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

June 11, 2002 Board Meeting

9-1

Subject

Approve fiscal year 2002/03 Annual Budget

Description

Submitted for your consideration is the annual budget financial summary for fiscal year 2002/03 (**Attachment 1**). In 1999, Metropolitan faced many challenges and demands issued by the state Legislature, member agencies and the public in general. Since that time, we have made significant changes. In 2000, we began the process of settling a long-running conflict over water from the Colorado River. We continue to work to implement the Quantification Settlement Agreement (QSA) and implement programs to assure a full Colorado River Aqueduct (CRA) into the future. The 14 state and federal agencies that make up CALFED ratified a 30-year framework to restore ecological health and improve water management for the State Water Project. Diamond Valley Lake (DVL) has been completed and will be full by the end of 2002. We have adopted a new rate structure, ending years of debate over this critical issue. Finally, cultural changes within Metropolitan are occurring that will yield returns over the long run in terms of increased output and other efficiency gains.

Where does Metropolitan go from here? The proposed 2002/03 annual budget identifies Metropolitan's key goals and objectives for the coming fiscal year and the cost of achieving those objectives. The budget was developed to meet three broad goals: implementing the strategic plan, ensuring reliability and high water quality, and effectively managing business operations and water services.

To do this, key policy decisions will need to be made and milestones met, such as implementing the new rate structure, completing the Integrated Resource Plan (IRP) Update, and finalizing the Colorado River QSA. Federal reauthorization of CALFED is also a high priority. Continued investments in Metropolitan's infrastructure to meet water reliability and water quality goals are also included in this budget.

This budget reflects our new organizational structure. While last year the budget was planned to allow us to transition to the new organization, this budget year we will be working under the new organizational structure. Over the past three years, we have developed the organization structure, worked with the bargaining units to help ensure the effectiveness of the transition, and filled most of the manager positions.

Total expenditures in the proposed 2002/03 budget are $81 million less than in the 2001/02 budget; and for the seventh consecutive year, Metropolitan will not require a rate increase to recover its costs.

Budget Objectives and Strategies

Implement the Strategic Plan

The purpose of Metropolitan's strategic planning process is to coordinate Metropolitan's operational system and financial structure to accommodate choice for Metropolitan member agencies and to provide for effective water resource management. Strategies for 2002/03 include:

- Implementing the new rates and charges, including the Purchase Order and Capacity Reservation Charge.
- Updating Metropolitan's System Overview Study in conjunction with the Integrated Resource Plan Review and Update to evaluate available system capacity and necessary additions and expansions.

- Implementing an asset/liability management program and reporting system as part of the Long-Range Finance Plan.

Ensure Water Reliability and High Water Quality

One of Metropolitan's roles as a regional provider of services is to facilitate the integration of local and imported supply development. This includes encouraging the development of local supplies like cost-effective recycling and conservation and improving the reliability of Metropolitan's water supplies through programs that increase the availability of high quality water on the Colorado River Aqueduct and California Aqueduct. Strategies for fiscal year 2002/03 include:

- Advancing the implementation of the California Colorado River Water Use Plan including conservation, water transfer, water banking and conjunctive-use measures.
- Supporting the implementation of near-term projects for the Phase 8 settlement agreement and identifying the long-term projects to solve physical solutions for Sacramento Valley upstream interests as part of the CALFED process.
- Completing negotiations for water transfers in the San Joaquin Valley for additional dry-year supplies.
- Executing final agreements and completing feasibility studies and environmental documentation for conjunctive-use programs funded by Proposition 13.
- Evaluating and recommending projects for seawater desalination incentive agreements.
- Continuing with water quality exchange negotiations.
- Actively participating in the Desalination Research Innovation Partnership consortium with member agencies and other partners to reduce the cost of desalting Colorado River water and other water supplies.
- Securing federal legislation and appropriations for CALFED and the clean up of the Moab uranium tailings.

Effectively Manage Business Operations and Water Services

Metropolitan is committed to meeting customer needs and conducting Metropolitan's business, consistent with Board policies, in a competitive, cost-effective manner. Focus areas for 2002/03 include:

- Focusing on maintenance activities to reduce the maintenance backlog and increase the ratio of preventive maintenance to corrective maintenance.
- Proceeding with Board-approved projects in the CIP, including the Inland Feeder, Infrastructure Reliability Program projects, Lake Mathews Outlet Facilities, and the Oxidation Retrofit Program.
- Proceeding with the implementation of the Multi-Skilled Workforce Program, including the Apprenticeship Program.
- Complete filling DVL.
- Proceed with planning of DVL recreational projects.
- Implementing additional performance measures at the unit and team level to monitor and encourage efficiency improvements.
- Completing the Information Technology Strategic Plan and begin implementing the Plan's recommendations to improve value and achieve efficiencies.
- Implementing policies and programs that will promote a business environment where integrity, respect and accountability are incorporated in all aspects of doing business at Metropolitan.
- Establishing public agency partnerships with member agencies and their customers to maximize a regional approach to procuring goods and services.

Performance Management

Performance indicators were included in the 2001/02 budget to initiate the evaluation and collection of data to help improve overall effectiveness of Metropolitan's core business of treating and storing and transporting water. As part of the 2002/03 budget, we have included performance indicators, as well as targets for the coming fiscal year as shown on Table 1. Performance Indicators. This is the beginning of a process to measure Metropolitan's progress in four key areas – financial performance, maintenance, water quality and health and safety. These measures tell only part of the budget story. As noted above, many of the objectives in the budget and the Chief Executive Officer's Business Plan are more difficult to quantify. Many of the strategic efforts at Metropolitan fit in this class, including progress on CALFED, the Colorado River, and external communications. But, the following indicators are important in managing Metropolitan's core business. In addition, more specific metrics are being developed at the section, unit and team level. These metrics will help us to manage activities and demonstrate progress in improving efficiency and productivity.

Table 1. Performance Indicators

Indicator	Description	2001/02 Value	2002/03 Objective
Financial Performance			
Debt to Equity Ratio	This is one measure of Metropolitan's financial flexibility – a lower debt to equity ratio means that Metropolitan helps ensure ready access to capital markets. Metropolitan is limited to a ratio of 1 by the Metropolitan Act.	.63	.65 - .70 Metropolitan Act requires this ratio to be 1 or lower.
Debt Service Coverage Ratio	This measure is one of the key statistics used by rating agencies when evaluating the financial strength of public entities. This measure is the ratio of net operating revenues to revenue bond debt service.	2.37	2 or higher
Current Ratio	The current ratio is one measure of liquidity and is the ratio of current assets to current liabilities.	3.3	1.62 or higher
Maintenance			
Preventive/ Corrective maintenance	Preventive maintenance is done to avoid and reduce unplanned outages. Current industry standards for this ratio are 75% preventive maintenance to 25% corrective maintenance	56/44	60/40 – 65/35
Backlog (# of weeks)	Backlog is one measure of the effectiveness and quality of maintenance work completed. Metropolitan's two year goal is to reduce the backlog to 4-6 weeks, consistent with industry standards.	22 weeks	12 – 15 weeks
Maintenance Hours (% of available time)	This is the percent of field labor time spent on maintenance work rather than in meetings, training, vacation, etc.	56.5%	60 – 65%
Design Cost/Construction Cost	The ratio of design cost to construction cost is one measure of engineering efficiency. It is the ratio of design costs (including overtime, benefits, etc.) to direct construction costs of a project.	13-16% for projects $10 million or greater 15-19% for projects under $10 million	11-14% for projects $10 million or greater 14-17% for projects under $10 million

Indicator	Description	2001/02 Value	2002/03 Objective
Water Quality			
95th percentile of effluent water turbidity	One water quality measure that measures turbidity in effluent waters	.08 NTU	.08-1 NTU
Compliance with Drinking Water Standards	Percent of time that effluent quality meets or exceeds federal and state standards	100% of the time	100% of the time
Meet Board's TDS target	Measure of salinity based on six-month rolling average	500 mg/L	500 mg/L or less
Health and Safety			
Recordable injury/illness rate	Number of injuries/illnesses per 100,000 hours	7.62	8.0 or less
Cost per claim	Measures the average cost of worker's compensation claim	$13,711	$13,500-13,800

Budget Estimates

Table 2 provides an overview of key elements of the budget. Total Uses of Funds are $53.3 million less than the 2001/02 budget. In addition, the number of positions continues to decline and consulting and debt service costs are lower than in the 2001/02 budget.

Table 2. 2002/03 Annual Budget Key Elements
($ in Millions)

	2000/01 Actual	2001/02 Budget Estimates	2002/03 Projected	2002/03 Proposed Budget	Change 2001/02 Budget to 2002/03 Proposed
Total Uses of Funds	$1,174	$1,306	$1,301	$1,253	$-53.3
Operations & Maintenance	$209.6	$215.5	$215.0	$245.7	$30.2
CRA/SWP Power	$202.9	$322.9	$314.7	$183.4	$-139.5
CIP and Supply Program Capital	$201.9	$288.0	$178.9	$238.8	$-49.2
Positions	1,958	2,068	1,932	2,065	-3
Consultants					
O&M	$11.7	$15.7	$15.0	$15.6	$-0.1
Capital	$25.0	$26.5	$19.2	$24.5	$-2.0
Water Sales (Million Acre-Feet)	2.16 MAF	1.94 MAF	2.26 MAF	2.15 MAF	.21 MAF
Water Sales Receipts	$809.3	$737.8	$840.4	$811.4	$73.7

Receipts and Funding Sources

Estimated receipts total $1.05 billion for fiscal year 2002/03. The three largest components are water sales at $811.4 million, taxes at $102.1 million and the readiness-to-serve charge at $80.0 million. Interest income, power recoveries, capacity reservation charges and miscellaneous income will produce $59.6 million. In addition, debt proceeds of $98.7 million, along with $50.1 million of reserves will be used to help fund the CIP and Supply

Program Capital (SPC) costs. Another $50.6 million from the Water Transfer Fund will be utilized to pay costs associated with the initial fill of DVL and water transfers and options. In total, $1.25 billion will be available to cover expenditures and other obligations.

Expenditures and Other Obligations

Cash outlays for operating costs, the CIP and SPC for fiscal year 2002/03 are projected to be $1.18 billion. This is approximately $81.4 million less than the 2001/02 budget reflecting lower construction expenditures and CRA power costs. CIP and SPC expenditures are projected to total $238.8 million, $49.2 million less than the 2001/02 budget but $59.9 million more than projected expenditures in 2001/02. Projects with substantial expenditures during 2002/03 include Inland Feeder, Lake Mathews Outlet Facilities, Jensen/Mills oxidation retrofit projects, Skinner Filtration Plant Improvements Program, and infrastructure reliability and protection plan projects.

State Water Contract (SWC) expenditures are projected to increase $16.8 million from the 2001/02 budget.

Water transfer payments are estimated to be $36.7 million. This is $20.8 million higher than the 2001/02 budget reflecting anticipated payments for the Palo Verde Land Management and Water Supply Program. To assure there is adequate funding for future water transfer projects, it is proposed that an additional $25 million be deposited in this fiscal year into the Water Transfer Fund for the Palo Verde Land Management and Water Supply Program initial payments.

O&M expenditures are estimated to be $245.7 million. This is $30.2 million more than the current year's budget and reflects increased labor costs associated with negotiated Memoranda of Understandings with the bargaining units, increased water treatment costs, higher security costs, and projected increases in CALPERS health care insurance premiums. These increases are more than offset by lower power costs on the CRA.

Debt service and cash defeasance payments totaling $225.4 million are $12.9 million less than the 2001/02 budget.

Fund Balances and Reserve Levels

Fund balances are projected to be $893.8 million at June 30, 2003. Of that total, $525.7 million is restricted by bond covenants, contracts, or board policy, and $368.1 million is unrestricted. The minimum and maximum reserve levels are projected to be $138.7 million and $331.5 million, respectively, at the end of fiscal year 2002/03. Based on estimated receipts and expenditures, Water Rate Stabilization funds are projected to be $10.9 million under the maximum amount at June 30, 2003.

A more detailed discussion on the budget estimates is included in the Financial Summary (**Attachment 2**).

Staffing

The total proposed personnel complement for 2002/03 is 2,065 positions, down three positions compared to 2001/02. The personnel complement is broken down by regular and temporary positions in Table 3.

Table 3. 2002/03 Regular and Temporary Positions

	1999/00 Budget	2000/01 Budget	2001/02 Budget	2002/03 Budget	Change from 2001/02
Regular Full Time Positions	1,879	1,855	1,960	1,963	3
District Temporary Positions	133	105	75	54	-21
Agency Temporary Positions	243	150	33	48	15
Total	**2,255**	**2,110**	**2,068**	**2,065**	**-3**

District temporary positions will be reduced by 21 positions. There are three additional regular positions proposed in the 2002/03 budget. One position is to support the recently hired Ethics Officer and two positions are being proposed for the General Auditor's Department. The increase in agency temporary positions is needed to supplement the maintenance and construction workforce due to vacancies. The agency labor is also used for projects such as the Lake Mathews shoreline vegetation clearing and reservoir cover cleaning at Garvey Reservoir and the Jensen Finished Water Reservoir No. 2.

Of the 2,065 positions, 1,687 positions are dedicated to operations and maintenance activities and 378 will be working on the Capital Investment Plan.

Policy

Metropolitan Water District Administrative Code § 5107: Annual Budget

California Environmental Quality Act (CEQA)

CEQA determination for 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 is: Determine that the proposed action is not subject to CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and

a. Approve the 2002/03 Annual Budget;
b. Appropriate $706.9 million for the projected annual cash outlays for Metropolitan O&M, including power costs on the Colorado River Aqueduct, SWP operations, maintenance, power and replacement costs and SWP capital charges; water management programs; and costs associated with supply programs paid from the Water Transfer Fund;
c. Appropriate as continuing appropriations, $204.4 million for debt service on Metropolitan general obligation and revenue bonds;
d. Appropriate, as continuing appropriations, $8.5 million for operating equipment, computers and inventory supplies;
e. Authorize $21 million to be used to cash defease debt as directed by the Board in July 2000;
f. Authorize the use of $90 million in Pay-As-You-Go funds to finance a portion of the Capital Investment Plan during fiscal year 2002/03; and
g. Authorize $25 million to be deposited into the Water Transfer Fund in fiscal year 2001/02 and $45 million in fiscal year 2002/03.

Fiscal Impact: $1.253 billion

Option #2

Adopt the CEQA determination and approve the 2002/03 Annual Budget with changes as recommended by the Board.

Fiscal Impact: Impact depends on adopted changes.

Staff Recommendation

Option #1

5/17/2002
Brian G. Thomas *Date*
Chief Financial Officer

5/20/2002
Ronald R. Gastelum *Date*
Chief Executive Officer

Attachment 1 – 2002/03 Proposed Annual Budget; Sources and Uses of Funds - Cash Basis

Attachment 2 – Financial Summary

BLA #1640

2002/03 Proposed Annual Budget

Table 4. Sources and Uses of Funds – Cash Basis

($ in Thousands)

	2001/02 Adopted Budget	2001/02 Projected	2002/03 Proposed Budget	2002/03 Budget Compared to Projected	2002/03 Budget Compared to 2001/02 Budget
TOTAL USES OF FUNDS	**$1,305,965**	**$1,301,409**	**$1,252,627**	**$ (48,781)**	**$ (53,338)**
Operating Expenditures					
State Water Contract	326,909	331,401	343,754	12,354	16,845
Supply Programs Paid from Water Transfer Fund	15,946	18,728	36,724	17,996	20,778
Colorado River Power Costs	141,091	104,334	48,884	(55,450)	(92,207)
Debt Service and Bond Defeasance	238,252	223,136	225,369	2,233	(12,883)
Water Management Programs	32,364	27,063	38,446	11,383	6,082
Departmental and Other O&M	215,529	215,020	245,711	30,691	30,182
Wadsworth Pumping Plant Power Costs	2,848	6,019	1,815	(4,204)	(1,033)
Subtotal Operating Expenditures	**972,939**	**925,701**	**940,704**	**15,002**	**(32,235)**
CIP and Supply Program Capital					
Paid from Bond Proceeds	203,026	93,918	98,734	4,816	(104,292)
Paid from PAYG	85,000	85,000	140,100	55,100	55,100
Subtotal CIP/SPC Expenditures	**288,026**	**178,918**	**238,834**	**59,916**	**(49,192)**
Fund Deposits					
Deposit to Water Transfer Fund	45,000	70,000	45,000	(25,000)	–
Deposit to PAYG Fund		50,100	–	(50,100)	–
Increase in Required Reserves	–	43,289	21,368	(21,921)	21,368
Increase in Rate Stabilization Funds	–	–	6,721	6,721	6,721
Subtotal Fund Deposits	**45,000**	**163,389**	**73,089**	**(90,300)**	**28,089**
Member Agency Credit	–	33,400	–	(33,400)	–
SOURCES OF FUNDS					
Receipts					
Taxes	102,952	105,529	102,110	(3,419)	(842)
Interest	42,048	29,183	29,378	195	(12,670)
Power & Misc.	24,278	19,331	18,153	(1,178)	(6,125)
Readiness to Serve Charge	80,000	80,000	80,000	–	–
Connection Maintenance Charge	2,870	2,870	1,424	(1,446)	(1,446)
Capacity Reservation Charge			9,030	9,030	9,030
SDCWA/MWD Exchange Agreement			1,620	1,620	1,620
Wheeling	–	1,676	–	(1,676)	–
Water Sales	737,773	840,398	811,440	(28,958)	73,667
Subtotal Receipts	**989,921**	**1,078,987**	**1,053,155**	**(25,832)**	**63,234**
Fund Withdrawals					
Withdrawal from Transfer Fund	34,265	32,877	50,638	17,761	16,373
Pay As You Go Funds for Construction			50,100	50,100	50,100
Bond Funds for Construction	203,026	93,918	98,734	4,816	(104,292)
Decrease in Required Reserves	21,386	–	–	–	(21,386)
Use of Rate Stabilization Funds	57,367	95,627	–	(95,627)	(57,367)
Subtotal Fund Withdrawals	**316,044**	**222,422**	**199,472**	**(22,949)**	**(116,572)**
TOTAL SOURCES OF FUNDS	**$1,305,965**	**$1,301,409**	**$1,252,627**	**$ (48,781)**	**$ (53,338)**

Financial Summary

The financial summary includes a discussion of (1) cash basis Sources and Uses of Funds, (2) an accrual basis pro-forma Statement of Operations, and (3) a five-year forecast.

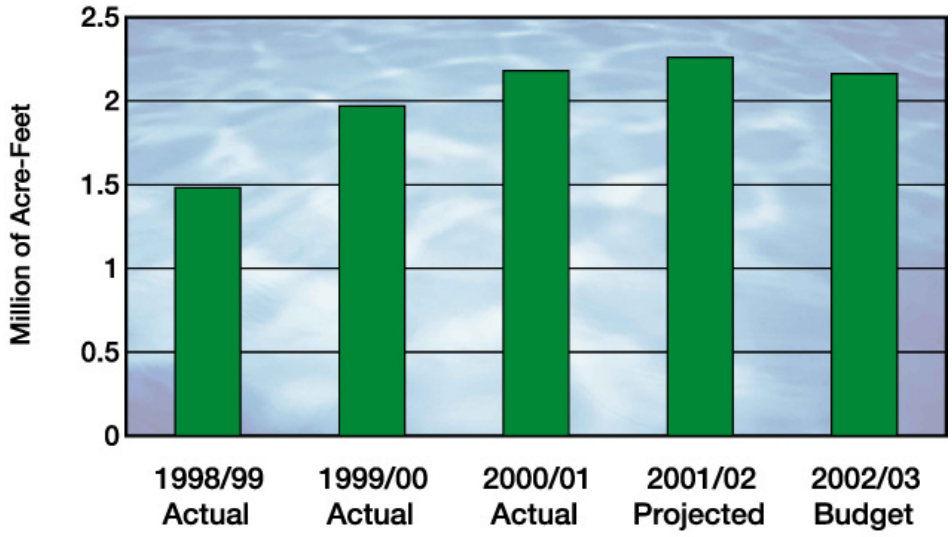
Sources of Funds (Cash Basis)

Estimated receipts from water sales, readiness-to-serve charges, capacity reservation charges, taxes, interest, power recoveries and other income are projected to be $1.05 billion for fiscal year 2002/03. This is $63.2 million more than the 2001/02 budget but $25.8 million below projected for 2001/02. The variance is primarily due to projected water sales.

Receipts from water sales for 2002/03 are estimated to be $811.4 million based on water sales of 2.15 million acre-feet (MAF). Because there is a two-month lag between when sales occur and when Metropolitan receives payment, the cash water sales year is for the months of May 2002 – April 2003. Water sales for 2001/02 are projected to be 2.26 MAF, the second highest in Metropolitan's history. These sales are expected to generate $840.4 million. For the third year in a row, the region continued to experience warm, dry weather. This has resulted in continued high sales. The 2002/03 sales estimate was developed from input from the member agencies on their projected demands and an assumption that weather conditions (both precipitation and temperature) will be within a normal range.

Figure 1 shows the five-year trend of water sales.

Figure 1. Five-Year Trend of Water Sales



The 2002/03 water sales mix includes 1.842 MAF of full service sales, 194,400 AF of long-term seasonal water, and 105,100 AF of agricultural sales. Treated sales are estimated to be 1.353 MAF.

Water Rates and Charges

As stated earlier, water sales receipts are budgeted at $811.4 million and are based on rates and charges adopted by the Board for fiscal year 2002/03 as shown on Table 5.

Table 5. 2002/03 Water Rates and Charges

	Current Rate Structure Effective January 1, 2002	New Rate Structure Effective January 1, 2003
Tier 1 Supply Rate ($/AF)	N/A	$73
Tier 2 Supply Rate ($/AF)	N/A	$154
System Access Rate ($/AF)	N/A	$141
System Power Rate ($/AF)	N/A	$89
Water Stewardship Rate ($/AF)	N/A	$23
Full Service Untreated Water Rate ($/AF)	$349	N/A
Seasonal Shift Untreated Water Rate ($/AF)	$289	N/A
Long-term Seasonal Storage Water Rate ($/AF)	$233	$233
Long-term Seasonal Storage Treated Water Rate ($/AF)	$290	$290
Interim Agricultural Water Program ($/AF)	$236	$236
Interim Agricultural Water Program Treated ($/AF)	$294	$294
Treatment Surcharge ($/AF)	$82	$82
Readiness-to-Serve Charge ($M)	$80.0	$80.0
Capacity Reservation Charge ($/cfs)	N/A	$6,100
Peaking Surcharge ($/cfs)	N/A	$18,300
Connection Maintenance Charge ($M)	$2.9	N/A

The rates and charges to be effective January 1, 2003, are a result of Metropolitan's efforts to improve its rate structure to encourage cost-effective water recycling, conservation and water management, accommodate a water transfer market and secure a greater level of financial commitment from the member agencies. The new rate structure changes how Metropolitan currently recovers costs by: (1) implementing a tiered pricing structure for supply; (2) unbundling the current water rate into supply, conveyance, distribution, water stewardship and power elements; (3) implementing a Capacity Reservation Charge and Peaking Surcharge; and (4) establishing a financial commitment from the member agencies through a purchase order. A brief explanation of the new rate structure is included at the end of the Executive Summary.

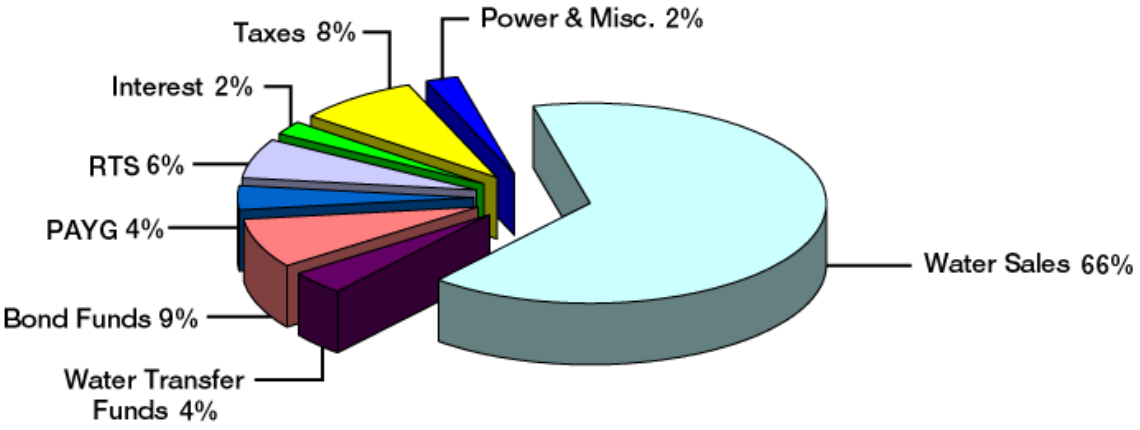
Income from Readiness-to-Serve (RTS) charges for 2002/03 is estimated to be $80 million, which is unchanged from 2001/02. The RTS is a fixed charge that recovers a portion of the system conveyance, distribution and system capacity that is on standby to provide emergency service and operational flexibility. Capacity Reservation Charge collections are estimated to be $9.0 million and are based on recent member agency daily peaking trends.

Revenues from taxes and annexation fees, which will be used to pay voter-approved debt service on general obligation bonds and a portion of the capital costs of the State Water Contract, are estimated to be $102.1 million. This is based on the tax rate used for the 2001/02 tax levy (.0077%).

Interest earnings are estimated to total $29.4 million, excluding trust accounts and construction funds. Receipts from power recoveries, connection maintenance charges, and the San Diego/Metropolitan Exchange Agreement are estimated to be approximately $21.2 million.

Debt proceeds of $98.7 million generated from debt sales in fiscal year 2001/02, $90 million from current revenues (PAYG), along with $50.1 million of reserves, will be used to fund the CIP and SPC. Another $50.6 million from the Water Transfer Fund will be utilized to pay costs associated with completing the fill of Diamond Valley Lake and water transfers and storage programs.

Figure 2. Sources of Funds



In total, $1.25 billion will be available for expenditures and other obligations.

Uses of Funds (Cash Basis)

Colorado River Aqueduct Power

Colorado River Aqueduct pumping costs are projected to be $48.9 million. This is $92.2 million less than the 2001/02 budget and $55.5 million less than 2001/02 projections. The assumption for supplemental power rates is 43.24 mills per kilowatt-hour. In 2001/02, supplemental power rates averaged 99.7 mills per kilowatt-hour. Diversions are estimated to be 1.211 MAF.

Wadsworth Pumping Plant Power

In order to put water into DVL, water must be pumped through the Wadsworth Pumping Plant into the reservoir. The pumping costs for 2002/03 are estimated to be $1.8 million. This is $4.2 million less than 2001/02 projections. It is expected that the initial fill will be completed by the end of 2002.

State Water Contract

SWC expenditures of $343.8 million are projected to be $16.8 million more than the current year's budget and $12.4 million more than 2001/02 projected of $331.4 million. The increase reflects the fact that Metropolitan prepaid part of its 2001/02 bill in fiscal year 2000/01. It should also be noted that in the current fiscal year (2001/02) Metropolitan will be paying the Department of Water Resources (DWR) for power costs DWR incurred in 2000 and 2001 but did not collect from the contractors in that time period. DWR recently notified the SWP contractors of this situation and indicated they would like to collect this money before June 30, 2002. It is anticipated that Metropolitan's share of the under collection is about $50 million.

Water Management Costs

Metropolitan provides financial assistance to its member agencies for the development of local water recycling and groundwater recovery projects under the Local Projects Program (LPP) and the Groundwater Recovery Program (GRP) as part of the Local Resources Program. Metropolitan also provides financial assistance for the development of their conservation programs under the Conservation Credits Program (CCP).

Metropolitan has entered into agreements to provide financial assistance to 53 water recycling projects. Thirty-seven of these projects are in operation and the remaining 16 projects are under design or construction. Recycling projects that receive Metropolitan contributions are expected to produce about 89,900 acre-feet of recycled water, principally for landscape irrigation, nurseries, groundwater recharge and industrial uses in 2002/03 at a cost to Metropolitan of about $17.2 million.

Metropolitan has entered into agreements to provide financial assistance to 22 projects that recover contaminated groundwater. Operating groundwater recovery projects are expected to produce about 47,500 acre-feet of mostly municipal water supplies in 2002/03 at a cost to Metropolitan of about $8.9 million.

Metropolitan's CCP provides financial assistance to local agency conservation programs. The budget for 2002/03 totals $12.4 million, and it is expected that over 150,000 low-flow toilets will be installed. In addition, program funds will continue to support commercial, industrial, and landscape conservation efforts by local agencies.

Operations and Maintenance

The 2002/03 operations and maintenance (O&M) budget, including operating equipment purchases, is estimated to be $245.7 million. This is $30.2 million more than the current year's budget of $215.5 million and $30.7 million more than the 2001/02 projected.

O&M labor costs are $14.4 million, or 10 percent, higher than the 2001/02 budget. This reflects salary and benefit adjustments associated with negotiated labor contracts with ASFCME 1902, the Supervisors Association, and Management and Professional Association ($13.7 million). There has also been a $4.0 million labor shift from the CIP for 2002/03 to O&M to concentrate on maintenance and reduce backlog. Offsetting these increases are reductions in Metropolitan and agency temporary costs of $1.1 million, reduced overtime of $750,000 and a higher vacancy factor (a $2.1 million reduction). The increase in the vacancy factor was made to reflect experience over the past two years.

One of the cornerstones of providing reliable service is preventive maintenance (PM). PM includes inspections, calibrations, and lubrication to keep equipment operating efficiently. Improving PM has been a priority since 1999 when the new management team was put into place. Although a PM program was developed in the mid-1990s, there was little coordination between work groups and the system was not used consistently. Standards have now been developed; and since June 2001, accurate data has been collected. Table 6 below shows baseline data, industry practice, and Metropolitan's two-year goal.

Table 6. Maintenance Performance Measures

Measure	June 2001	March 2002	Industry Practice	Two-Year Goal
Maintenance Hours (%)	21 – 29	56.5	60 – 65	60 – 65
PM/CM Ratio (%)	50/50	56/44	75/25	75/25
Backlog (# of weeks)	15.7	22	4-5	5

To achieve this goal, key strategies include shifting labor from the CIP to O&M and contracting out weed abatement and landscape maintenance to free up maintenance crews. As a result, there is a $2.1 million increase in the weed abatement budget for next year. This will cover not only the weed abatement for parcels that staff in the past has maintained, but also new property procured as part of the DVL project.

Water treatment costs are projected to increase $8.6 million. Chemical costs have increased by $6.6 million because of additional dosages required to meet water quality regulations for total organic carbon removal, arsenic removal, chromium 6 removal, and disinfection by-products precursor removal. Additionally, the cost of chlorine has increased by approximately 40 percent. There is also an associated increase in sludge removal costs of $2.0 million due to the higher chemical usage.

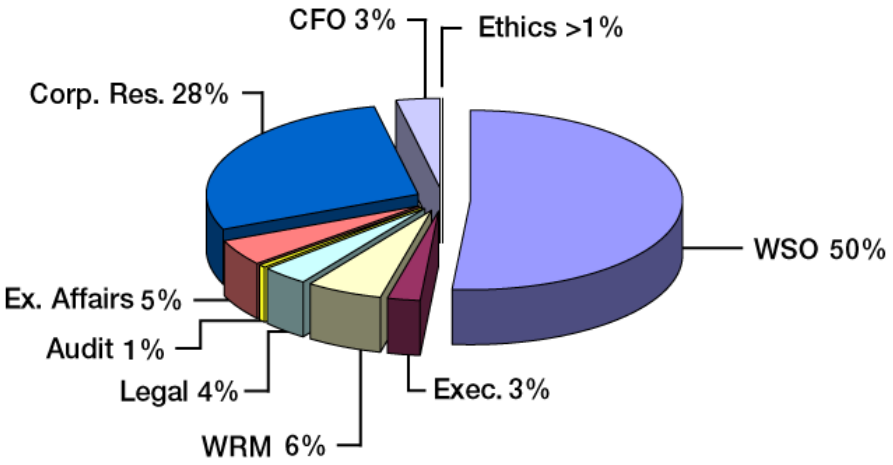
Security costs for guard services are estimated to be $1.5 million more than the 2001/02 budget. Insurance costs are also projected to increase because the insurance market has undergone dramatic changes since September 11.

Other increases include $250,000 for training and employee development, $600,000 for outside investment management services, $250,000 to fund an Innovative Conservation Program to research advances in technologies, $150,000 to fund the Municipal Water Quality Investigation previously paid through State Water Contract charges, $400,000 to pay vendor services associated with Conservation Credits that were previously included in the Water Management Program, $277,000 in property taxes on the recently acquired property in the Palo Verde Valley, and $200,000 in debt administrative fees as more variable rate debt is issued. Additionally, CALPERS announced that health care insurance premiums will be increasing by approximately 25 percent effective January 1, 2003. It is anticipated that this will result in a $2.6 million increase to Metropolitan. The payroll split between O&M and the CIP is about 80% / 20%. Using this ratio, $2.0 million of the increase is reflected in the O&M budget, while the remaining $600,000 will be allocated to capital projects.

Equipment purchases total $8.5 million. This is just slightly higher than 2001/02. Major purchases include a tunnel cleaner, water truck and pressure power pole digger for the Colorado River Aqueduct, a portable boring bar for machine shop, a chlorine recompressor and scrubber system for the use at the Chlorine Unloading Facility, and computer servers and back up systems. The budget also includes $1.5 million for the replacement of lap top computers. This is the second year of a two-year program to replace desktop/laptop computers. In 2001/02, desktop computers were replaced.

Figure 3 shows the breakdown of the departmental budget for 2002/03.

Figure 3. Proposed 2002/2003 Departmental Budget



An overview of O&M expense is shown in Table 7.

Table 7. Operations & Maintenance Budget Summary

Departmental Units	2001/02 Budget	2001/02 Projected	2002/03 Proposed	Change: Proposed to Budget	%	Change: Proposed to Projected	%
Executive Offices	5,604,300	5,757,800	6,174,900	570,600	10.2%	417,100	7.2%
Water Systems Operations	101,743,800	105,744,400	124,413,700	22,669,900	22.3%	18,669,300	17.7%
Water Resource Management	12,616,100	12,066,100	13,941,700	1,325,600	10.5%	1,875,600	15.5%
Corporate Resources	66,482,200	63,793,200	68,243,400	1,761,200	2.6%	4,450,200	7.0%
External Affairs	11,482,900	11,347,300	11,650,500	167,600	1.5%	303,200	2.7%
Office of the Chief Financial Officer	7,759,100	6,928,500	7,660,700	(98,400)	-1.3%	732,200	10.6%
Subtotal – Chief Executive Officer's Department	**205,688,400**	**205,637,300**	**232,084,900**	**26,396,500**	**12.8%**	**26,447,600**	**12.9%**
General Counsel	8,133,300	7,514,500	8,652,400	519,100	6.4%	1,137,900	15.1%
Audit	1,254,700	1,399,700	1,663,600	408,900	32.6%	263,900	18.9%
Ethics Office	126,300	104,600	278,000	151,700	120.1%	173,400	165.8%
Total Departmental Budget	**215,202,700**	**214,656,100**	**242,678,900**	**27,476,200**	**12.8%**	**28,022,800**	**13.1%**
Other:							
Debt Administrative Fees	2,423,100	2,000,000	2,216,400	(206,700)	-8.5%	216,400	10.8%
Agency Dues	1,504,000	1,429,300	1,430,000	(74,000)	-4.9%	700	0.0%
Leases Payments/Property Taxes	730,000	667,600	1,007,000	277,000	37.9%	339,400	50.8%
Contingency	2,989,800	0	2,426,800	(563,000)	-18.8%	2,426,800	n/a
Increase in CALPERS Health Insurance	0	0	2,000,000	2,000,000	n/a	2,000,000	n/a
Overhead Credit from Construction	(15,688,000)	(12,100,000)	(14,514,300)	1,173,700	-7.5%	(2,414,300)	20.0%
Subtotal - Other	**(8,041,100)**	**(8,003,100)**	**(5,434,100)**	**2,607,000**	**-32.4%**	**2,569,000**	**-32.1%**
Total OPERATIONS & MAINTENANCE	**207,161,600**	**206,653,000**	**237,244,800**	**30,083,200**	**14.5%**	**30,591,800**	**14.8%**
Operating Equipment	5,734,100	5,734,100	6,966,000	1,231,900	21.5%	1,231,900	21.5%
Desktop and Laptop Computers	2,633,500	2,633,500	1,500,000	(1,133,500)	-43.0%	(1,133,500)	-43.0%
GRAND TOTAL	**215,529,200**	**215,020,600**	**245,710,800**	**30,181,600**	**14.0%**	**30,690,200**	**14.3%**

Water Transfer Fund

Deposits into the Water Transfer Fund are projected to be $45.0 million for 2002/03. This would be $25.0 million less than what is proposed for the current year. The 2001/02 budget authorized a deposit of $45.0 million. However, it is proposed that an additional $25.0 million be deposited in this fiscal year to fund an estimated initial payment of $25.0 million for the Palo Verde Land Management and Water Supply Program that will be made in 2002/03.

Water transfer payments are estimated to be $36.7 million, which is $20.0 million more than the 2001/02 budget. Major expenditures for 2002/03 include $25.0 million for the Palo Verde Land Management and Water Supply Program, $5.8 million for the Imperial Irrigation District 1 agreement, $4.6 million for the Semitropic agreement, $3.0 million for the San Bernardino Valley Municipal Water District agreement, and $1.6 million for the Arizona Groundwater Banking Program.

Debt Service

Debt service payments are projected to be just slightly higher ($2.2 million) than the current year but $12.9 million less than the 2001/02 budget. Metropolitan currently has 32 percent of its debt in variable rate mode (either directly or though interest rate swaps). This has resulted in much lower debt service costs than in past years. In fiscal year 2000/01, debt service costs were $232.4 million as compared to the 2002/03 estimate of $204.4 million. The budget also includes $20.9 million to cash defease debt in 2002/03 as directed by the Board in July 2000.

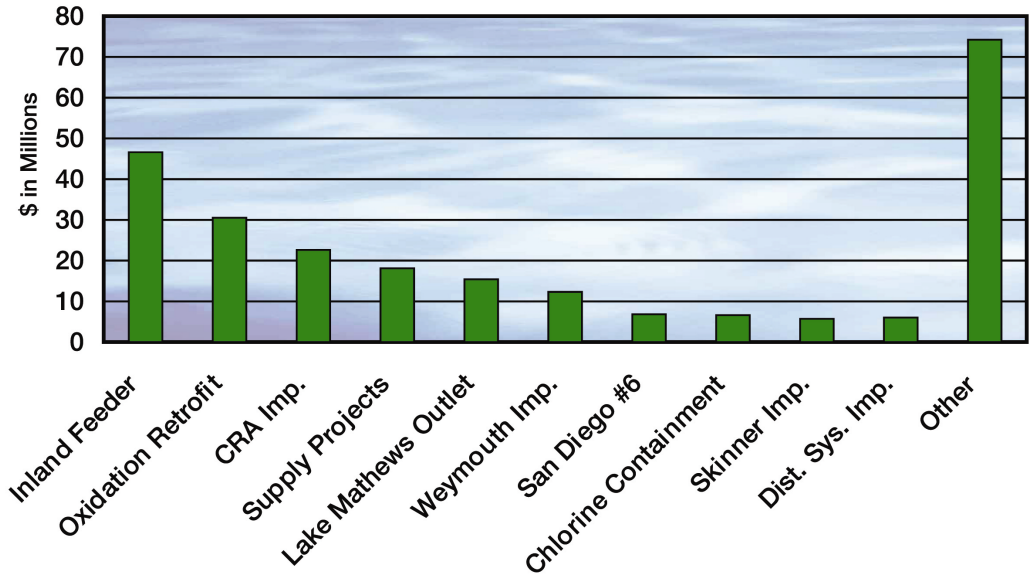
Annual Capital Investment Plan and Supply Program Capital

The CIP/SPC for fiscal year 2002/03 totals $238.8 million. This is $59.9 million higher than the projected expenditures for 2001/02, but $49.2 million less than the 2001/02 budget. The CIP totals $229.3 million. Major CIP projects in design and/or construction include the Inland Feeder, Oxidation Retrofit Program, CRA and pumping plant reliability projects, Lake Mathews Outlet Facilities, Weymouth and Skinner filtration plants improvements, San Diego Pipeline #6, Distribution System Rehabilitation Program, Chlorine Containment and Handling Facilities, Local Groundwater Storage Programs and Colorado River Banking Programs.

There is $9.5 million included for the SPC. These funds will be used to purchase participation rights in conjunctive-use projects and Colorado River Banking programs.

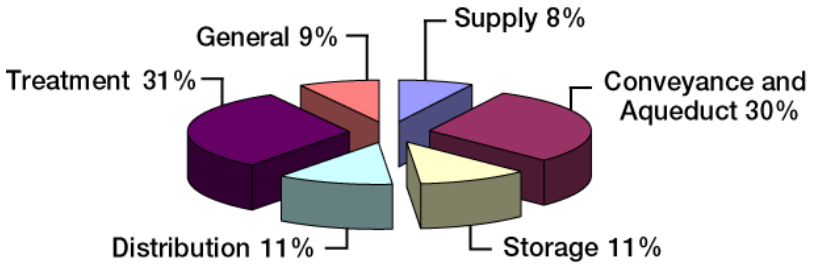
The projects listed above account for approximately 75 percent of the total CIP/SPC expenditures. Figure 4 shows the major projects included in the 2002/03 CIP/SPC.

Figure 4. 2002/03 Proposed Capital Investment Plan and Supply Program Capital Expenditures



Programs are categorized as source of supply, conveyance and aqueduct, storage, treatment, distribution, and general. The 2002/03 expenditure plan by category is shown on Figure 5.

Figure 5. Capital Investment Plan and Supply Program Capital Expenditures by Category



Information on construction projects can be found in the CIP Appendix.

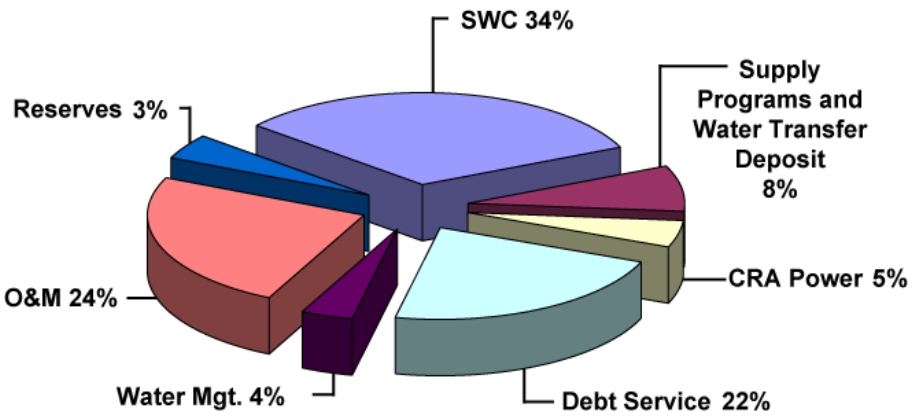
PAYG will fund $140.1 million and bond proceeds will provide $98.7 million. The PAYG amount is made up of $90 million from current year revenues and $50.1 million that was transferred from the Water Rate Stabilization Fund as directed by your Board in October 2001.

Reserve Transfers

Reserve transfers are projected to be $21.4 million. The transfers will fund required restricted reserves, and all bond covenants and Board policies regarding reserves will be complied with under the proposed budget.

Total expenditures and obligations total $1.25 billion. Figure 6 shows the breakdown of expenditures and other obligations that make up the Uses of Funds for 2002/03.

Figure 6. Uses of Funds



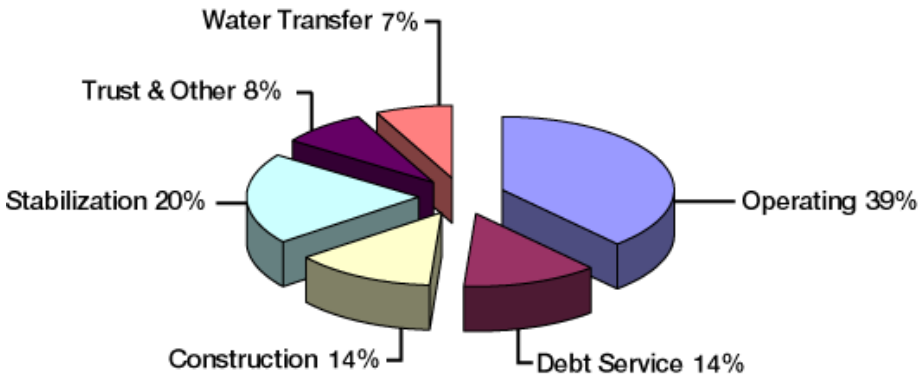
Fund Balances and Reserve Levels

Fund balances are projected to be $893.8 million at June 30, 2003. Of that total, $525.7 million is restricted by bond covenants, contracts, or board policy, and $368.1 million is unrestricted. Table 8 shows a breakdown of reserves by fund type. Figure 7 shows the funds distribution by type.

Table 8. Projected Fund Balances at June 30, 2003

	$ in Millions			
	Restricted		Unrestricted	Total
	Contractual	Board		
Operating Funds	$105.1	$98.1	$138.7	$341.90
Debt Service Funds	106.2	8.0	0.0	114.2
Construction Funds	71.5	0.0	47.5	119.0
Stabilization Funds	0.0	0.0	181.9	181.9
Water Transfer Fund	0.0	64.4	0.0	64.4
Trust and Other Funds	67.2	5.2	0.0	72.4
Total	**$350.00**	**$175.70**	**$368.10**	**$893.80**

Figure 7. Fund Distribution by Type



The minimum and maximum reserve levels are projected to be $138.7 million and $331.5 million, respectively, at the end of fiscal year 2002/03. Based on estimated receipts and expenditures, reserves are projected to be $10.9 million under the maximum amount at June 30, 2003.

Pro-Forma Statement of Operations (accrual Basis)

Metropolitan operates as a utility enterprise and prepares its financial statements using the accrual basis of accounting. Under accrual accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred regardless of the timing of related cash flows. While water rates and charges are based on cash needs as reflected in the budget, the accrual statement is provided to present Metropolitan's financial position.

Operating revenues for fiscal year 2002/03 are estimated to be $919.2 million. This estimate is based on water sales of 2.15 MAF. Water sales income is projected to be $803.1 million for sales between July 2002 and June 2003. The RTS will raise $80.0 million. As noted earlier, Metropolitan's new rate structure becomes effective on January 1, 2003. As part of the structure, a capacity reservation charge and peaking surcharge has been developed. This charge is designed to provide a price signal to encourage agencies to reduce peak day demands on the system and shift demands from the summer months to other times of the year to more efficiently utilize Metropolitan's system and defer capacity expansion costs. In fiscal year 2002/03, it is anticipated that income from the capacity reservation charge will be $13.6 million. Hydroelectric power and other income is estimated to be $22.5 million.

Operating expenses are projected to be $703.1 million. This is $74.1 million less than in 2001/02. Cost of Water Delivered (COWD) is projected to be $239.8 million, which is $115.2 million less than the current year. COWD reflects the moving average cost of water delivered from our water in inventory. It is based on the power costs to deliver Colorado River water and State Water Project water and O&M on the State Water Project. COWD is decreasing as power costs return to more normal levels than those experienced in 2000 and 2001.

Operations and maintenance (O&M) costs are estimated to be $243.1 million. This is $30.0 million more than estimated expenditures for 2001/02. As explained earlier, a large portion of the increase is associated with higher water treatment costs, increased security at all facilities, and an increased focus on maintenance activities. Another driving force is the impact of the bargaining units' negotiated Memoranda of Understandings on labor costs. This cost also includes increases for reserves for worker compensation and liability claims.

Net income of $251.9 million will be used to fund principal payments on outstanding debt, pay a portion of the State Water Contract capital costs, fund the PAYG construction program, and fund equipment purchases and reserve adjustments.

Table 9 provides the Comparative Statements of Operations.

Table 9. Comparative Statements of Operations - Accrual Basis

Metropolitan Water District of Southern California

2002/03 Proposed Annual Budget
Comparative Statements of Operations - Accrual Basis
($ in Millions)

	2000/01 Actual	2001/02 Projected	2002/03 Proposed
Operating Revenues:			
Water Sales	$ 806.7	$ 819.5	$ 803.1
RTS	80.0	80.0	80.0
Capacity Reservation Charge	–	–	13.6
Hydroelectric Power and Other	21.3	18.3	22.5
Total Operating Revenues	**908.0**	**917.8**	**919.2**
Operating Expenses:			
Operations & Maintenance	209.6	213.1	243.1
Cost of Water Delivered	221.6	355.0	239.8
Water Management Programs, Net	25.8	32.2	38.4
Depreciation & Amortization	199.4	176.9	181.8
Total Operating Expenses	**656.4**	**777.2**	**703.1**
Operating Income	**251.6**	**140.6**	**216.1**
Other Income (Expense):			
Net Taxes/Annexations	105.0	103.0	103.0
Interest Income	51.3	39.4	40.5
Bond Interest Expense	(136.8)	(118.4)	(107.7)
Member Agency Distributions	–	(33.4)	–
Miscellaneous Income (Expense)	1.8	–	–
Total Other Income - Net	**21.3**	**(9.4)**	**35.8**
Net Income	**$ 272.9**	**$ 131.2**	**$ 251.9**
Water Sales (MAF)	**2.165**	**2.272**	**2.150**

Five-Year Financial Forecast

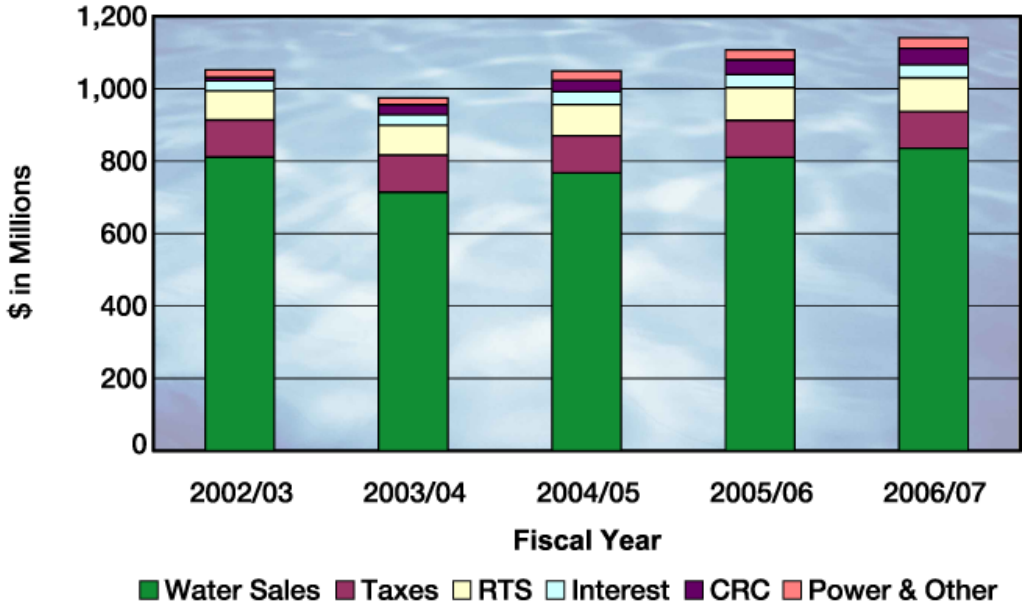
Projected costs and revenues for the period 2002/03 – 2006/07 are estimates and subject to variations inherent in all such projects. Consequently, the estimates should not be viewed as precise predictions but rather as indications of expected trends, given certain expenditure, revenue, and financing assumptions. The assumptions included in this section are based on current Board policy and goals and represent management's best estimates of results at this time. The five-year forecast is shown on Table 11.

Sources of Funds

Revenues

Revenues are projected to increase from about $1.05 billion to $1.14 billion over the next five years. Figure 8. Revenue Forecast, shows the major revenue categories and the expected trend for the next five years.

Figure 8. Revenue Forecast

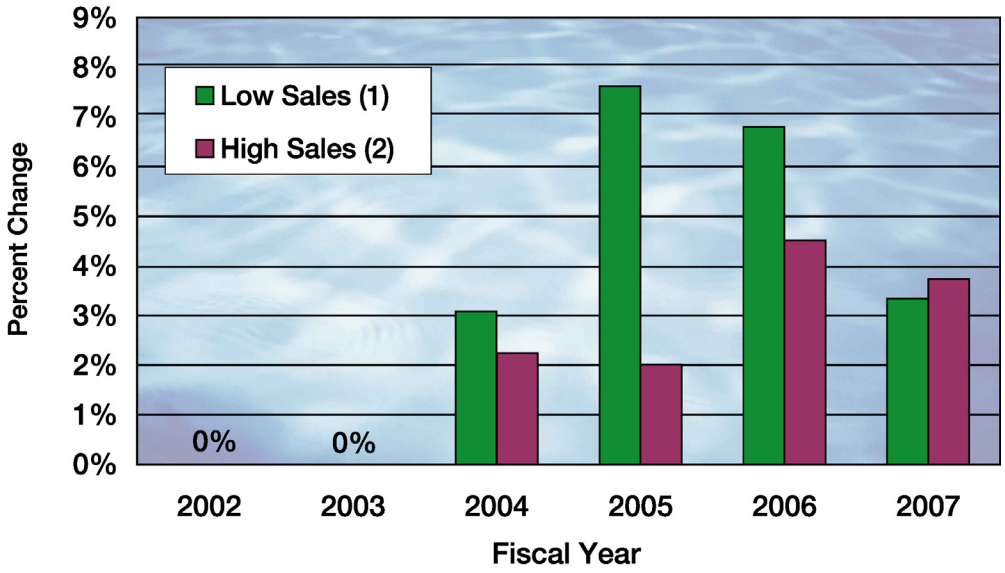


In fiscal year 2002/03, water sales revenues are estimated to be $811.4 million based on sales of 2.15 MAF. Revenue from water sales in fiscal year 2006/07 is projected to produce $835.0 million based on sales of approximately 1.9 MAF. The sales forecast is based on input from the member agencies and normal weather and hydrology. Under this scenario, the average cost per acre-foot would increase 3 percent in 2004, 7 ½ percent in 2005, 6 ¾ percent in 2006 and 3 ¼ percent in 2007. The primary drivers for the increase are planned investments in supply programs (e.g., California's Colorado River Water Use Plan), higher treatment costs associated with ozone or some alternative treatment process and funding for replacements and refurbishments.

However if water sales were to be 2.05 MAF per year, these rate increases would be much more modest, in the two – four percent range. Figure 9 shows the percent change in the average cost per acre-foot under these two scenarios. The average cost per acre-foot is defined as all collections from

water rates and charges (supply rates, system access rate, system power rate, water stewardship rate, long-term seasonal storage water rates, interim agricultural water program, treatment surcharge, capacity reservation charge and readiness-to-serve charge) divided by the estimate of acre-feet to be sold.

Figure 9. Percent Change in Average MWD Rate



(1) Expected sales are estimated at about 1.9 MAF each year.
(2) High sales are estimated at about 2.05 MAF each year.

Detailed tables showing projected rates and charges for the time period are included at the end of the 2002/02 Annual Budget Executive Summary under Metropolitan's New Rate Structure.

Interest income is projected to increase from $29.4 million in 2002/03 to $37.0 million in 2006/07 because increases in receipts result in higher cash balances available for investment. Ad valorem property taxes are projected to remain at approximately $102.0 million over this period. This is based on the maximum tax rate allowable under Section 124.5 of the Metropolitan Water District Act. Depending on increases in assessed valuation, the tax rate could be reduced from the current rate of .0077 percent.

Sales from Metropolitan's 16 hydroelectric power recovery plants are projected to increase from $18.2 million to $20.0 million over this time period. Historically, hydropower revenues have ranged from about $15 million to about $25 million depending on demands on the system.

Revenue from the San Diego/Metropolitan Exchange Agreement is projected to grow from $1.6 million in 2002/03 to about $10.0 million in 2006/07.

Other Funding Sources

Other sources of funds include withdrawals from the Water Transfer Fund, bond construction funds, and rate stabilization funds.

Over this planning horizon, it is anticipated that between $50 million to $83 million annually will be drawn from the Water Transfer Fund to pay for water transfer and storage programs. The projects that the money will be used for are outlined under Uses of Funds.

PAYG and bond proceeds will be used to fund the CIP. PAYG funding from current revenues will increase $5 million per year from $90 million in 2002/03 to $110 million in 2006/07. A discussion of increasing PAYG is included under the "Capital Investment Plan and Financing Plan". The balance of the money needed to fund the CIP will come from bond proceeds.

Draws from rate stabilization funds (RSF) are projected to vary year to year, largely depending on water sales. Based on sales of 1.9 MAF per year, approximately $86.1 million will be needed in 2003/04, $39.2 million in 2004/05, and $29.5 million in 2005/06. Higher water sales will result in a lower draw from RSF, and lower water sales than estimated would result in an increased need for RSF.

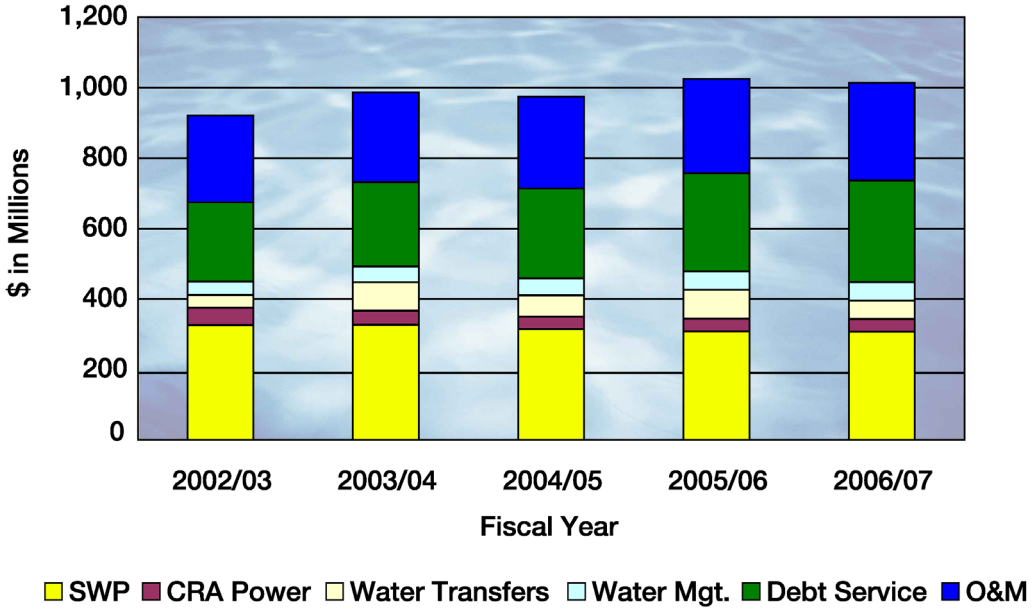
Uses of Funds

Over the next five years, expenditures and other obligations are projected to increase from $1.25 billion to $1.46 billion.

Expenditures

There are six major categories of operating expenditures: SWC, CRA power, water transfer expenditures, water management programs (WRM), debt service, including debt defeasance, and O&M. As shown on Figure 10, operating expenditures are projected to increase from $940.7 million to 1.014 billion.

Figure 10. Expenditure Forecast



State Water Contract

SWC expenditures are projected to decline from $343.8 million to $307.6 million over the five-year period. The primary reason for the decrease is lower power costs associated with a return to normal wholesale power costs and reduced deliveries. Based on sales of 1.9 MAF per year, diversions from the State Water Project are projected to decline from 1.16 MAF in 2002/03 to 984,000 AF in 2006/07. These flows are adequate to meet the Board's policy of maintaining a salinity level of 500 milligrams

per liter or less. If diversions are higher, power costs will also increase. The power estimates are based on net billing rates (after power sales) for variable power of about 14 mills/kWh.

Colorado River Aqueduct Power Costs

Pumping costs on the CRA are projected to decline from $48.9 million in 2002/03 to $35.7 million in 2007. Diversions are projected to decrease from 1.21 MAF in 2002/03 to 1.13 MAF in 2006/07. It is assumed that the cost of supplemental energy will be about 11 mills/kWh over this period.

Water Transfers and Options

Annual project outlays are projected to range from $36.7 million to $82.6 million over this time period. Programs that could have major expenditures in this window, if approved by the Board, include Palo Verde Land Management and Water Supply Program, agreements with Rosedale Rio Bravo Water District, West Kern Water District, Buena Vista Water District, and other water districts in the San Joaquin Valley, as well as Cadiz, and San Bernardino Valley Municipal Water District.

Water Management Programs

Water management costs are projected to increase from $38.4 million in 2002/03 to $53.5 million in 2006/07. Conservation costs are projected to be relatively flat at $13 – 14 million per year. The increase reflects additional investment in the LRP. Twelve projects are scheduled to come on line during the period. The yield from the LRP is expected to increase from 137,400 AF in 2002/03 to 214,000 AF in 2006/07. These estimates are consistent with the Report on Metropolitan's Water Supplies dated February 11, 2002.

Debt Service and Bond Defeasance

Revenue bond debt service costs are projected to increase from $153.7 million to $237.1 million over the next five years. General obligation bond debt service will be relatively flat at $50 million per year. The increase in revenue bond debt service reflects future debt sales to finance the CIP. A mix of fixed rate debt and variable rate debt will be issued to help manage debt service costs. More information on Metropolitan's financing plan is included below.

This forecast includes cash defeasance of debt of about $22 million per year. This is consistent with the Board's action in July 2000 to defease $84.6 million in August 2000 and then use the savings to defease additional debt in subsequent years.

Operations and Maintenance

O&M costs in 2006/07 are projected to be $277.8 million. This represents an average annual increase of less than three percent from 2002/03. We are projecting that we will be able to absorb a portion of the increases associated with the negotiated Memoranda of Understanding and also bring ozone on-line at the Mills and Jensen filtration plants with modest increases due to productivity gains. We will be focusing on investing in our workforce, judiciously using technology to boost productivity, and identifying business process reengineering opportunities to reduce cycle time for support services. It is also anticipated that implementing streamlined maintenance practices developed by multi-skilled worker teams can offset the need for additional positions to handle new facilities such as Skinner Filtration Plant Module No. 7 and maintaining ozone equipment.

Staffing levels are projected to decline to about 2,025 positions.

Included in the 2002/03 Annual Budget document are "Three-Year Outlooks" by Group that provide more information.

Capital Investment and Financing Plans

CIP/SPC expenditures over the next five years are shown by category in Table 10 below. In 2000, an Infrastructure Reliability and Protection Plan (IRPP) was developed to identify critical features of Metropolitan's infrastructure that need to be refurbished or replaced. In 2001, an Asset Replacement Study was undertaken to help formulate a financial policy for funding refurbishments and replacements (R&R). For R&R projects that have been identified thus far, outlays are projected to decrease from $95.1 million in 2002/03 to $63.1 million in 2006/07. However it is anticipated that as we continue to refine the infrastructure review process by linking the IRPP to the asset replacement model, R&R requirements will be in excess of $100 million per year over the next five years. The use of PAYG funds are projected to increase $5 million per year from $90 million to $110 million to provide necessary funds for R&R projects.

New facilities included in the CIP over this period that have large expenditures include Inland Feeder, Oxidation Retrofit Program, San Diego Pipeline #6, Colorado River Banking Programs, and Diamond Valley Lake Recreation Program. These five programs account for more than 80 percent of the projected expenditures.

Table 10 shows Metropolitan's financing plan for the CIP.

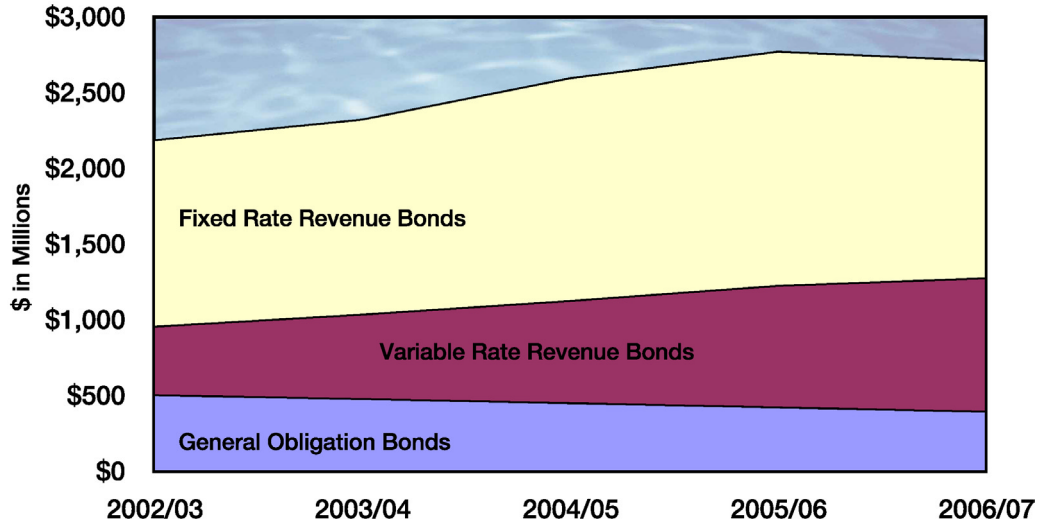
Table 10. CIP/SPC Five-Year Forecast and Funding Sources

	2002/03	2003/04	2004/05	2005/06	2006/07	Total
Program Category						
Supply	$18.2	$31.3	$125.7	$52.8	$17.3	**$245.30**
Conveyance and Aqueduct	73.2	126.1	124.0	63.6	67.8	**454.7**
Storage	25.8	28.7	42.9	2.6	2.4	**102.4**
Treatment	25.0	49.2	79.8	174.3	177.3	**505.6**
Distribution	75.4	124.6	117.1	129.1	113.6	**559.8**
General	21.2	10.8	3.9	1.7	0	**37.6**
Total	**$238.80**	**$370.70**	**$493.40**	**$424.10**	**$378.40**	**$1905.40**
Funding Sources						
Variable Rate Debt	$98.8	$101.7	$76.4	$93.1	$252.4	**$622.40**
Fixed Rate Debt	0.0	174.0	317.0	226.0	16.0	**733.0**
PAYG	140.0	95.0	100.0	105.0	110.0	**5500.0**
Total	**$238.80**	**$370.70**	**$493.40**	**$424.10**	**$378.40**	**$6855.40**

As shown above, 71 percent of future capital expenditures will necessarily be funded by debt proceeds.

Figure 11 below shows the composition of Metropolitan's projected outstanding debt over this time period.

Figure 11. Total Outstanding Debt
Fiscal Years 2002/03 - 2006/07



Other Obligations

Other obligations include deposits to the Water Transfer Fund and increases in required reserves.

In order for Metropolitan to ensure reliability and quality, it will be necessary to invest in a variety of water transfer, banking, and other cooperative agreements. In order to fund these programs while providing stable and predictable water rates, the Board approved Water Transfer Fund deposits to be made from annual operating revenues as part of the 2001/02 budget. Over the next five years, deposits are projected to increase from $45 million per year to $60 million per year.

Metropolitan must make transfers to reserves to meet revenue bond covenants and board policies. Over the next five years, the annual transfer amount is estimated to range from a high of $29.6 million to a low of $6.6 million per year.

Fund Balance and Reserves

Over the next five years, it is anticipated that the total fund balances will decrease from $893.8 million at the end of 2002/03 to $730.5 million at the end of 2006/07 as reserves are utilized to meet projected expenditures. Unrestricted fund balances are projected to be $368.1 million at the end of 2002/03 and $230.5 million at the end of 2006/07. Use of WRSF reserves is projected to be $86.1 million in 2003/04, $39.2 million in 2004/05, and $29.5 million in 2005/06. The use of these funds is driven by the need to implement water transfer/banking programs on the Colorado River Aqueduct and California Aqueduct to ensure water reliability and quality and projected capital financing costs. At the same time, fixed costs are increasing, and the minimum reserve level is projected to increase from $138.7 million in 2002/03 to $144.8 million in 2006/07. The maximum reserve level increases from $331.5 million in 2002/03 to $343.3 million in 2006/07.

Current estimates indicate that reserves at June 30, 2007 will be $170.3 million under the maximum reserve level and $28.8 million over the minimum reserve level.

Financial Ratios

The revenue bond coverage ratio is projected to decline from 2.70 times to 2.06 times. This important statistic is equal to the ratio of net revenues to debt service on revenue bond debt. While this ratio is trending down, the levels are sufficient to maintain Metropolitan's credit ratings of Aa2 for fixed rate bonds and VMIG 1 for variable rate bonds from Moody's Investment Service, AA and A-1+ (fixed rate bonds and variable rate bonds, respectively) from Standard & Poor's corporations, and AA from Fitch over this period. Staff will continue to implement cost savings measures and explore financing options to maintain a coverage of 2.0 times or better.

Fixed charge coverage measures the amount by which net operating revenues "cover" all recurring fixed costs. This is a broader ratio than the revenue bond coverage ratio and is one measure used to gauge Metropolitan's overall financial strength. For fiscal year 2002/03, the fixed charge coverage is projected to be 1.49 times. Like the revenue bond coverage ratio, this ratio is also projected to decline. At the end of fiscal year 2006/07, this ratio is projected to be 1.35 times. Ratios over 1.0 times are considered adequate.

Metropolitan's variable rate debt as a percentage of total revenue bond debt is projected to remain at 32 percent. The appropriate amount of variable rate debt will continue to be monitored and adjusted, depending on market rates, financing needs and available short-term investments.

Table 11. Five-Year Financial Forecast – Cash Basis

($ in Thousands)

	2002/03	2003/04	2004/05	2005/06	2006/07
TOTAL USES OF FUNDS	**$1,252,627**	**$1,417,530**	**$1,541,998**	**$1,538,425**	**$1,461,081**
Operating Expenditures					
State Water Contract	343,754	327,986	313,792	308,078	307,636
Supply Programs Paid from Water Transfer Fund	36,724	80,567	60,327	82,602	51,645
Colorado River Power Costs	48,884	39,763	36,030	35,961	35,712
Debt Service and Bond Defeasance	225,369	239,460	255,680	277,210	287,829
Water Management Programs	38,446	44,687	48,950	51,859	53,549
Departmental and Other O&M	247,526	255,501	261,309	268,957	277,851
Subtotal Operating Expenditures	**940,704**	**987,964**	**976,088**	**1,024,666**	**1,014,222**
CIP and Supply Program Capital					
Paid from Bond Proceeds	98,734	275,653	393,373	319,143	268,380
Paid from PAYG	140,100	95,000	100,000	105,000	110,000
Subtotal CIP/SPC Expenditures	**238,834**	**370,653**	**493,373**	**424,143**	**378,380**
Fund Deposits					
Deposit to Water Transfer Fund	45,000	45,000	55,000	60,000	60,000
Increase in Required Reserves	21,368	13,913	17,537	29,616	6,683
Increase in Rate Stabilization Funds	6,721	–	–	–	1,796
Subtotal Fund Deposits	**73,089**	**58,913**	**72,537**	**89,616**	**68,479**
Member Agency Credit	–	–	–	–	–
SOURCES OF FUNDS					
Receipts					
Taxes	102,110	102,202	102,139	101,726	101,383
Interest	29,378	30,055	36,120	36,676	36,958
Power & Misc.	18,153	16,209	20,000	20,000	20,000
Readiness to Serve Charge	80,000	82,289	86,323	90,621	92,754
Connection Maintenance Charge	1,424	–	–	–	–
Capacity Reservation Charge	9,030	27,117	31,609	39,934	44,953
SDCWA/MWD Exchange Agreement	1,620	3,619	5,680	7,803	9,992
Wheeling	–	–	–	–	–
Water Sales	811,440	713,675	767,196	810,445	835,016
Subtotal Receipts	**1,053,155**	**975,166**	**1,049,067**	**1,107,206**	**1,141,056**
Fund Withdrawals					
Withdrawal from Transfer Fund	50,638	80,567	60,327	82,602	51,645
Pay As You Go Funds for Construction	50,100	–	–	–	–
Bond Funds for Construction	98,734	275,653	393,373	319,143	268,380
Decrease in Required Reserves	–	–	–	–	–
Use of Rate Stabilization Funds	–	86,145	39,231	29,475	–
Subtotal Fund Withdrawals	**199,472**	**442,364**	**492,931**	**431,219**	**320,025**
TOTAL SOURCES OF FUNDS	**$1,252,627**	**1,417,530**	**1,541,998**	**1,538,425**	**1,461,081**
WATER SALES (millions of acre-feet)	**2.15**	**1.90**	**1.89**	**1.89**	**1.89**

	2002/03	2003/04	2004/05	2005/06	2006/07
RATIOS					
Jr. Lien Revenue Bond Coverage	2.70	1.93	2.21	2.14	2.06
Fixed Charge Coverage	1.49	1.09	1.30	1.28	1.35
Variable Rate Debt as a % of Total Revenue Bond Debt	32.5%	32.7%	31.9%	32.3%	32.0%
RESTRICTED FUNDS					
Bond Construction	$71,540	$49,944	$1,866	$50,420	$49,376
Debt Service Funds	114,200	120,810	132,439	161,185	163,841
State Water Contract Fund	73,069	74,045	72,761	72,065	72,382
O&M Fund	105,068	104,187	105,434	107,207	107,777
Transfer Fund	64,371	28,804	23,477	875	9,230
Self-insured Retention Fund	25,000	25,000	25,000	25,000	25,000
All other (e.g trust funds)	72,400	72,400	72,400	72,400	72,400
Subtotal Restricted Funds	**525,648**	**475,190**	**483,377**	**489,152**	**500,006**
UNRESTRICTED FUNDS					
PAYG	47,500	50,000	52,500	55,000	57,500
Revenue Remainder Fund	138,727	143,435	146,880	144,173	144,173
Rate Stabilization Funds	181,900	95,755	56,525	27,050	28,846
Subtotal Unrestricted Funds	**368,127**	**289,190**	**255,904**	**226,223**	**230,519**
Total Funds	**893,775**	**764,380**	**739,281**	**715,375**	**730,525**