MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

BOARD ACTION

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

June 8, 2004 Board Meeting

9-1

Subject

Approve fiscal year 2004/05 annual budget and change to fiscal year 2003/04 budget

Description

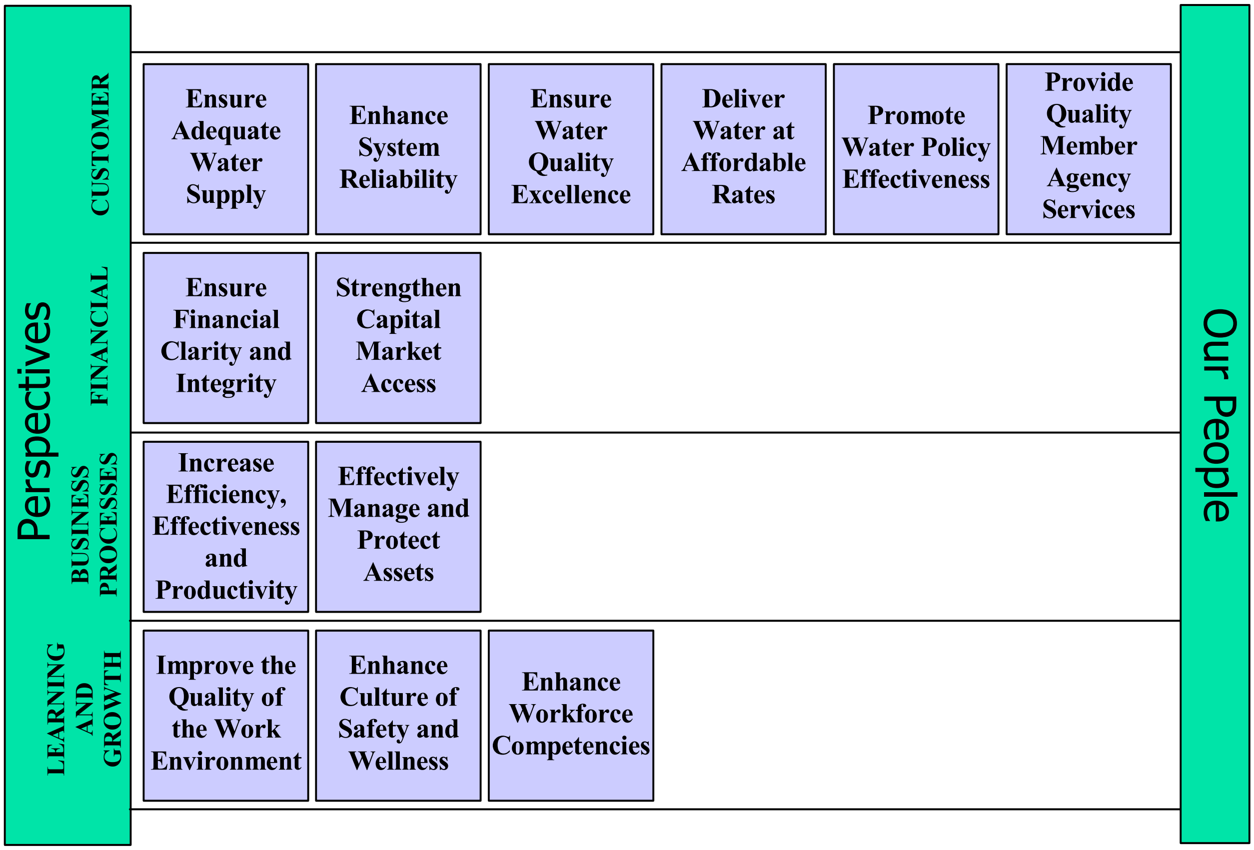
Fiscal year 2003/04 was marked by a number of water supply and quality challenges, including delivering 2.3 million acre-feet of water to our member agencies while managing Colorado River supplies that were about half of previous years. As Metropolitan moves into the coming fiscal year and beyond, continuing to add to our diverse water supply portfolio, storage, and conservation resources will be an ongoing effort that will require additional investments into the future. Further, water quality improvements, including the addition of ozone and the expansion of our treatment capacity, will put upward pressure on costs. Metropolitan's challenge will be to meet our member agencies' and the region's water reliability and quality needs in a manner that is fiscally responsible and with an impact on water rates that is close to inflation.

Some of the more notable accomplishments of the past fiscal year include: met 2.3 million acre-feet of demand; increased storage capacity by 320,000 acre-feet to 2.7 million acre-feet by implementing conjunctive-use programs with our member agencies and the North Kern and Mojave storage programs; complied with all primary drinking water quality standards; maintained a Total Dissolved Solids running average of less than 500 mg/liter; implemented the Perchlorate Action Plan; completed all financial audits with evaluations of generally satisfactory or better; managed operations and maintenance and capital expenditures within budget; executed the Quantification Settlement Agreement; finalized the Palo Verde Land Management Program; implemented infrastructure security improvements; operated the treatment and distribution system without any unplanned outages disrupting service; limited the water rate increase to less than half the overall water industry rate increase index; received an upgrade in long-term bond ratings from "AA" to "AA+" by Fitch Ratings; issued $775 million of refunding bonds, resulting in a net present value savings of $45 million; opened Diamond Valley Lake for public recreation and fishing; and launched the outdoor water conservation program.

Although we have been successful in many areas, several challenges remain. The arid conditions and supply variability in Southern California and the Colorado River watershed, when combined with varying degrees of member agency capability to withstand planned outages, require maximum flexibility in the operations of Metropolitan's treatment and distribution system. Metropolitan will supply almost 2.3 million acre-feet in fiscal year 2003/04. It is projected that system demands will be just over 2.3 million acre-feet in 2004/05. Regional growth management plans indicate that economic growth will continue in Metropolitan's service area. Metropolitan must continue to work to ensure that the challenges faced in meeting these demands and maintaining excellent water quality do not result in unexpected or unmanageable financial impacts to the member agencies and their customers. To this end, the proposed 2004/05 budget maintains total O&M costs at their 2003/04 budgeted level. Capital projects were carefully reprioritized and rescheduled for 2004/05 to reduce estimated capital costs by about $110 million, compared to last year's projection for 2004/05. However, State Water Project costs will be higher due to the greater need for energy to pump greater quantities of water through the California Aqueduct.

The 2004/05 budget supports the Chief Executive Officer's Business Plan. The CEO's Business Plan identifies strategies that help achieve Metropolitan's mission. These strategies reflect four perspectives of Metropolitan's operations: customer, financial, business process, and learning and growth. Each strategy is supported by initiatives, actions, and tasks that will continue, start, or be completed during the coming year. A diagram summarizing the perspectives and strategies is shown in Figure 1.

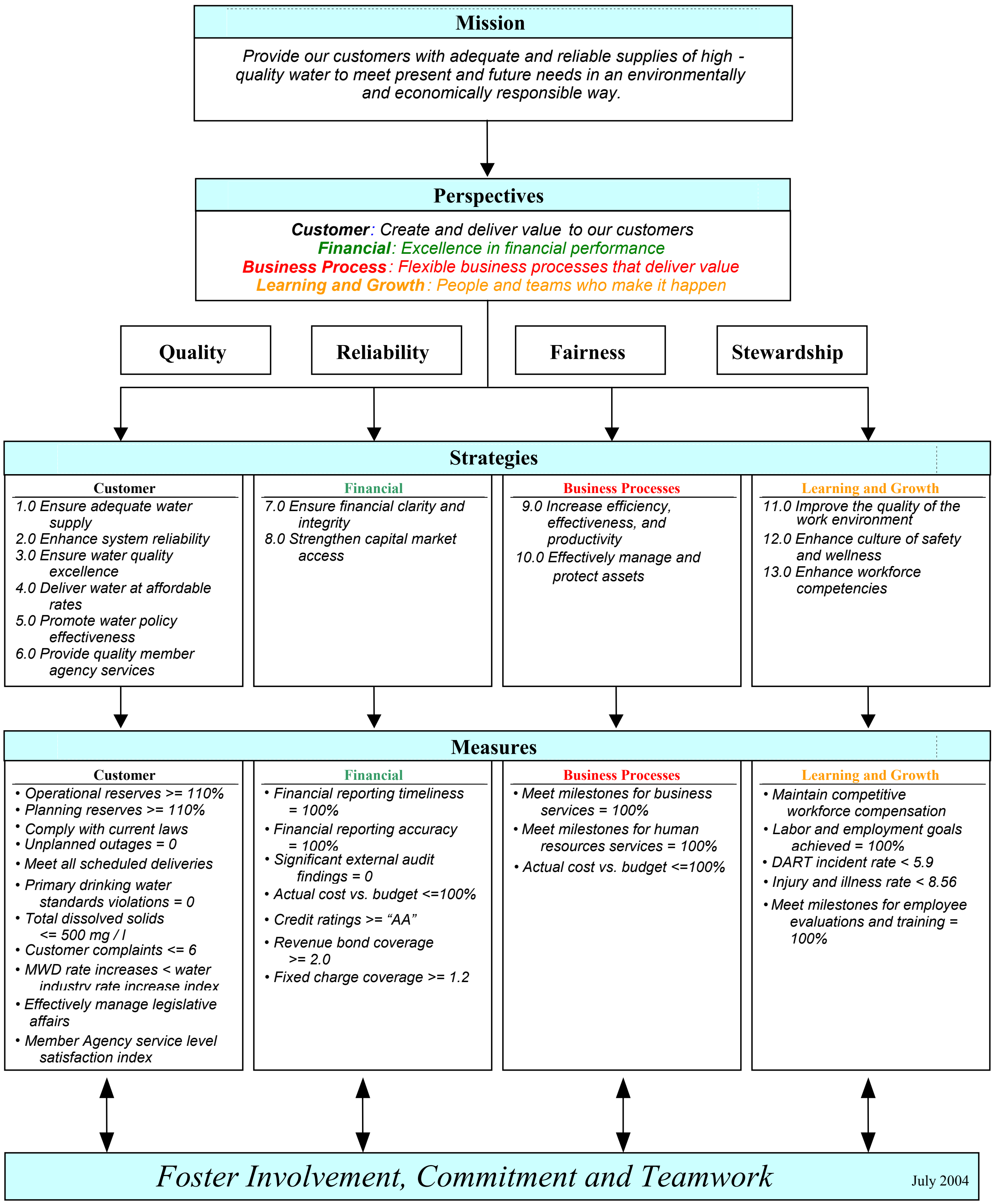
Figure 1. Metropolitan Perspectives and Strategies



ACCOUNTABILITY AND PERFORMANCE MEASUREMENT

Performance measures are one means to monitor success implementing the CEO's Business Plan. Progress has been made developing and implementing performance measures throughout Metropolitan. Efforts to refine the use of performance measures in Metropolitan's daily operations include developing successive levels of performance measures within each of the groups, producing quarterly reports to the CEO that include discussion of performance measures, training staff on performance measures and reviewing business system applications for performance measure reporting. For fiscal year 2004/05, each group's budget includes performance measures in addition to those included in the CEO's Business Plan. Figure 2 shows the linkage between Metropolitan's mission, strategies, and performance measures as described in the Business Plan.

Figure 2. CEO's Business Plan Flowchart



MAJOR STRATEGIES AND INITIATIVES

As seen in Figures 1 and 2, Metropolitan will utilize 13 major strategies to meet its mission in the coming years:

1. **Ensure adequate water supply:** Acquire sufficient water supply and demand management resources to satisfy dry-year demands through 2025, or as otherwise established by Integrated Resources Plan updates. Important initiatives include completing the Integrated Resources Plan update; implementing and administering local resource, conservation, and Seawater Desalination Programs; securing water transfers and storage; implementing Colorado River programs (e.g., Palo Verde Land Management Program); and supporting federal legislation to reauthorize CALFED and fund Record of Decision implementation.
2. **Enhance system reliability:** Maximize effectiveness of maintenance activities and implement replacement and improvement projects to ensure the delivery of water without interruption. Initiatives include completing the System Overview Study, implementing the board-approved Capital Investment Plan and implementing the Maintenance Action Plan.
3. **Ensure water quality excellence:** Develop and implement comprehensive programs to ensure Metropolitan delivers water that meets or exceeds all water quality regulations and objectives. Major initiatives include implementing the ozone retrofit program at all Metropolitan filtration plants to allow for treatment of higher blends of SWP supplies.
4. **Deliver water at affordable rates:** Manage costs to ensure reliable, quality water service at the lowest possible rates. Initiatives include active debt management, maintaining prudent investment and management of Metropolitan financial assets, competitive bidding of contracts, implementing more efficient business processes, and annually reviewing Metropolitan activities and their cost. The proposed budget is a reflection of these actions, resulting in a zero increase in the O&M budget.
5. **Promote water policy effectiveness:** Provide leadership and proactively address local, statewide and national issues to ensure water policy changes are positive and coordinated with member agencies. Initiatives include managing information programs to emphasize the value of long-term resource planning and managing federal, state, and local legislative programs and relationships.
6. **Provide quality member agency services:** Listen and work with Metropolitan's member agencies to assist in coordination and delivery of common water policy themes and actions to assure that Metropolitan is addressing those issues that are most important to its member agencies. Initiatives include updating the Regional Urban Water Management Plan and working with member agencies on local groundwater contamination issues.
7. **Ensure financial clarity and integrity:** Assure member agencies, rating agencies, the legislature and the public that Metropolitan is effectively managing the public's finances through consistent, clear, and timely financial policies and reporting. Initiatives include providing accurate and timely financial reports and ensuring adequate financial controls.
8. **Strengthen capital market access:** Ensure that Metropolitan continues to have access to capital markets at cost-effective rates by maintaining credit ratings of "AA" or better. Initiatives include upgrading Asset/Liability Management systems and updating the Long-Range Finance Plan.
9. **Increase efficiency, effectiveness, and productivity:** Improve employee productivity and morale through enhanced communications and process improvements, including application of advanced technologies. Initiatives include implementing the Information Technology Strategic Plan.
10. **Effectively manage and protect assets:** Maintain and improve Metropolitan's real property assets and facilities in a condition needed to support future demands, operational challenges, and business needs. Initiatives include implementing the Diamond Valley Lake recreation program and enhancing the security of Metropolitan infrastructure.

11. **Improve the quality of the work environment:** Provide the workforce with training and tools necessary to improve processes and services to member agencies and other customers. Initiatives include supporting the Labor Management Committee, enhancing training opportunities, improving the performance evaluation process, and continuing investments in technology.
12. **Enhance culture of safety and wellness:** Emphasize safe work practices that ensure the health and safety of the workforce. Initiatives include implementing Health, Safety, and Environmental audit recommendations and continuing to provide training on safe work practices.
13. **Enhance workforce competencies:** Provide training, tools, and career development opportunities to continually improve workforce skills and competencies. Initiatives include implementing a career planning process and the continued improvement of training for management and staff.

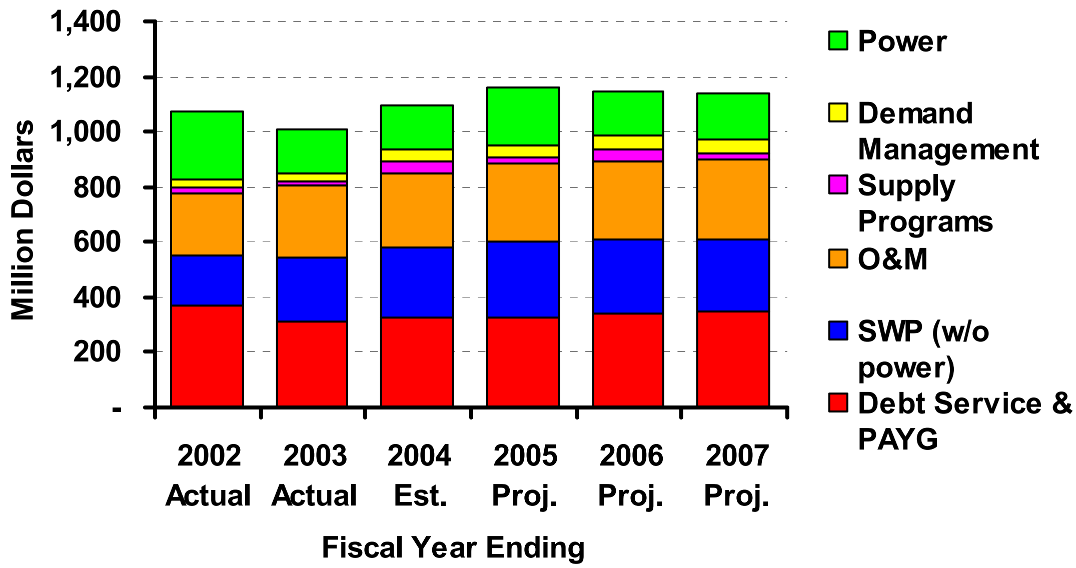
BUDGET TREND

To provide a longer-term picture of Metropolitan's costs, Figure 3 shows the major cost categories over the past three years, as well as the forecast for the following three years. Future cost drivers continue to be higher operations and maintenance costs due to inflation and labor costs, rising demand management costs for increased local resources and conservation investments, increasing State Water Project costs for operations and maintenance, and CIP financing costs. For 2004/05, the total annual capital cost for the CIP is $400.8 million. Carefully reprioritizing and rescheduling projects reduced CIP expenditures in 2004/05 by about $110 million, compared to the estimate included in the 2003/04 budget. As shown in Figure 3, from 2001/02 through 2004/05, expenditures are expected to increase by about $78.7 million, an average annual increase of about 2.4 percent. However, from 2004/05 through 2006/07, expenditures are forecasted to decrease by about $12.0 million, or about 0.5 percent per year. This decrease is driven by the up-front payments for the Palo Verde Land Management and Crop Rotation Program in 2004/05 that are not present in 2006/07 and high power costs on the State Water Project in 2004/05 that are expected to trend downward as supply programs on the Colorado River come on-line.

2003/04 BUDGET

While 2003/04 operations and maintenance costs have been equal to or less than budget, record high levels of pumping on the State Water Project have led to 2003/04 power costs exceeding budget estimates. During 2003/04, Metropolitan will have moved about 1.7 million acre-feet over the State Water Project system, about 400,000 acre-feet more than budget. This level of State Water Project power use is anticipated to continue into the 2004/05 year as we forecast almost 1.9 million acre-feet of water delivered over the State Water Project to Metropolitan. As a result of this higher level of use, total State Water Project costs are expected to be about $16 million over budget. Therefore, this letter requests that the 2003/04 budget appropriation of $752.8 million be increased by $16 million to $768.8 million to authorize these payments.

Figure 3. Six-year Budget Trend



Uses of Funds

As shown in Table 1, the total FY 2004/05 uses of funds are budgeted at $1.61 billion, an increase of $187.6 million (13 percent) from the 2003/04 budget. Total cash outlays for State Water Contract payments, supply programs, Colorado River Aqueduct power, debt service, demand management programs, operations and maintenance, and the CIP are budgeted at over $1.51 billion. This is about $230.4 million (18 percent) greater than the 2003/04 budget and $225.9 million (18 percent) greater than projected. In addition, $95.0 million of water revenues will be used for capital construction. This is the same level as in 2003/04 and about 24 percent of total 2004/05 budgeted capital expenditures.

SWP costs are estimated to be about $87.5 million higher than in the 2003/04 budget, reflecting costs to fund a power cost hedging program, the Hyatt Thermalito refurbishment program, a reduction in the Rate Management Rebate, financing costs associated with capital projects, and an increase in the Delta Conservation portion of the Replacement Account System. Power costs on the SWP are estimated to be $187.9 million for the delivery of about 1.86 million acre-feet into the service area.

Supply programs are estimated to be $35.6 million higher than the 2003/04 budget due primarily to up-front payments for the Palo Verde Land Management Program. The up-front payment will be funded from the Water Transfer Fund.

Colorado River Aqueduct power costs are increasing from the 2003/04 budget of $17.1 million by $1.7 million due to increased volume of water. It is expected that 0.60 million acre-feet will be diverted, including the use of several supply programs, such as the Palo Verde Land Management Program and the SDCWA/IID transfer.

Demand management costs, which include incentive payments made under Metropolitan's Local Resources and Conservation Credits Programs, are budgeted at about $46.8 million. This is up $8.4 million from the 2003/04 projected amount due to a projected increase of 30,000 acre-feet in local supply yield due to increased yields under the Local Resources Program.

O&M costs for 2004/05 are expected to remain flat, decreasing by about $0.7 million or 0.3 percent from the 2003/04 budget. Primary drivers include reduced chemical and sludge handling costs, which are offset by labor cost increases. The sludge handling, chemical and utilities costs for water treatment have decreased by $11.7 million as compared to last year's budget due to better than expected operational performance and lower chemical prices achieved through negotiation of longer term chemical contracts. Increases in labor costs account for a $10.7 million increase as compared to the 2003/04 budget. The personnel complement for 2004/05 is 2,018 positions, down three positions from the 2003/04 budget.

The CIP is budgeted at $400.8 million, or about $103 million higher than the 2003/04 budget. The major projects in this upcoming budget year include the Inland Feeder Project, the Oxidation Retrofit Projects at the Jensen and Skinner filtration plants, Diamond Valley Lake (DVL) recreation, filtration plant improvement projects, as well as infrastructure rehabilitation and replacement projects. While this represents a significant increase in capital spending, through careful screening, prioritization, and scheduling of projects, staff was able to reduce the 2004/05 capital spending by about $110 million from a previous estimate of about $511 million needed for 2004/05.

Sources of Funding

As shown in Table 1, FY 2004/05 sources of funds are projected to total $1.61 billion. This includes receipts of $1.13 billion, with water sales of $872.5 million accounting for the majority of receipts. These receipts are based on projected water sales of 2.34 million acre-feet and include the board-approved increase in rates and charges of about 4.4 percent, effective January 1, 2005. Other revenues include readiness-to-serve charge revenues of $80.0 million, revenues from the capacity charge of $30.7 million, and tax revenues at about $97.4 million. Interest earnings are significantly lower due to lower market interest rates and are estimated to be $17.0 million. Power and other miscellaneous sales are expected to generate about $33.4 million.

Capital projects will be funded from a combination of bond proceeds, revenues, and existing balances from the PAYG fund. Fund withdrawals from PAYG will provide $100.1 million and withdrawals from the construction fund (bond proceeds) will provide another $300.7 million. Finally, the Water Transfer Fund will provide $45.3 million for the purchase of water transfers and storage program operating cost. About $30.9 million will be withdrawn from the Water Rate Stabilization Fund to meet 2004/05 expenditures.

Table 1. 2004/05 Annual Budget Uses and Sources of Funds – Cash Basis

				2004/05 Budget Compared to	
	2003/04 Budget	2003/04 Projected	2004/05 Budget	2003/04 Budget	2003/04 Projected
USES OF FUNDS					
Expenditures					
State Water Contract	374.1	390.2	461.6	87.5	71.3
Supply Programs	31.9	42.1	67.1	35.3	25.1
Colorado River Power Costs	17.1	22.5	18.8	1.7	(3.7)
Debt Service	236.7	231.9	233.7	(3.0)	1.9
Demand Management Costs	43.8	38.4	46.8	3.0	8.4
Departmental O&M	229.6	233.1	240.2	10.7	7.1
Treatment O&M	41.2	30.4	29.5	(11.7)	(0.9)
Other O&M	11.9	8.8	12.3	0.3	3.5
Sub-total Expenditures	**986.3**	**997.3**	**1,109.9**	**123.6**	**112.6**
Capital Investment Plan	**297.4**	**287.5**	**400.8**	**103.3**	**113.3**
Fund Deposits					
Deposit to Water Transfer Fund	45.0	45.0	-	(45.0)	(45.0)
Deposit to PAYG Fund	95.0	95.0	95.0	-	-
Increase in Reserves	-	11.5	2.1	2.1	(9.4)
Sub-total Fund Deposits	**140.0**	**151.5**	**97.1**	**(42.9)**	**(54.4)**
Member Agency Credit	**-**	**36.3**	**-**	**-**	**(36.3)**
TOTAL USES OF FUNDS	**1,423.8**	**1,472.6**	**1,607.8**	**184.0**	**135.2**
SOURCES OF FUNDS					
Receipts					
Taxes & Annexation Fees	98.0	98.0	97.4	(0.6)	(0.6)
Interest, Power and Miscellaneous	77.1	57.6	50.3	(26.8)	(7.3)
Fixed Charges	102.5	101.8	110.7	8.2	8.8
Water Sales Revenue	807.9	834.2	872.5	64.6	38.3
Sub-total Receipts	**1,085.5**	**1,091.7**	**1,130.9**	**45.4**	**39.2**
Fund Withdrawals					
Transfer Fund	31.5	42.1	45.3	13.8	3.2
PAYG Funds for Construction	77.9	90.8	100.1	22.2	9.3
Bond Funds for Construction	219.5	196.7	300.7	81.2	104.0
Decrease in Reserves	9.4	51.4	30.9	21.5	(20.5)
Sub-total Fund Withdrawals	**338.3**	**381.0**	**476.9**	**138.7**	**96.0**
TOTAL SOURCES OF FUNDS	**1,423.8**	**1,472.6**	**1,607.8**	**184.0**	**135.2**

Totals may not foot due to rounding.

Reserves

The maximum reserve level target for the Water Rate Stabilization and Revenue Remainder funds as of June 30, 2005 is estimated to be $387 million. Based on projected receipts and expenditures, it is estimated that reserves will be about $288 million, about $123 million over the minimum reserve level.

Attachment 1, Fiscal Year 2004/05 Budget Summary, discusses the sources of funds including receipts and fund withdrawals and uses of funds including expenditures and fund deposits.

Policy

Metropolitan Water District Administrative Code § 5107: Annual Budget

California Environmental Quality Act (CEQA)

CEQA determination for Options #1 and #2:

The proposed actions are not defined as a project under CEQA because they involve continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed actions are not subject to CEQA because they involve the creation of government funding mechanisms or other government fiscal activities, which do not involve any commitment to any specific project that may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines). For those anticipated projects listed in the budget that may require subsequent board approval, a CEQA review will be carried out, and if appropriate, environmental documentation for such projects will be prepared and processed in accordance with CEQA and the State CEQA Guidelines.

The CEQA determination is: Determine that the proposed actions are 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 2004/05 budget, including total budgeted positions of 2,018 and debt defeasance of $26.1 million;
b. Appropriate $876.2 million for the projected 2004/05 cash outlays for Metropolitan O&M and operating equipment, power costs on the Colorado River Aqueduct, SWP operations, maintenance, power and replacement costs and SWP capital charges; demand management programs including the local resources and conservation credits program; and costs associated with supply programs paid from the Water Transfer Fund;
c. Appropriate as continuing appropriations, $233.7 million for debt service on Metropolitan general obligation and revenue bonds including continuing debt defeasance in the amount of $26.1 million as per board action from July of 2000;
d. Authorize the use of $95 million in operating revenues for fund deposits to the PAYG Fund; and
e. Increase the 2003/04 budget appropriation for O&M, State Water Project, Colorado River Power, Demand Management and Supply Program Costs by $16 million from $752.8 million to $768.8 million.

Fiscal Impact: $1.62 billion

Option #2

Adopt the CEQA determination and approve the 2004/05 Annual Budget with changes as recommended by the Board.

Fiscal Impact: Impact depends on adopted changes.

Staff Recommendation

Option #1

	5/20/2004
Brian G. Thomas	*Date*
Chief Financial Officer	
	5/20/2004
Ronald R. Gastelum	*Date*
Chief Executive Officer	

Attachment 1 – Fiscal Year 2004/05 Budget Summary

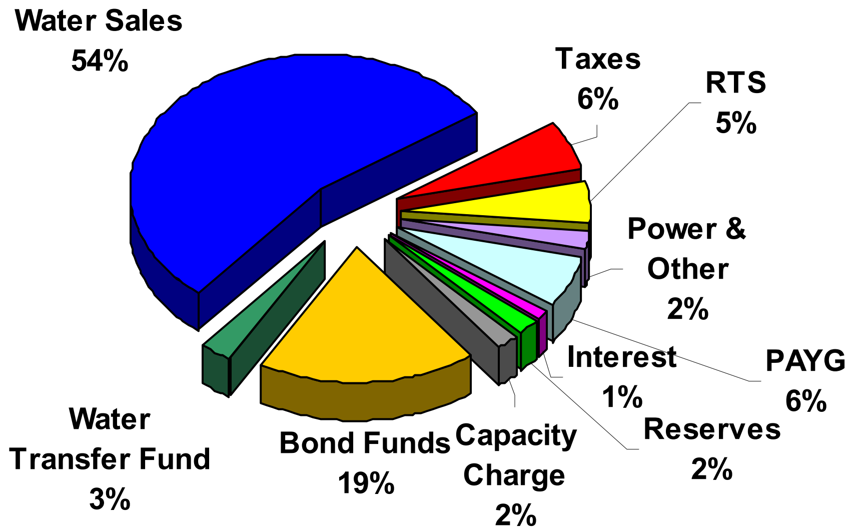
BLA #2764

FISCAL YEAR 2004/05

BUDGET SUMMARY

This budget summary includes a discussion of cash basis sources and uses of funds, and an accrual basis pro-forma statement of operations. The budget is developed and monitored on a cash basis. This means that revenues and expenses are recognized when cash is received and cash is paid. The pro-forma statement of operations is prepared using an accrual basis of accounting. Accrual basis accounting records revenues and expenses in the period they are earned and incurred regardless of whether cash has been received or disbursed.

Figure 4. Sources of Funds



SOURCES OF FUNDS

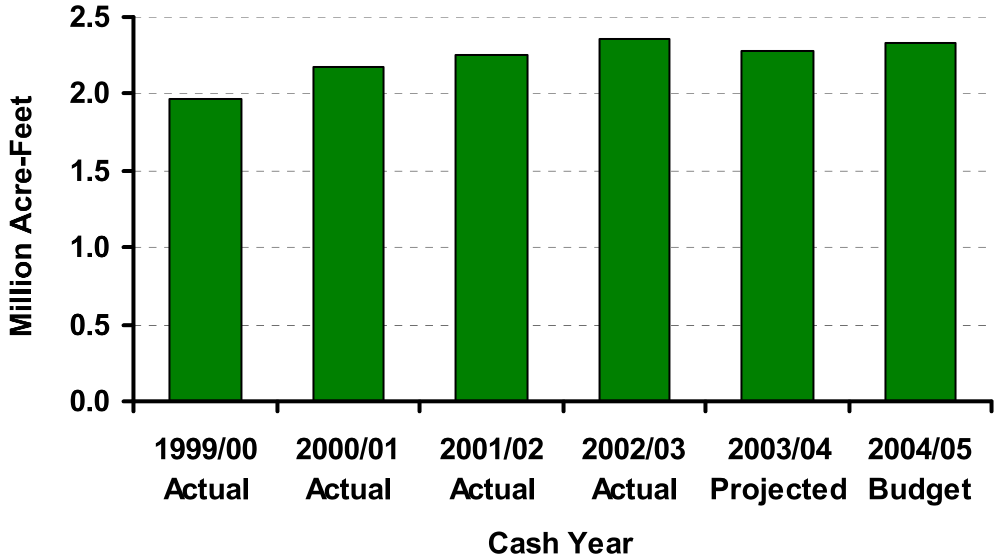
Estimated receipts from water sales, readiness-to-serve charge, capacity charge, taxes, interest, power recoveries, and other income are budgeted to be $1.13 billion for fiscal year 2004/05. This is $45.4 million more than the 2003/04 budget and about $39.3 million more than projected for 2003/04. These higher receipts are attributed to a combination of high water sales and the 2005 water rate increase of 4.4 percent. Figure 4 graphically depicts the major sources of funds.

Water Sales

Water sales for 2003/04 are projected to be 2.28 million acre-feet (MAF). Receipts from water sales for 2004/05 are estimated to be $872.5 million based on water sales of 2.34 MAF during the May through April period. Sales estimates are developed from member agencies input.

The 2004/05 water sales include 1.96 MAF of firm sales, 0.22 MAF of replenishment sales, 0.13 MAF of agricultural sales, and 0.02 MAF of exchanges under the SDCWA Exchange Agreement for the SDCWA/IID transfer. Treated sales are estimated to be 1.44 MAF or 62 percent of total sales. Figure 5 shows the five-year trend of water sales.

Figure 5. Five-Year Trend of Water Sales



Water Rates and Charges

Water sales receipts are budgeted at $872.5 million and are based on rates and charges adopted by the Board for calendar year 2004 and 2005, as shown in Table 2.

Table 2 shows that certain elements of the unbundled rates are increasing, while others are decreasing in 2005. These rates reflect Metropolitan's cost of service. The overall effect of these changes is an effective rate increase of approximately 4.4 percent.

The Capacity Charge (CC) for 2004/05 is estimated to generate $30.7 million, an increase of $8.7 million over the estimated 2003/04 revenues of $22.0 million.

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 $97.4 million.

Interest earnings are estimated to total $16.9 million, excluding trust accounts and construction funds. Receipts from power sales are estimated to be $33.5 million. This includes $18.6 million from small hydroelectric facilities and the Wadsworth pumping plant at Diamond Valley Lake, and $14.9 million from the sale of supplemental energy on the Colorado River Aqueduct.

The Capital Investment Plan (CIP) will be funded with $300.7 million of debt proceeds and $100.1 million of PAYG funding. In 2004/05 a total of $1.61 billion will be available for expenditures and other obligations.

Table 2. 2004/05 Water Rates and Charges

	Effective January 1st, 2004	Effective January 1st, 2005
Tier 1 Supply Rate ($/AF)	$73	$73
Tier 2 Supply Rate ($/AF)	$154	$154
System Access Rate ($/AF)	$163	$152
Water Stewardship Rate ($/AF)	$30	$25
System Power Rate ($/AF)	$60	$81
Full Service Untreated Volumetric Cost ($/AF)		
Tier 1	$326	$331
Tier 2	$407	$412
Replenishment Water Rate Untreated ($/AF)	$233	$238
Interim Agricultural Water Program Untreated ($/AF)	$236	$241
Treatment Surcharge ($/AF)	$92	$112
Full Service Treated Volumetric Cost ($/AF)		
Tier 1	$418	$443
Tier 2	$499	$524
Treated Replenishment Water Rate ($/AF)	$300	$325
Treated Interim Agricultural Water Program ($/AF)	$304	$329
Readiness-to-Serve Charge ($M)	$80	$80
Capacity Charge ($/cfs)	$6,100	$6,800

USES OF FUNDS

Colorado River Aqueduct Power

Colorado River Aqueduct pumping costs are budgeted to be $18.8 million based on pumping 605 TAF at Whitsett Intake Pumping Plant. This is $1.7 million more than the 2003/04 budget and $3.7 million less than the 2003/04 projection.

State Water Contract

State Water Contract (SWC) expenditures of $461.6 million are budgeted to be $87.5 million more than the current year's budget and $71.3 million more than 2003/04 projected.

Power costs are expected to be about $187.9 million or $27.1 million more than the projected 2003/04 power costs. In addition, the State Water Contract 2003/04 minimum operations maintenance power and replacement charge are $10.6 million higher than the projected 2003/04 costs.

Demand Management Costs

Metropolitan provides financial assistance to its member agencies for the development of local water recycling and groundwater recovery projects through the Local Resources Program (LRP). Metropolitan also provides financial assistance for the development of conservation programs through the Conservation Credits Program (CCP).

As part of the LRP, 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 over 115,000 acre-feet of recycled water, principally for landscape irrigation, nurseries, groundwater recharge and industrial uses in 2004/05 at a cost to Metropolitan of about $21.7 million.

Metropolitan has also entered into agreements to provide financial assistance to 22 projects to recover contaminated groundwater. These groundwater recovery projects are expected to produce about 54,000 acre-feet in 2004/05 at a cost to Metropolitan of $10.1 million.

Furthermore, the CCP provides financial assistance to local agencies for conservation programs. The 2004/05 budget contains $15.0 million for the CCP which will provide funding for commercial, industrial, and landscape conservation. In addition, Metropolitan has begun a public outreach campaign that shifts the focus of water conservation from inside the home to outside, where 30 to 70 percent of water is used.

Operations and Maintenance

The 2004/05 operations and maintenance (O&M) budget, including operating equipment purchases, is estimated to be $281.9 million. This is $0.8 million less than the current year budget of $282.7 million and $9.6 million more than the 2003/04 projected.

Treatment costs for power, chemicals, and sludge disposal are $29.5 million, a decrease of $11.7 million from 2003/04 budgeted costs of $41.2 million.

O&M labor costs are $178.6 million, $11.6 million or 6.9 percent higher than the 2003/04 budget of $167.0 million. This $11.6 million increase reflects base salary increases consistent with approved Memoranda of Understanding (MOUs) with the bargaining units totaling $3.5 million, as well as additional retirement contributions of $5.6 million, a $2.0 million increase in medical insurance costs, a $1.1 million increase in worker's compensation, and a $0.7 million reduction of outside labor and other benefit costs. Operating equipment purchases will total $6.8 million for 2004/05.

A summary of the 2004/05 O&M budget is shown in Table 3, which shows the departmental budgets to be essentially flat as compared with the 2003/04 budget.

A detailed departmental budget for each group is included in the accompanying 2004/05 Departmental Budget book. Figure 6 provides the distribution of departmental O&M by organization. The Water System Operations group accounts for 56 percent of the total departmental budget. Figure 7 summarizes the total departmental budget by expenditure type, of which 63 percent is labor.

Table 3. 2004/05 Operations & Maintenance Budget Summary (dollars)

Departmental Units	2003/04 Budget	2003/04 Projected	2004/05 Budget	Change: 2004/05 to 2003/04 Budget	%	Change: 2004/05 to 2003/04 Projected	%
Executive Offices	$ 14,327,800	$ 14,695,700	$ 14,534,500	$ 206,700	1.4%	$ (161,200)	-1.1%
Water System Operations	159,332,600	156,280,200	158,398,100	(934,500)	-0.6%	2,117,900	1.4%
Water Resource Management	15,361,700	15,148,800	15,243,000	(118,700)	-0.8%	94,200	0.6%
Corporate Resources	58,791,800	58,711,400	60,305,000	1,513,200	2.6%	1,593,600	2.7%
External Affairs	15,080,600	14,743,600	14,979,200	(101,400)	-0.7%	235,600	1.6%
Office of the Chief Financial Officer	8,839,100	8,696,000	8,822,300	(16,800)	-0.2%	126,300	1.5%
Subtotal - CEO's Department	**271,733,600**	**268,275,700**	**272,282,100**	**548,500**	**0.2%**	**4,006,400**	**1.5%**
General Counsel	9,720,700	9,534,400	10,025,700	305,000	3.1%	491,300	5.2%
Audit	1,666,500	1,440,100	1,837,100	170,600	10.2%	397,000	27.6%
Ethics Office	256,000	244,000	383,700	127,700	49.9%	139,700	57.3%
Total Departmental Budget	**283,376,800**	**279,494,200**	**284,528,600**	**1,151,800**	**0.4%**	**5,034,400**	**1.8%**
Other O&M							
Leases	367,000	445,300	445,300	78,300	21.3%	-	NA
Association Dues	1,599,400	1,600,600	1,600,600	1,200	0.1%	-	NA
Contingency	2,864,500	-	2,864,500	-	NA	2,864,500	NA
Property Tax	215,000	470,400	517,300	302,300	140.6%	46,900	10.0%
Overhead Credit from Construction	(12,623,511)	(16,011,800)	(14,865,900)	(2,242,389)	17.8%	1,145,900	-7.2%
Subtotal - Other	**(7,577,611)**	**(13,495,500)**	**(9,438,200)**	**(1,860,589)**	**24.6%**	**4,057,300**	**-30.1%**
TOTAL OPERATIONS & MAINTENANCE	**275,799,189**	**265,998,700**	**275,090,400**	**(708,789)**	**-0.3%**	**9,091,700**	**3.4%**
Operating Equipment	6,897,700	6,277,100	6,823,800	(73,900)	-1.1%	546,700	8.7%
GRAND TOTAL	**$ 282,696,889**	**$ 272,275,800**	**$ 281,914,200**	**$ (782,689)**	**-0.3%**	**$ 9,638,400**	**3.5%**

Totals may not foot due to rounding

Figure 6. Departmental Budget by Organization

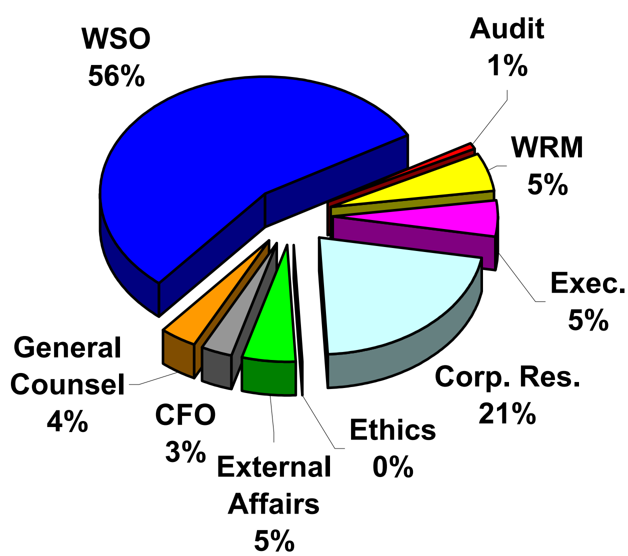
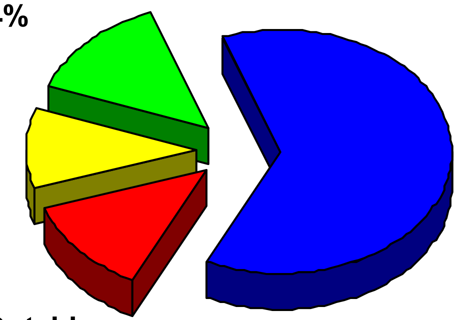


Figure 7. Departmental Budget by Expenditure Type



STAFFING

The total personnel complement for 2004/05 is 2,018 positions, down 3 positions from 2003/04. As noted previously, O&M personnel are down by 27 full-time-equivalent (FTE) positions to 1,646. Positions dedicated to capital work are up by 24 to 372 FTEs. The personnel complement is broken down on Tables 4 and 5.

Table 4. 2004/05 Regular and Temporary Positions

	2001/02 Budget	2002/03 Budget	2003/04 Budget	2004/05 Budget	Change from 2003/04
Regular Full Time Positions	1,855	1,963	1,946	1,946	0
District Temporary Positions	105	54	36	27	-9
Agency Temporary Positions	150	48	39	45	6
Total	**2,110**	**2,065**	**2,021**	**2,018**	**-3**

Table 5. 2004/05 O&M and Capital Staffing Levels

	2003/04			2004/05		
	O&M	Capital	Total	O&M	Capital	Total
Regular Full Time Positions	1,623	323	1,946	1,611	335	1,946
District and Agency Temporary Positions	50	25	75	35	37	72
Total	**1,673**	**348**	**2,021**	**1,646**	**372**	**2,018**

Water Transfer Fund and Supply Programs

Deposits to the Water Transfer Fund (WTF) will end in 2003/04. The estimated ending balance on June 30, 2004 is $104.9 million. By June 30 2005, the expected balance will be $59.6 million. The fund will be drawn down over the ensuing two years to pay for expenditures that cause peaks in supply program costs. The remaining supply program cost will be funded from current operating revenues.

Major supply program expenditures for 2004/05 will include:

1. $45.4 million for the Palo Verde Land Management Program. The first of two large up-front payments will be paid from the Water Transfer Fund.
2. $8.0 million for Kern-Delta Program
3. $7.9 million for Imperial Irrigation District/MWD conservation agreement
4. $3.4 million for the San Bernardino Valley Municipal Water District agreement
5. $2.2 million for the Semitropic Groundwater Storage and Exchange Program
6. $0.2 million to pay for the O&M costs of various groundwater storage programs funded by Proposition 13.

Of the total $67.1 million supply program cost, $21.9 million will be funded by current operating revenues while the up-front payments for the Palo Verde Land Management Program will be funded from the Water Transfer Fund. The operation of these programs is expected to allow for 106 TAF puts to storage, and generate 108 TAF of transfer water in 2004/05.

Annual Capital Investment Plan

The Capital Investment Plan (CIP) for 2004/05 is $400.8 million. The CIP is funded by a combination of debt and current operating revenues (PAYG). The detail of each project within the CIP is discussed in the 2004/05 Proposed Capital Investment Plan Budget.

The 2004/05 CIP is $113.3 million higher than the projected expenditures for 2003/04. Major CIP projects in design and/or construction include $157.0 million for 183 various refurbishment and replacement (R&R) projects, $106.0 for the Oxidation Retrofit Program (ORP) and other improvements on Metropolitan's five filtration plants, $75.1 million for the Inland Feeder project, $21.0 million for DVL Recreation, and $15.0 million for San Diego Pipeline number 6. The projects listed above account for 93 percent of the total 2004/05 CIP expenditures. Figure 8 shows the major project categories of the 2004/05 CIP.

These projects are also categorized as source of supply, conveyance, storage, treatment, distribution, general, and replacement and refurbishment. The 2004/05 expenditure plan by major service function is shown graphically on Figure 9.

Figure 8. 2004/05 Capital Investment Plan by Major Project Category

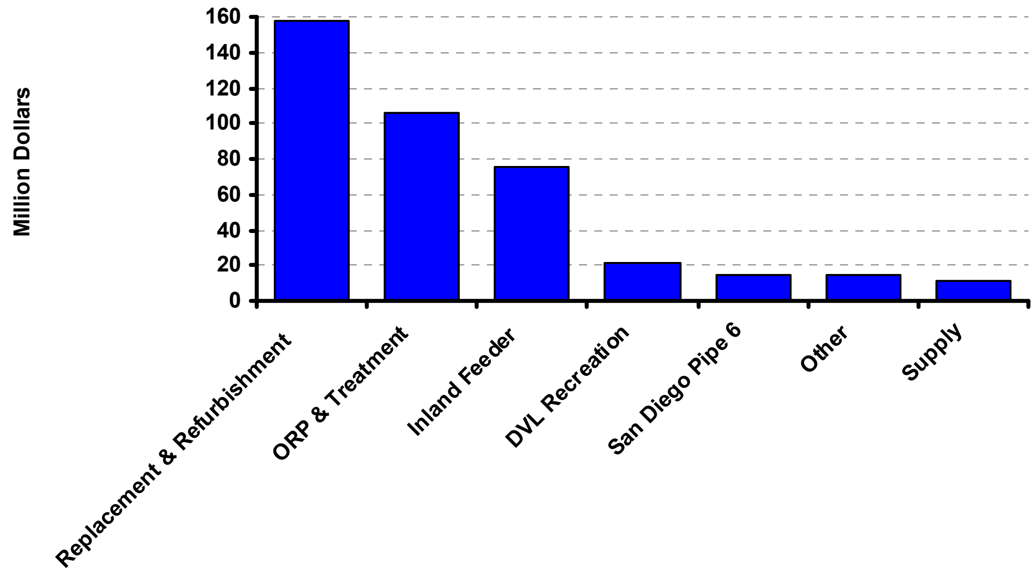
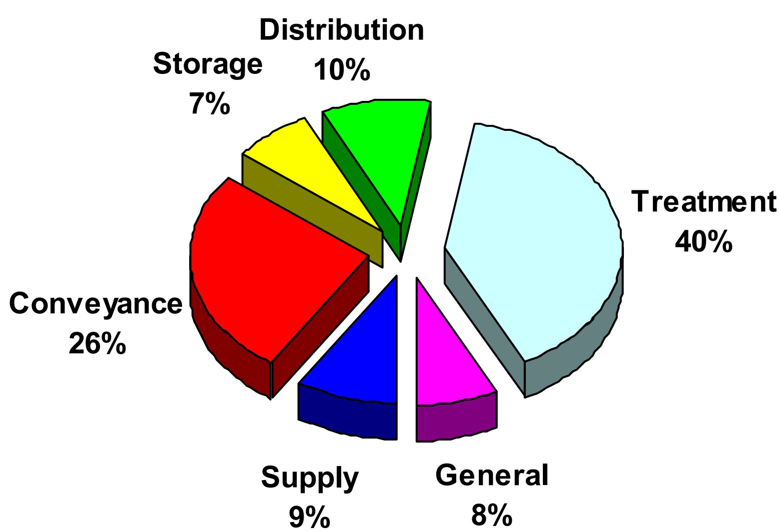


Figure 9. Capital Investment Plan by Service Function



PAYG Funding

The 2004/05 CIP includes estimated R&R programs totaling $157.0 million. While the PAYG Fund is the primary funding source for these types of programs it is expected that $57.2 million of R&R will be funded from debt proceeds to manage future rate increases.

Debt Service

The portion of the CIP that is not funded by PAYG will be funded from debt proceeds. In 2004/05, $300.7 million of capital will be funded with bond proceeds. Debt service payments are budgeted to be $233.7 million and include $49.0 million in G.O. Bond debt service, $152.6 million in revenue bond debt service, $18.9 million of bond defeasance, and $4.4 million in variable rate debt administration cost. Total debt service costs are $0.1 million more than the 2003/04 budget. Metropolitan currently has over $3.59 billion in outstanding debt. Of this amount, $3.14 billion is revenue bond debt of which 30 percent is in a variable rate mode (either directly or though interest rate swaps). A bond sale of about $289 million is planned for 2004/05.

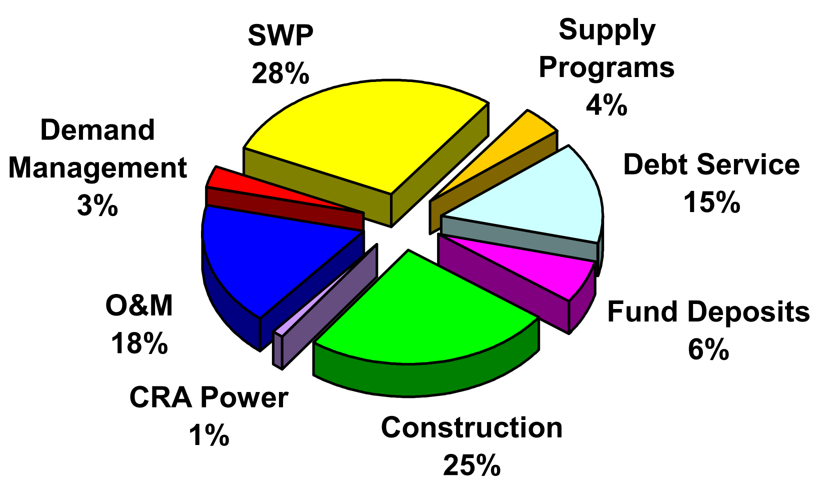
Over the next five years it is expected that an additional $1.44 billion in debt will be issued to fund the CIP. The cost of debt is assumed to be 1.25 percent and 5.00 percent for variable and fixed rate debt, respectively, in 2004/05. Variable rates are anticipated to increase to 2.1 percent by 2006/07.

Reserve Transfers

During the 2004/05 budget year, $30.9 million dollars will be withdrawn from the Rate Stabilization Funds (RSF).

Total uses of funds are $1.61 billion. Figure 10 shows the breakdown of expenditures and other obligations that make up the Uses of Funds for 2004/05. A detailed sources and uses of funds table is shown in Table 7.

Figure 10. Uses of Funds



Fund Balances and Reserve Levels

Fund balances are budgeted to be $970 million at June 30, 2005. Of that total, $584 million is restricted by bond covenants, contracts, or board policy, and $396 million is unrestricted. Table 6 shows a breakdown of reserves by fund type. Figure 11 shows the distribution of funds by type.

The minimum and maximum Water Rate Stabilization Fund reserve levels are budgeted to be $165 million and $387 million, respectively at June 30, 2005. Based on current projected receipts and the $24.1 million cash defeasance in 2005/06, the reserves are budgeted to be $99 million under the maximum amount on June 30, 2005.

Table 6. Budgeted Fund Balances at June 30, 2005 (dollars in millions)

	Restricted		Unrestricted	
	Contractual	Board		Total
Operating Funds	162	91	165	418
Debt Service Funds	149			149
Construction Funds	74		74	148
Reserve Funds			147	147
Water Transfer Fund		60		60
Trust and Other Funds	47			47
Total	**433**	**151**	**386**	**970**

Totals may not foot due to rounding

Figure 11. Fund Distribution by Type

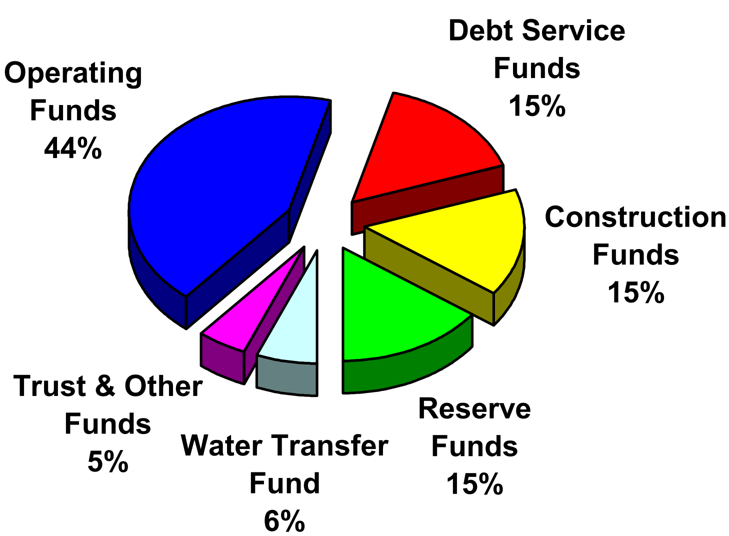


Table 7. 2004/05 Budget Sources and Uses of Funds – Cash Basis (dollars in millions)

	2003/04 Budget	2003/04 Projected	2004/05 Budget	2004/05 Budget Compared to 2003/04 Budget	2004/05 Budget Compared to 2003/04 Projected
USES OF FUNDS					
Expenditures					
State Water Contract	374.1	390.2	461.6	87.5	71.3
Supply Programs	31.9	42.1	67.1	35.3	25.1
Colorado River Power Costs	17.1	22.5	18.8	1.7	(3.7)
Debt Service	236.7	231.9	233.7	(3.0)	1.9
Demand Management Costs	43.8	38.4	46.8	3.0	8.4
Departmental O&M	229.6	233.1	240.2	10.7	7.1
Treatment O&M	41.2	30.4	29.5	(11.7)	(0.9)
Other O&M	11.9	8.8	12.3	0.3	3.5
Sub-total Expenditures	**986.3**	**997.3**	**1,109.9**	**123.6**	**112.6**
Capital Investment Plan	**297.4**	**287.5**	**400.8**	**103.3**	**113.3**
Fund Deposits					
Deposit to Water Transfer Fund	45.0	45.0	-	(45.0)	(45.0)
Deposit to PAYG Fund	95.0	95.0	95.0	-	-
Increase in Reserves	-	11.5	2.1	2.1	(9.4)
Sub-total Fund Deposits	**140.0**	**151.5**	**97.1**	**(42.9)**	**(54.4)**
Member Agency Credit	**-**	**36.3**	**-**	**-**	**(36.3)**
TOTAL USES OF FUNDS	**1,423.8**	**1,472.6**	**1,607.8**	**184.0**	**135.2**
SOURCES OF FUNDS					
Receipts					
Taxes & Annexation Fees	98.0	98.0	97.4	(0.6)	(0.6)
Interest, Power and Miscellaneous	77.1	57.6	50.3	(26.8)	(7.3)
Fixed Charges	102.5	101.8	110.7	8.2	8.8
Water Sales Revenue	807.9	834.2	872.5	64.6	38.3
Sub-total Receipts	**1,085.5**	**1,091.7**	**1,130.9**	**45.4**	**39.2**
Fund Withdrawals					
Transfer Fund	31.5	42.1	45.3	13.8	3.2
PAYG Funds for Construction	77.9	90.8	100.1	22.2	9.3
Bond Funds for Construction	219.5	196.7	300.7	81.2	104.0
Decrease in Reserves	9.4	51.4	30.9	21.5	(20.5)
Sub-total Fund Withdrawals	**338.3**	**381.0**	**476.9**	**138.7**	**96.0**
TOTAL SOURCES OF FUNDS	**1,423.8**	**1,472.6**	**1,607.8**	**184.0**	**135.2**

Totals may not foot due to rounding

PRO-FORMA STATEMENT OF OPERATIONS (ACCRUAL BASIS)

Metropolitan operates as a utility enterprise and prepares its financial statements using the accrual basis of accounting. Accrual basis accounting records revenues and expenses in the period they are earned and incurred regardless of whether cash has been received or disbursed. However, as is typical for a government utility, the water rates and charges are based on the cash needs approach and therefore the annual revenue requirements and budget are prepared on a cash basis. Table 8 provides the Comparative Statement of Operations. This pro-forma statement of operations is provided as additional information.

Operating revenues for fiscal year 2004/05 are estimated to be $1.03 billion, an increase of $53.6 million from 2003/04 projected. This estimate is based on water sales of 2.33 MAF during the July through June period. Water sales income is budgeted to be $881.3 million. The RTS will raise $80.0 million. Income from the capacity charge will be $30.7 million. Hydroelectric power and other income is estimated to be $33.5 million.

Operating expenses are budgeted to be $835.6 million. This is $67.1 million more than projected for 2003/04. Cost of Water Delivered (COWD) is budgeted to be $304.3 million, or $48.7 million more than the current year projection. COWD reflects the moving average cost of water delivered from water in inventory. It is based on the power costs to pump water from the Colorado River and State Water Project, and O&M on the State Water Project.

Operations and maintenance (O&M) costs are budgeted to be $282.0 million. This is $10.8 million more than projected expenditures for 2003/04.

Net income of $171.1 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 8. Comparative Statements of Operations – Accrual Basis (dollars in millions)

Departmental Units	2003/04 Budget	2003/04 Projected	2004/05 Budget	Change: 2004/05 to 2003/04 Budget	%	Change: 2004/05 to 2003/04 Projected	%
Operating Revenues:							
Water Sales	$ 841.9	$ 852.1	$ 881.3	$ 39.4	4.7%	$ 29.2	3.4%
Readiness-to-Serve	80.0	78.0	80.0	-	0.0%	2.0	2.6%
Capacity Charge	22.5	22.5	30.7	8.2	36.3%	8.2	36.3%
Hydroelectric Power	17.9	19.3	33.5	15.6	87.3%	14.2	73.7%
Total Operating Revenues	**962.3**	**971.9**	**1,025.5**	**63.2**	**6.6%**	**53.6**	**5.5%**
Operating Expenses:							
Operations & Maintenance	286.2	271.2	281.9	(4.3)	-1.5%	10.7	4.0%
Cost of Water Delivered	290.8	255.6	304.3	13.5	4.6%	48.7	19.0%
Water Management Programs, Net	43.8	39.1	46.8	3.0	6.8%	7.7	19.6%
Depreciation & Amortization	202.6	202.6	202.6	-	0.0%	-	0.0%
Total Operating Expenses	**823.4**	**768.5**	**835.6**	**12.2**	**1.5%**	**67.1**	**8.7%**
Operating Income	**138.9**	**203.4**	**190.0**	**51.1**	**36.8%**	**(13.4)**	**-6.6%**
Other Income (Expense):							
Taxes & Annexations	95.6	95.6	97.4	1.8	1.9%	1.8	1.9%
Interest Income	43.2	22.0	16.8	(26.4)	-61.1%	(5.2)	-23.7%
Bond Interest Expense	(96.7)	(139.5)	(134.6)	(37.9)	39.2%	4.9	-3.5%
Member Agency Distributions	-	36.3	-	-		(36.3)	-100.0%
Miscellaneous Income (Expense)	-	(3.0)	-	-		3.0	-100.0%
Total Other Income - Net	**42.1**	**11.4**	**(20.4)**	**(62.5)**	**-148.4%**	**(31.8)**	**-278.7%**
Net Income	**$ 181.0**	**$ 214.8**	**$ 169.6**	**$ (11.4)**	**-6.3%**	**$ (45.2)**	**-21.0%**
Water Sales (MAF)	**2.26**	**2.32**	**2.33**	**0.1**	**3.0%**	**0.0**	**0.4%**

Totals may not foot due to rounding