

• Budget and Finance CommitteeDecember 11, 2000 Committee Meeting

9b**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 that are 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. Total revenue required to meet Metropolitan's projected expenditures in 2001-02 is estimated to be \$928.8 million. Of that amount, \$683.3 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 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 revenues needed 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 total revenue estimate for Fiscal Year 2001-02 are shown in [Attachment 2](#). For purposes of this analysis, it is assumed that the 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

PROJECTED COSTS FOR FISCAL YEAR 2001-02**Total = \$928.8 million****State Water Project****\$293.0 million**

Total costs for 2001-02 under the State Water Project (SWP) are estimated to be approximately \$293.0 million (net of projected credits and based on projected water deliveries of about 1.24 MAF). The cost projections for 2001-02 are at approximately the same levels as projections for SWP costs for the current fiscal year. Projections include power costs for the delivery of about 212,000 acre-feet into Diamond Valley Lake (DVL). However, these power costs for delivery of water into DVL will continue to be paid from the Water Transfer Fund and will not impact the water revenue requirement for Fiscal Year 2001-02.

The deregulation of the electrical power industry creates additional uncertainty about the cost of imported SWP water. Current estimates are the best available at this time and the situation continues to be monitored closely.

Colorado River Supplies**\$100.6 million**

Colorado River Aqueduct deliveries to the member agencies are expected to total 1.29 MAF. Power costs for pumping are estimated to be \$50.0 million. The estimates also include \$50.6 million for CRA programs to secure additional water supplies. This includes \$5.6 million for the existing conservation agreement between Metropolitan and Imperial Irrigation District (IID), and \$45.0 million for additional groundwater conjunctive-use projects.

Withdrawal from the Water Transfer Fund for DVL Fill Costs**(\$18.3) million**

The Water Transfer Fund was created to provide funds for the purchase of water transfers and to accrue funds to pay for power charges associated with the initial fill of Diamond Valley Lake. There will be no deposits to the Water Transfer Fund during Fiscal Year 2001-02. It is estimated that \$18.3 million will be expended during 2001-02 to fund power charges for filling DVL. The total cost of filling DVL, which will be paid from the Water Transfer Fund, is estimated to be between \$40 million and \$70 million. Depending on hydrologic conditions, current projections indicate that the initial fill will be completed by December 2001. The Water Transfer Fund is currently scheduled to sunset in 2004.

Water Management Programs**\$38.0 million**

Funding in 2001-02 for water management programs is expected to total \$38.0 million. The estimate is based on sustained efforts in Metropolitan's conservation credits program and higher yields from local water recycling projects and groundwater recovery projects. Projected expenditures reflect Metropolitan's ongoing commitment to water conservation, local recycling projects, and groundwater cleanup. These estimates are consistent with efforts to develop local water supplies in cooperation with the member agencies and other local agencies based on the Integrated Resources Plan.

Metropolitan Capital Financing Program**\$326.0 million**

Costs include \$176.4 million of revenue bond debt service, and \$51.3 million of general obligation bond debt service. Projected revenue bond debt service payments include interest payments for the \$355.2 million variable rate water revenue bond issue that was priced on September 19, 2000, the proceeds of which were used to refund Metropolitan's then-outstanding \$350 million of commercial paper notes. Estimates also include projected interest payments for a \$200 million variable rate water revenue bond issue anticipated to be sold in late spring or early summer of 2001 to continue funding the capital investment program. In May 2000, the Board also authorized a revenue bond tender program of up to \$500 million, but due to current market conditions the impact of a potential tender financing is not reflected in projected debt service requirements.

In August 2000, Metropolitan used funds available from reserves to cash defease approximately \$84.4 million of certain outstanding water revenue bonds. Projected costs for revenue bond debt service include the impact of the cash defeasance. In addition, at the direction of the Board, reserves available due to reductions in debt service payments

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 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

(\$24.7) million

During Fiscal Year 2001-02, a decrease in required reserve balances of \$24.7 million has been calculated in accordance with revenue bond covenants and Board policies contained in Metropolitan's Administrative Code. Of the \$24.7 million decrease in reserves, \$12.2 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 = \$1.044 billion

Total revenues for Fiscal Year 2001-02 are projected to be \$1.044 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 \$59.8 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 \$928.8 million. After accounting for the revenues projected from all other sources, required revenues from water sales are projected to be \$683.3 million. Water revenues are projected to be \$798.8 million; therefore, water revenues are projected to exceed water revenue requirements by \$115.5 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 under way, 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 estimated maximum reserve level established and approved by the Board during the adoption of the 1999 update to the Long Range Finance Plan (LRFP). As described in the Proposed Rate Structure Action Plan dated November 14, 2000, and distributed at the recent Board Workshop, these funds will be reserved in accounts for each member agency to use for purposes of mitigating impacts of the change in the rate structure, to fund local capital projects in each member agency's service area, or to be credited against the member agency's water bill. The allocation of funds for each member agency will be based on the member agency's relative share of basic water sales, less any treatment surcharge revenues, during the relevant fiscal year.

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 \$683.3 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 \$683.3 million will be sufficient to recover estimated expenditures in Fiscal Year 2001-02.



Brian G. Thomas
Chief Financial Officer

11/16/2000
Date



Ronald R. Jester
General Manager

11/18/2000
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>(2,433)</u>	<u>(24,682)</u>
Total Obligations	\$ 964,888	\$ 928,791
Less Other Revenues		
Property Taxes	\$ (103,189)	\$ (102,884)
Interest Income	(47,546)	(42,181)
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	\$ (249,283)	\$ (245,523)
Total Water Revenue Requirement	\$ 715,605	\$ 683,268
Water Sales Revenue	\$ 843,536	\$ 798,789
Increase (Decrease) in Receipts	\$ 127,931	\$ 115,521
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.