- **Board of Directors**
  Audit, Budget and Finance Committee

October 16, 2001 Board Meeting

9-1

Subject

Approve use of funds in the Water Rate Stabilization Fund

Description

The principal purpose of the Water Rate Stabilization Fund (WRSF) is to help maintain stable and predictable rates by serving as a buffer against fluctuations in water sales. Under existing policy, amounts in the WRSF are targeted to be equal to the portion of fixed costs (approximately 18 percent) that are covered through the last increment of water sales that may not be realized due to weather. For FY 2000/01, the target level was $285.9 million. As of June 30, 2001, Metropolitan had $83.5 million more than the target in the WRSF. If the fixed charge ratio is less than 1.2 times, the monies in the WRSF are to be "… utilized for capital expenditures in lieu of the issuance of additional debt, or for the redemption, defeasance or purchase of outstanding bonds or commercial paper as determined by the Board". The fixed charge coverage ratio for FY 2000/01 was 1.39 times. Therefore, the Board may utilize the available funds for any lawful purpose. On two occasions, Metropolitan faced a similar situation. In 1996, the Board authorized a refund program that provided each member agency the option of a cash refund or a credit to their water bill. In 2000, outstanding debt was defeased with the associated debt service savings used to further reduce debt in the future.

Four options for use of the funds are presented for Board consideration.

Option 1. Fund a Member Agency Transition Account. In December 2000, the Board approved the rate structure action plan, which included establishing "transition funds" as follows:

> Metropolitan will reserve funds in excess of the maximum reserve level available at the end of FY 2000/01 and 2001/02 in accounts for each member agency to use for purposes of mitigating impacts of the change in rate structure, to fund local capital projects in each member agency's service area or to be credits 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.

The FY 2001/02 annual budget adopted by the Board on June 12, 2001 authorized the establishment of a Member Agency Transition Account and authorized that funds over the maximum reserve level at June 30, 2001 be deposited into this account. The allocation of funds for each member agency would be based on the member agency's relative share of basic water sales, less any treatment surcharge revenues during FY 2000/01. The budget also recognized that the Board would have to approve any transfer of funds into these accounts.

Option 2. Provide a credit on each member agency's water bill. As with the Member Agency Transition Account, the allocation would be based on the member agency's relative share of basic water sales, less any treatment surcharge revenues during FY 2000/01.

Option 3. Reduce and defer issuance of additional debt by using this money for funding the Capital Investment Plan (CIP). Any funds remaining at year-end would continue to be designated for the CIP. This option would lower water rates in the future for the benefit of all member agencies. The current financial forecast indicates that a $15 per acre-foot water rate increase will be needed in 2005, 2006 and 2007 to cover projected increases in expenditures. These rate increases are needed to fund the projected five-year $1.5 billion CIP and water storage/transfer program costs. If the $83.5 million were used to fund capital expenditures, the rate increase could be deferred for about one year. Under this scenario, there would be a need for a $20 per acre-foot water rate increase in 2006 and 2007. **Attachment 1** shows the projected untreated full service water rates under both scenarios.

Option 4. Utilize the funds to help achieve long-term reliability and water quality goals by matching the $45 million received under Proposition 13 for the Groundwater Conjunctive Use Program, funding $5 million for security measures to protect Metropolitan facilities and operations, and using $8 million to fund conservation and water efficiency programs. The remaining $25.5 million would be returned as credits on the member agencies' water bills in December.

This topic was discussed in detail at the September 6, 2001 meeting of the Subcommittee on Investments and Bond Financing. It was noted that since Metropolitan will be a net user of capital for the foreseeable future, using this money to fund CIP projects is the most fiscally responsible option. Accordingly, the Subcommittee on Investments and Bond Financing unanimously approved Option 3.

Policy

Metropolitan Water District Administrative Code § 5202(e).

> Amounts in the Water Rate Stabilization Fund shall be held for the principal purpose of maintaining stable and predictable water rates and charges. The amount to be held in the Water Rate Stabilization fund shall be targeted to be equal to the portion of the fixed costs of the District estimated to be recovered by water sales revenues during the two years immediately following the eighteen-month period referenced in Section 5202(a). Funds in excess of such targeted amount shall be utilized for capital expenditures of the District in lieu of the issuance of additional debt, or for the redemption, defeasance or purchase of outstanding bonds or commercial paper of the District as determined by the Board. Provided that the District's fixed charge coverage ratio is at or above 1.2 amounts in the Water Rate Stabilization Fund may be expended for any lawful purpose of the District, as determined by the Board of Directors.

CEQA

The proposed action is not defined as a project under the California Environmental Quality Act (CEQA) because it involves the creation of government funding mechanisms or other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378 (b)(4) of the State CEQA Guidelines). In addition, where it can be seen with certainty that there is no possibility that the proposed action in question may have a significant effect on the environment, the proposed action is not subject to CEQA (Section 15061(b)(3) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not subject to the provisions of CEQA per Sections 15378(b)(4) and 15061(b)(3) of the State CEQA Guidelines.

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and authorize that $83.5 million be deposited into the Member Agency Transition Account. 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 FY 2000/01.
Fiscal Impact: $83.5 million

Option #2

Adopt the CEQA determination and authorize that $83.5 million be credited against member agency water bills. 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 FY 2000/01.
Fiscal Impact: $83.5 million

Option #3

Adopt the CEQA determination and authorize that $83.5 million be designated to fund Capital Investment Plan expenditures in lieu of the issuance of additional debt.

Fiscal Impact: Reduces the need for additional debt by $87.7 million

Option #4

Adopt the CEQA determination and authorize that $58 million be designated to help achieve long-term reliability, security, and water quality goals and $25.5 million be credited on the member agencies' water bills.

Fiscal Impact: $83.5 million

Staff Recommendation

Staff concurs that the Subcommittee's recommendation to use these available funds to defer and reduce debt is a fiscally responsible use of the Water Rate Stabilization Funds. In addition, the use of these funds to encourage and finance conjunctive use, conservation and one-time security measures is consistent with Metropolitan's mission and role as regional provider. Therefore, staff recommends the Board approve either Option #3 or Option #4.

Brian G. Thomas 9/24/2001

Brian G. Thomas *Date*
Chief Financial Officer

Ronald R. Gastelum 9/27/2001

Ronald R. Gastelum *Date*
Chief Executive Officer

Attachment 1 – Untreated Full Service Water Rate

BLA #1262

Untreated Full Service Water Rate