

● **Budget, Finance and Investment Committee**

December 9, 2002 Committee Meeting

6a

Subject

Determination of water revenue requirements for fiscal year 2003/04

Description

The first step in Metropolitan's rate setting process is the determination of the annual cost to be paid from water rates and charges (revenue requirements). The revenue requirements will be used to determine the water rates and charges to be effective on January 1, 2004.

Estimates of the total revenues required to fund expenditures not funded from debt proceeds and taxes have been prepared for FY 2003/04. 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 2003/04 are estimated to be \$1,082.1 million. Of this amount, \$147.0 million will be generated from property taxes, interest income and other revenues. Therefore, rates and charges will need to generate \$935.1 million.

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

MAJOR ASSUMPTIONS

Cash year water sales are projected to be 2.43 million acre-feet in FY 2002/03, and about 2.07 MAF in FY 2003/04. These forecasts reflect actual sales through September 2002 and estimates for the remaining period. The estimates are based on demands under average weather conditions.

Variations in water sales will greatly impact reserve levels and possibly 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 FY 2003/04, sales are estimated to be 2.07 MAF. However, based on weather conditions, sales could range from a low of about 1.70 MAF to a high of about 2.50 MAF. The major assumptions on which the expenditure and revenue requirements for FY 2003/04 are based include:

Water Sales	2.07 MAF
Water to Storage, Exchanges and Losses	0.25 MAF
Water from Storage, Exchanges, and Transfers	0.00 MAF
Colorado River Supplies	1.11 MAF
State Water Project Supplies	1.21 MAF

The revenue requirement assumes the Quantification Settlement Agreement is successfully implemented. But, due to the current dry conditions in the Colorado River watershed, the revenue requirement assumes that Metropolitan will receive about 1.1 million acre-feet from the Colorado River in FY 2003/04 as a result of a partial surplus. If sufficient SWP supplies are available Metropolitan will continue to store water. If water demands are higher than those assumed for the revenue requirements and less SWP and Colorado River water supplies are available, additional expenses for the development of supplies (e.g., water transfers) will be incurred. A discussion of the costs associated with expected operating conditions is included below under "Water Transfer Fund."

PROJECTED COSTS FOR FISCAL YEAR 2003/04 Total = \$1,082.1 million**State Water Project \$358.2 million**

Total costs for FY 2003/04 under the State Water Project are estimated to be approximately \$358.2 million (net of projected credits and based on projected water deliveries of about 1.21 MAF).

Colorado River Power Costs \$29.6 million

Colorado River Aqueduct diversions are expected to total about 1.11 MAF in FY 2003/04. Power costs for pumping are estimated to be about \$29.6 million. This estimate includes an average cost for wholesale market power purchases of about \$28 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.

Deposit to Water Transfer Fund \$45.0 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. Although it is anticipated that a significant amount of funds will be withdrawn from the Water Transfer Fund, the impact of the Water Transfer Fund on the revenue requirement is limited to the deposit of \$45.0 million from operating revenue.

Withdrawals from the Water Transfer Fund include expenditures for CRA Programs of \$50.0 million. This includes \$6.7 million for the existing conservation agreement between Metropolitan and Imperial Irrigation District and \$43.3 million for the Palo Verde Irrigation District Land Management, Crop Rotation and Water Supply Program (partial up-front payment and initial operating cost).

About \$10.1 million will be withdrawn from the Water Transfer Fund to fund operating costs for the Semitropic Water Banking and Exchange Program and the San Bernardino Transfer Program.

At the end of FY 2003/04 the Water Transfer Fund is expected to have a balance of \$9.6 million. If demands are higher than assumed and/or supplies are less than assumed, costs for the operations of storage programs and the purchase of water transfers could increase substantially. These additional costs would be paid from the Water Transfer Fund and Water Rate Stabilization Fund as needed.

Water Management Programs \$46.7 million

Water management program expenses are expected to total \$46.7 million in FY 2003/04. The estimate is based on increased efforts in Metropolitan's conservation credits program, particularly in the area of large landscape programs, 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 their annual production by about 29,000 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 agencies and other local agencies based on the Integrated Resources Plan.

Metropolitan's recent Request for Proposals for desalination projects identified five projects with a potential total yield of about 126,000 acre-feet per year. These projects should not impact Metropolitan's revenue requirements until 2007.

Metropolitan Capital Financing Program \$332.6 million

Capital Financing Program costs include \$165.3 million of revenue bond debt service, and \$50.5 million of general obligation bond debt service.

The Capital Financing Program costs also include \$95.0 million of Pay-As-You-Go expenditures funded from current operating revenue and \$21.9 million for bond defeasance as previously directed by the Board. Total FY 2003/04 capital investment program expenditures for Metropolitan's CIP are estimated to be \$377.9 million.

MWD O&M and Operating Equipment **\$256.1 million**

Projected departmental operation and maintenance, operating equipment and other O&M expenditures of \$256.1 million are projected to be approximately \$9.9 million higher than estimates for the current fiscal year. This increase is largely attributed to increased chemical, sludge and power costs for treatment. A detailed breakdown of projected O&M expenditures will be provided during the development of the FY 2003/04 Annual Budget.

Adjustments in Reserves **\$13.9 million**

During FY 2003/04, an increase in required reserve balances of \$13.9 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 (on July 1) to make interest and principal payments for outstanding and projected debt obligations due July 1, 2004 and to meet revenue bond covenant requirements for debt payments after July 2004. Other fund requirements for July 1, 2004 include the State Water Contract Fund and the Operations and Maintenance Fund.

PROJECTED REVENUES FOR FISCAL YEAR 2003/04 **Total = \$1,082.1 million**

To determine the rates and charges revenue requirements this total is reduced by revenue from ad valorem property taxes, interest income, hydropower revenues and miscellaneous revenues. Ad valorem property taxes levied at the reduced tax rate of 0.0067 percent of assessed valuations and from annexation charges are estimated to be \$99.3 million. Power recoveries, interest on investments and miscellaneous revenue are expected to produce \$47.7 million during FY 2003/04. Based on the projected expenditure estimates described above, total revenues required from rates and charges in FY 2003/04 are projected to be \$935.1 million.

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 Budget, Finance and Investment Committee. The Budget, Finance and Investment 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)

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 determine that revenues required from rates and charges during FY 2003/04 should not be less than \$935.1 million; and use this determination for consideration at the January 2003 meeting of the Budget, Finance and Investment Committee in establishing water rates and charges to be effective January 1, 2004.

Fiscal Impact: Revenues from rates and charges of \$935.1 million

Option #2

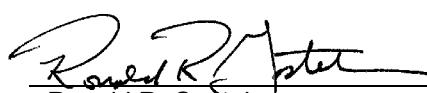
Adopt the CEQA determination and direct staff to revise the FY 2003/04 revenue requirement per board direction.

Fiscal Impact: Undetermined

Staff Recommendation

Option #1



Brian G. Thomas
Chief Financial Officer11/22/2002
Date

Ronald R. Gastelum
Chief Executive Officer11/22/2002
Date**Attachment 1 – Projected Fiscal Year 2003/04 Revenue Requirements**

BLA #1983

ATTACHMENT 1							
PROJECTED FISCAL YEAR 2003/04 REVENUE REQUIREMENTS							
(Cash Basis: \$ in thousands)							
Fiscal Year	<u>Estimated</u> 2002/03		<u>Projection ---></u> 2003/04		2004/05	2005/06	2006/07
Expenditures							
State Water Contract	\$ 352,970	\$ 358,216	\$ 349,359	\$ 355,086	\$ 360,469	\$ 363,504	
Colorado River Aqueduct Power Costs	49,305	29,606	23,180	23,318	26,085	28,433	
Deposit to Transfer Fund	45,000	45,000	50,000	55,000	55,000	55,000	
Withdrawal from Transfer Fund for DVL Initial Fill	(13,234)	-	-	-	-	-	
Water Management Programs	34,570	46,725	50,125	52,156	55,398	57,241	
Capital Program Financing	333,965	332,634	351,296	372,487	383,388	378,766	
O&M and Operating Equipment	246,255	256,108	261,549	270,193	276,155	281,491	
Member Agency Credit	-	-	-	-	-	-	
Sub-Total Expenditures	1,048,831	1,068,289	1,085,510	1,128,240	1,156,495	1,164,435	
Increase/(Decrease) in Required Reserves	20,588	13,882	18,267	28,878	4,325	10,475	
Total Obligations	1,069,418	1,082,171	1,103,777	1,157,118	1,160,820	1,174,910	
Less Other Revenues							
less Property Taxes	(101,813)	(99,318)	(98,936)	(98,474)	(98,185)	(98,100)	
Interest Income	(37,066)	(32,853)	(40,692)	(39,823)	(40,203)	(42,089)	
Power and Miscellaneous Revenue	(17,948)	(13,209)	(11,184)	(11,177)	(10,580)	(9,413)	
Contracts	-	(1,630)	(2,318)	(3,362)	(4,437)	(5,195)	
Wheeling	(3,243)	-	-	-	-	-	
Prior Period Revenues Used to Reduce Debt	(21,119)	-	-	-	-	-	
Sub-Total Other Revenues	(181,189)	(147,010)	(153,131)	(152,837)	(153,405)	(154,797)	
Total Rates and Charges Revenue Requirement	\$ 888,229	\$ 935,161	\$ 950,646	\$ 1,004,281	\$ 1,007,415	\$ 1,020,113	
Rates and Charges Revenue	\$ 964,065	\$ 860,050	\$ 876,123	\$ 967,886	\$ 1,009,481	\$ 1,041,567	
Reserve Levels							
Maximum Reserve Level	\$ 330,879	\$ 339,584	\$ 342,941	\$ 340,609	\$ 343,367	\$ 349,150	
Projected Reserve Level	\$ 386,392	\$ 316,263	\$ 246,474	\$ 208,378	\$ 210,444	\$ 231,905	
Minimum Reserve Level	\$ 138,138	\$ 143,119	\$ 147,855	\$ 146,154	\$ 146,161	\$ 146,898	
Water Sales (Cash Year TAF)							
Full Service Treated	1,304	1,124	1,103	1,101	1,106	1,114	
Full Service Untreated	681	622	564	573	573	575	
Seasonal Treated	62	47	48	31	26	25	
Seasonal Untreated	253	128	140	130	103	94	
Agricultural Treated	97	114	95	89	87	86	
Agricultural Untreated	35	33	20	17	17	17	
Total Cash Year Sales (TAF)	2,433	2,068	1,970	1,941	1,912	1,910	