levels for Fiscal Year 2001-02 do not include the use of these reserve balances (which could be as much as \$200 million).

In accordance with Board policy described in Section 5202(e) of Metropolitan's Administrative Code, at the end of each fiscal year if Metropolitan's fixed charge coverage ratio is at or above 1.2, the amount in the Water Rate Stabilization Fund in excess of the maximum reserve level may be used for any lawful purpose as determined by the Board. It is anticipated that fixed charge coverage for Fiscal Year 2000-01 will be greater than 1.2. Therefore, the Board may use anticipated funds in excess of the maximum reserve level for any lawful purpose. The following options for use of any funds in excess of the maximum reserve level are provided as information:

- Provide funding for water supply programs, including the California 4.4 Plan
- Cash defease Metropolitan debt
- Increase the use of PAYG construction funding
- Implement a member agency credit/refund program
- Establish a replacement fund
- Reduce the water rate

Projections of reserve funds as shown on [Attachment 1](#) assume that reserves above the maximum level at the end of each fiscal year remain in the Water Rate Stabilization Fund pending direction from the Board.

Policy

As per Section 4304(a) of Metropolitan's Administrative Code, the General Manager presents his recommendation of the total revenues required to fund all expenditures not financed by debt proceeds and the revenues to be derived from water sales, for the following fiscal year, to the Budget and Finance Committee. The Budget and Finance Committee makes a determination of revenue requirements for the following fiscal year at its December meeting and uses that determination for consideration of water rates and charges at its January meeting, with final action in March.

Staff Recommendation/Fiscal Impacts

Make a determination that revenues required from water sales during Fiscal Year 2001-02 should not be less than \$671.0 million; and use this determination for consideration at the January 2001 meeting of the Budget and Finance Committee in establishing water rates and charges to be effective January 1, 2002.

Fiscal Impact: Revenues from water sales of \$671.0 million will be sufficient to recover estimated expenditures in Fiscal Year 2001-02.


 Brian G. Thomas
 Chief Financial Officer

10/30/2000
 Date


 Ronald R. Jester
 General Manager

10/30/2000
 Date

[Attachment 1](#)
[Attachment 2](#)

ATTACHMENT 1

PROJECTED 2001-2002 WATER REVENUE REQUIREMENTS

(Cash Basis: \$ in thousands)

	<u>2000-01</u>	<u>2001-02</u>
Expenditures		
State Water Contract	\$ 294,618	\$ 292,988
Colorado River Aqueduct	63,294	100,593
Deposit to Transfer Fund	-	-
Withdrawal from Transfer Fund for ESRP Fill	(29,327)	(18,319)
Water Management Programs	33,621	38,042
Capital Program Financing	394,170	325,975
O&M and Operating Equipment	<u>210,945</u>	<u>214,193</u>
Sub-Total Costs	\$ 967,322	\$ 953,473
Adjustments		
Increase/(Decrease) in Required Reserves	<u>(5,616)</u>	<u>(24,911)</u>
Total Obligations	\$ 961,706	\$ 928,561
Less Other Revenues		
Property Taxes	\$ (103,189)	\$ (102,884)
Interest Income	(47,447)	(54,205)
Power and Miscellaneous Revenue	(15,700)	(16,014)
Contracts	-	(1,595)
Readiness to Serve Charge	(80,000)	(80,000)
Connection Maintenance Charge	<u>(2,849)</u>	<u>(2,849)</u>
Sub-Total Other Revenues	\$ (249,185)	\$ (257,547)
Total Water Revenue Requirement	\$ 712,522	\$ 671,014
Water Sales Revenue	\$ 843,536	\$ 798,789
Increase (Decrease) in Reserve Balances	\$ 131,014	\$ 127,775
Water Sales (Cash Year TAF)		
Basic Treated	1,161	1,158
Basic Untreated	546	537
Seasonal Treated	84	75
Seasonal Untreated	298	254
Agricultural Treated	104	90
Agricultural Untreated	<u>18</u>	<u>12</u>
Total	2,212	2,126

ATTACHMENT 2
PROJECTED RATES AND CHARGES (Effective January 1)
 (Cash Basis: \$ in thousands)

	<u>2001</u>	<u>2002</u>
Readiness to Serve Charge	\$ 80,000	\$ 80,000
Connection Maintenance Charge	\$ 2,849	\$ 2,849
 <u>WATER RATES (\$/AF)</u>		
Basic Treated	\$431	\$431
Basic Untreated	\$349	\$349
Seasonal Long-Term Treated	\$290	\$290
Seasonal Shift Treated	\$334	\$346
Seasonal Long-Term Untreated	\$233	\$233
Seasonal Shift Untreated	\$277	\$289
Agricultural Treated	\$294	\$294
Agricultural Untreated	\$236	\$236

Note:

Rates are based on current cost projections and projections of increasing water sales.