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

November 18, 2003 Board Meeting

9-1

Subject

Approve use of funds over maximum reserve target

Description

Metropolitan's total sales in fiscal year 2002/03 were 2.34 million acre-feet, the third highest sales year on record and the third year in a row of above-average sales. Expenditures for the year totaled $980.8 million and receipts totaled $1,128.5 million. Metropolitan's maximum reserve level as of June 30, 2003 was $353 million. As of June 30, after accounting for required transfers and adjustments to reserves, the balance in the Revenue Remainder Fund and the Water Rate Stabilization Fund was $411.7 million. Funds in the WRSF allocated for the 2003 cash defeasance totaled $22.4 million. Therefore, the amount over the maximum reserve target as of June 30, 2003 was $36.3 million.

Funds available over the target may be expended for any lawful purpose provided that Metropolitan's fixed charge coverage ratio is at or above 1.2. The fixed charge coverage ratio was 1.83 as of June 30, 2003.

As in previous years when sufficient funds were available, the Board may utilize these funds in any of the following ways:

a. **Help fund the Capital Investment Program**. The CIP is estimated to be about $3.5 billion over the next ten years and almost $1.9 billion over the next five years. Use of these one-time revenues for long-term capital assets would help reduce future debt service, reducing water rates in the future.

b. **Defease existing debt**. Given that Metropolitan has outstanding revenue bond debt of about $3 billion, plus up to about $3.5 billion of capital to finance, the available funds could be utilized to help reduce debt service over the next four to ten years, allowing for a mitigation of necessary rate increases. If the funds were used to defease principal payments over the next four years, rates would be $4/acre-foot less than otherwise required. This effectively returns funds to the member agencies over the next four years.

c. **Reduce water bills**. The funds could be used as a credit against future water bills, reducing payments to Metropolitan. In effect, this would be a refund of the available funds.

d. **Fund water transfers and storage programs**. Metropolitan currently has about 2.5 million acre-feet of water in storage. If next year turns out to be dry, it may be necessary to replenish this storage or purchase additional water supplies to ensure reliable deliveries. The funds could help finance these efforts.

e. **Fund conservation and water recycling projects**. The monies could be used to fund Metropolitan's incentives for additional local resources and conservation programs that provide reliable long-term sources of water supply.

f. **Fund local supply reliability projects**. Some member agency managers have requested that the funds be allocated to each member agency on a pro-rata basis equal to their percentage of purchased water excluding treatment surcharges during FY 2002/2003 for use in developing local long-term water supply and infrastructure projects. Under this proposal, Metropolitan would create non-interest-bearing accounts for each member agency. The member agencies would then withdraw funds to help pay for local water supply and infrastructure projects.

Of course, any combination of these actions could also be approved.

Current estimates indicate that capital financing requirements, increasing operating costs, and the need to continue to invest in the region's supply reliability through Metropolitan's demand management programs (such as the Conservation Credits Program and the Local Resources Program) may require increasing the average effective water rate by 3 to 4.5 percent over the next five years, depending on actual water sales. These increases would be in line with previous projections provided to the Board and approximate the projected rate of inflation. To help meet a plan of maintaining predictable and manageable future rate increases, staff recommends that the funds over the maximum reserve level as of June 30, 2003 be used to defease outstanding debt. In this way, the $36.3 million may be used to augment Metropolitan's debt restructuring plan to help mitigate increases in water rates and charges over the next four or five years. The use of funds to defease additional outstanding debt will benefit both short-term and long-term ratepayers.

Policy

Metropolitan Water District Administrative Code § 5202 (e): Fund Parameters

California Environmental Quality Act (CEQA)

CEQA determination for Options #1, #2, and #3:

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

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

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and use $36.3 million to cash defease outstanding debt to create the greatest benefit in the next five years by reducing the magnitude of expected rate increases.

Fiscal Impact: Estimated reduction in rate increases of $4 per acre-foot per year for four years.

Option #2

Adopt the CEQA determination and increase capital investment plan funding. Use $36.3 million in lieu of issuing additional long-term debt to effectively advance funding future capital investment plan obligations with cash.

Fiscal Impact: Estimated long-term reduction in future rate increases of $1 per acre-foot.

Option #3

Adopt the CEQA determination and provide credits on member agencies' water bills or utilize funds to support local water supply projects. Apply $36.3 million as a credit on member agency bills or allocate $36.3 million to member agencies on a pro-rata basis (in proportion to water sales revenue, exclusive of treatment surcharge revenue).

Fiscal Impact: Loss of additional funding source for capital investment plan, resulting in additional future rate increases.

Staff Recommendation

Option #1

Brian G. Thomas	10/22/2003
Chief Financial Officer	*Date*
Ronald R. Gastelum	10/27/2003
Chief Executive Officer	*Date*

BLA #2532