

● **Audit, Budget and Finance Committee**

December 10, 2001 Committee Meeting

9a

Subject

Determination of water revenue requirements for fiscal year 2002/03

Description

The first step in Metropolitan’s rate setting process is to determine the annual cost to be paid from water rates and charges (revenue requirements). The revenue requirements will be used to determine water rates and charges to be effective on January 1, 2003.

Estimates of the total revenues required to fund expenditures not funded from debt proceeds and taxes have been prepared for FY 2002/03. The estimates are based on current information and will be updated as part of the annual budget process. Total revenues required to meet Metropolitan’s estimated obligations in FY 2002/03 are estimated to be \$1.07 billion, approximately \$46.2 million less than in FY 2001/02. Of this amount, \$213.4 million will be generated from property taxes, interest income and other revenues, including the use of water rate stabilization funds to reduce the amount of debt that will be issued to fund the capital improvement program. Therefore, rates and charges will need to generate about \$859.2 million.

A forecast of revenue requirements is provided in [Attachment 1](#).

MAJOR ASSUMPTIONS

Water sales are projected to be 2.07 million acre-feet (maf) in FY 2001/02 and 2.01 maf in FY 2002/03.

Variations in water sales will greatly impact reserve levels and changes in rates and charges. If water sales are less than anticipated, reserve levels will decrease below expected levels. Higher sales will lead to an increase in reserve levels. For FY 2002/03, sales are estimated to be 2.01 maf. However, based on weather conditions, actual sales could range from a low of about 1.6 maf to a high of about 2.4 maf. The major assumptions on which the expenditure and revenue requirements for FY 2002/03 are based include:

Water Sales	2.01 maf
Water to Storage, Exchanges, and Losses	0.21 maf
Colorado River Supplies	1.25 maf
State Water Project Supplies	0.97 maf

PROJECTED COSTS FOR FY 2002/03

Total = \$1.07 billion

State Water Project

\$342.1 million

Total costs for FY 2002/03 under the State Water Project (SWP) are estimated to be approximately \$342.1 million (net of projected credits and based on projected water deliveries of about 0.97 maf). The unstable situation in California's power market has adversely impacted SWP power costs. Metropolitan's payments for variable power costs on the SWP have increased from about \$43.6 million in FY 2000/01 to about \$108.3 million for FY 2001/02. The FY 2002/03 revenue requirements estimate includes an estimate of about \$59.6 million for SWP variable power costs. This estimate assumes that the net cost of variable power on the SWP is \$25 per megawatt-hour. Metropolitan is working with the Department of Water Resources (DWR) to ensure that there is sufficient cash available to maintain SWP power operations without causing an undue burden on the State Water Contractors and Metropolitan. Power costs billed to Metropolitan by DWR that are in excess of actual costs will be returned in later years.

Colorado River Power Costs**\$58.8 million**

Colorado River Aqueduct (CRA) diversions are expected to total about 1.25 maf in FY 2002/03. Power costs for pumping are estimated to be about \$58.8 million compared to about \$100 million in FY 2001/02. This estimate includes an average cost for wholesale market power purchases of \$49 per megawatt-hour. Metropolitan is continuing to identify and evaluate options for reducing the cost of wholesale market purchases and reducing the volatility of these costs. Immediate actions that will be brought before the Board for consideration include entering into economical forward contracts and/or purchasing price caps.

Water Transfer Fund**\$34.3 million**

The Water Transfer Fund was created to finance the purchase of water transfers and to accrue funds to pay for power charges associated with the initial fill of Diamond Valley Lake (DVL). The net impact of the Water Transfer Fund on the revenue requirement is expected to be \$34.3 million. This includes a \$45 million deposit from operating revenue. About \$10.7 million will be withdrawn from the Water Transfer Fund to offset power costs for the initial fill of DVL included in the SWP and CRA costs. Additional withdrawals from the Water Transfer Fund include a total expenditure for CRA Programs of \$53.7 million. This amount will fund anticipated expenses for Colorado River Programs such as the Metropolitan - Imperial Irrigation District (IID) Conservation Agreement; the Palo Verde Irrigation District Land Management, Crop Rotation and Water Supply Program; the Arizona Groundwater Bank; the Cadiz Groundwater Storage and Dry-Year Supply Program; and the Hayfield Conjunctive Use Program. In addition, about \$24.3 million will be withdrawn from the Water Transfer Fund for transfers, storage and exchange programs, including Semitropic Water Storage Program, Arvin-Edison Water Storage Program, the San Bernardino Valley Municipal Water District Water Transfer Program and an anticipated Kern/Delta storage program. At the end of FY 2002/03 the Water Transfer fund is expected to have a balance of about \$3.0 million.

Water Management Programs**\$41.1 million**

Water management program expenses are expected to total \$41.1 million in FY 2002/03, about \$7.5 million more than in FY 2001/02. 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. Recycling and groundwater recovery projects supported by Metropolitan's water management programs are expected to increase production by about 33,000 acre-feet over current year estimates. 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 public agencies and other local agencies based on the Integrated Resources Plan (IRP).

Metropolitan Water District Capital Financing Program**\$384.4 million**

Costs include \$179.9 million of revenue bond debt service and \$50.7 million of general obligation bond debt service. Estimates also include projected interest payments for a \$200 million variable rate water revenue bond issue anticipated to be sold in November of 2001 to continue funding the capital investment program. Revenue bond debt service costs will increase about \$11 million over the current fiscal year.

The capital financing program costs include \$85.0 million of Pay-As-You-Go (PAYG) expenditures funded from current operating revenues, the same amount budgeted for the current fiscal year. In addition, consistent with recent board action on the use of water rate stabilization funds, an additional \$50 million will be utilized to defer the issuance of additional debt. Projected PAYG expenditures for FY 2002/03 are consistent with the PAYG policy approved by the Board through the adoption of the 1999 update to the Long Range Finance Plan. Total FY 2002/03 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 \$361.5 million.

Metropolitan Water District Operating and Maintenance (O&M), Operating Equipment and other O&M Expenditures **\$215.2 million**

Projected departmental O&M, operating equipment and other O&M expenditures of \$215.2 million are projected to be about the same as for the current fiscal year. A detailed breakdown of projected O&M expenditures will be provided during the development of the FY 2002/03 annual budget.

Adjustments in Reserves**\$(3.3) million**

During FY 2002/03, a decrease in required reserve balances of \$3.3 million has been calculated in accordance with revenue bond covenants and board policies contained in Metropolitan's Administrative Code. Sufficient funds need to be on hand to make interest and principal payments for outstanding and projected debt obligations due July 1, 2003 and to meet revenue bond covenant requirements for debt payments after July 2003. Other fund requirements for July 1, 2003 include the State Water Contract Fund and the Operations and Maintenance Fund. Metropolitan's reserve policies are subject to change by the Board. Reserve policies will be reviewed and guidelines established before June 30, 2002, pursuant to recently enacted state law SB 350 (Alpert). The projected decrease is primarily driven by lower expected power costs. As power costs decrease to more normal levels the required O&M Fund balances also will decrease.

PROJECTED REVENUES FOR FY 2002/03 Total = \$1.07 billion

To determine the rates and charges revenue requirements, total projected expenditures are reduced by revenue from ad valorem property taxes, interest income, hydropower revenues, miscellaneous revenues and prior period operating revenues used for PAYG. Ad valorem property taxes levied at the tax rate of .0077 percent of assessed valuation and from annexation charges are estimated to be \$102.1 million. Power recoveries, interest on investments and miscellaneous revenue are expected to produce \$61.2 million during FY 2002/03. Operating revenues generated in FY 2001/02 of \$50.0 million will be used to finance capital expenditures and defer the issuance of additional debt, consistent with board action taken in October 2001.

Based on the projected expenditure estimates previously described, total revenues required from rates and charges in FY 2002/03 are projected to be \$859.2 million. Current estimates indicate that about \$14.6 million will be drawn from reserves to meet costs, while \$844.6 million will be funded from rates and charges. This estimate of rates and charges revenue assumes that overall rates and charges will not be increased in FY 2002/03.

Policy

As per § 4304 (a) of Metropolitan's Administrative Code, the Chief Executive Officer 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 Audit, Budget and Finance Committee. The Audit, 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.

California Environmental Quality Act (CEQA)

Options #1 and #2

The proposed action is not defined as a project under CEQA, because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to 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).

The CEQA determination for both Options #1 and #2 is: Determine that the proposed action is not subject to CEQA per Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and determine that revenues required from rates and charges during FY 2002/03 should not be less than \$844.6 million; and use this determination for consideration at the January 2002 meeting of the Audit, Budget and Finance Committee in establishing water rates and charges to be effective January 1, 2003.

Fiscal Impact: Revenues from rates and charges of \$844.6 million, combined with the use of \$14.6 million from reserves to meet higher power costs and \$50.0 million from reserves to defer the issuance of additional debt, will be sufficient to recover estimated expenditures in FY 2002/03.

Option #2

Adopt the CEQA determination and direct staff to revise the FY 2002/03 revenue requirement per Board direction.

Staff Recommendation

Option #1



Brian G. Thomas
Chief Financial Officer

11/14/2001
Date



Ronald R. Gastelum
Chief Executive Officer

11/27/2001
Date

Attachment 1 - Projected Fiscal Year 2002/03 Revenue Requirements

ATTACHMENT 1**PROJECTED FISCAL YEAR 2002/03 REVENUE REQUIREMENTS**

(Cash Basis: \$ in thousands)

Fiscal Year	<u>Estimated</u> 2001/02	<u>Projection ---></u> 2002/03	2003/04	2004/05	2005/06
Expenditures					
State Water Contract	\$ 333,100	\$ 342,087	\$ 308,744	\$ 286,358	\$ 283,328
Colorado River Aqueduct Power Costs	100,198	58,789	57,510	57,848	56,262
Deposit to Transfer Fund	45,000	45,000	45,000	45,000	45,000
Withdrawal from Transfer Fund for DVL Initial Fill	(13,933)	(10,725)	(2,688)	-	-
Water Management Programs	33,616	41,117	45,933	48,988	50,647
Capital Program Financing	322,604	384,418	336,034	333,077	347,671
O&M and Operating Equipment	215,547	215,198	215,232	221,185	226,058
Member Agency Credit	33,400	-	-	-	-
Sub-Total Expenditures	1,069,533	1,075,884	1,005,766	992,456	1,008,966
Increase/(Decrease) in Required Reserves	49,495	(3,278)	(393)	14,538	29,215
Total Obligations	1,119,028	1,072,605	1,005,373	1,006,994	1,038,181
Less Other Revenues					
less Property Taxes	(103,103)	(102,110)	(102,202)	(102,139)	(101,726)
Interest Income	(47,186)	(38,364)	(40,441)	(39,468)	(39,166)
Power and Miscellaneous Revenue	(24,278)	(21,200)	(21,000)	(19,877)	(19,806)
Contracts	-	(1,620)	(3,619)	(5,680)	(7,803)
Prior Period Revenues Used to Reduce Debt	-	(50,100)	-	-	-
Sub-Total Other Revenues	(174,567)	(213,394)	(167,263)	(167,164)	(168,502)
Total Rates and Charges Revenue Requirement	\$ 944,461	\$ 859,211	\$ 838,110	\$ 839,830	\$ 869,678
Rates and Charges Revenue	\$ 868,484	\$ 844,632	\$ 810,941	\$ 822,628	\$ 856,655
Reserve Levels					
Maximum Reserve Level	\$ 306,115	\$ 315,534	\$ 329,272	\$ 334,997	\$ 335,745
Projected Reserve Level	\$ 291,278	\$ 279,640	\$ 256,557	\$ 247,185	\$ 236,475
Minimum Reserve Level	\$ 129,269	\$ 132,211	\$ 136,297	\$ 143,514	\$ 145,202
Water Sales (Cash Year TAF)					
Full Service Treated	1,163	1,098	1,049	1,045	1,044
Full Service Untreated	561	539	528	525	520
Seasonal Treated	36	76	72	72	75
Seasonal Untreated	215	201	145	143	143
Agricultural Treated	80	88	95	94	92
Agricultural Untreated	16	12	13	13	13
Total Cash Year Sales (TAF)	2,072	2,014	1,904	1,893	1,886

LEGISLATIVE REVIEW PROCESS

