MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

INFORMATION

- **Board of Directors**
  Asset and Recreation Committee

November 14, 2006 Board Meeting

9-4

Subject

Financing options for The Center for Water Education

Description

The Center for Water Education (CWE) is currently experiencing financial difficulties and has approached Metropolitan and various financial institutions to explore funding options for the completion of construction and initial operations of its water education facility. It has always been CWE's intention to be self-sufficient. This item will be presented as information at the November board meeting. Staff will firm up the options based on the November discussion and bring this item back to the Board as directed.

In October 2001, following the recommendations of the Special Committee on Museum Feasibility and Development, Metropolitan's Board created the CWE (then called the Foundation for the Southern California Water Education Center). The CWE was created as a separate entity, an Internal Revenue Code section 501(c)(3) corporation, authorized to seek public and private support for a water education facility to be designed and constructed on Metropolitan-owned property located near Diamond Valley Lake in Hemet. As a separate 501(c)(3) corporation, it was anticipated that the CWE would improve fundraising from both public and private entities as a vehicle for tax-deductible contributions.

The goals of CWE are to advance the public's knowledge of water-related issues, to communicate information about the history of water in Southern California, and to emphasize the importance of water management and conservation for the region. The CWE helps extend Metropolitan's efforts in this area. In particular, the CWE builds on previous Metropolitan successes, such as the Allan Preston Museum at Metropolitan's Gene facility.

To support the CWE, Metropolitan's Board voted in February 2002 to approve a $2 million grant for initial planning and design of the facility. Metropolitan's Board granted an additional $14 million in May 2003 to complete design and construction. It was anticipated that the grants from Metropolitan, along with fundraising by the CWE, would be sufficient to complete construction and open the facility. Since then, the CWE has raised approximately $8.6 million of additional funds from public and private sources for construction.

Unfortunately, during the last several years there has been a tremendous increase in the cost of concrete, steel, and other construction materials. Increased construction costs also resulted from substantial delays caused by the rains of 2004, one of the wettest years in Southern California history. The CWE board initially sought to counter the steep cost increases by phasing construction of the facility. But, phasing alone has not been sufficient to counter the increases in the project costs, and the CWE today faces a shortfall of $3.7 million to pay for work already completed and to complete construction necessary to open to the public (see **Attachment 1**).

At this point, the CWE is seeking a loan to complete construction and provide sufficient funds for the initial operation and maintenance of the CWE facility. The CWE has acquired a $500,000 bridge loan, due in February 2007, to allow it to begin operation this month.

Construction of the facility is about 95 percent complete, and it opened to the public on November 8, 2006. The Western Center for Archaeology and Paleontology, which was built on the same campus, opened to the public on October 15, 2006. Under an operating agreement, CWE and the Western Center continually look for opportunities to minimize operating costs by sharing contract services and staff.

Both the CWE facility and Western Center have qualified for platinum-level certification as Leadership in Energy and Environmental Design (LEED) buildings. As such, the campus could attract visitors interested in energy, particularly solar power, and water conservation. Recently, Senator Diane Feinstein and Representative Mary Bono toured the CWE facility, and expressed appreciation for the efforts to date.

Options

With CWE's uncertain financial position, Metropolitan has at least four options to address CWE's funding issues, including: (1) an additional Metropolitan grant; (2) a loan from Metropolitan; (3) Metropolitan assuming ownership of the facility, with agreement of CWE; and (4) no action. Each of these options is described in more detail below and in the attachment (see **Attachment 2**). Under the first three options, Metropolitan would require complete access to all of CWE's financial records. Metropolitan would assign a Metropolitan employee to oversee the remainder of construction. Finally, Metropolitan would only release funds to the CWE after verifying that the funds were to be spent for purposes specified in the agreement. The funds would be restricted and would not be made available for new construction at the site without Metropolitan's approval. Staff has discussed these alternatives with the General Counsel and counsel for the CWE, and both have concluded that there is sufficient legal authority to adopt any of the identified options.

As mentioned above, the funding necessary to complete construction and pay off outstanding debts as of October 31, 2006, is approximately $3.7 million (see **Attachment 1**). CWE has estimated that their annual operations and maintenance costs will be around $2 million (see **Attachment 3**).

Option 1: Metropolitan Grant

The first option would provide the CWE with an additional grant (approximately $6.7 million) sufficient to complete construction and operate the facility for two years. The grant, which would be made from the DVL Recreation Appropriation (Approp. 15334), could be made subject to certain conditions, including providing specified amounts only upon the CWE updating its business plan and achieving specific performance targets. This option would leave the CWE and its board intact and independent of Metropolitan in its operations. Under this approach, Metropolitan would contract with the CWE for some services such as providing classroom space at the CWE for Metropolitan's use, transferring administration of the current docent program to the CWE, providing a reduced admission price for Metropolitan-related tour groups to the CWE, and providing for a mutual exchange of office space between the two entities.

Option 2: Loan from Metropolitan

Under the second option, Metropolitan would lend the CWE approximately $6.7 million from the DVL Recreation Appropriation, $3.7 million for completion of construction and up to $3 million for the first two years of operations. As to terms of the loan, it is recommended that the loan package be structured as two separate loans, a construction "take-out" loan for $3.7 million and a $3 million working capital line. The take-out loan would be amortized over twenty years with interest and principal payments to begin two years after the opening of the CWE facility. Interest would accrue at Metropolitan's cost of capital (about 4.5-5 percent) during the first two years of the loan (capitalized interest). The working capital line would accrue interest at 4.5-5 percent, due monthly and would be due in full within 15 years of the initial date of the loan. The CWE could utilize this line of credit as a revolving loan, if so desired. The CWE would have the option to prepay either loan without penalty. A loan would also provide Metropolitan with the ability to assure that if, for any reason, the CWE was unable to meet its loan obligations, all of the CWE's assets, including the solar panels, exhibits, furnishings and furniture, would become Metropolitan assets.

Additionally, the loan agreement would require the CWE to update its business plan and establish a series of performance targets to assess its progress. As with Option 1, Metropolitan would contract with the CWE for some services, such as providing classroom space at the CWE facility for Metropolitan's use, transferring administration of the current docent program to the CWE, providing a reduced admission price for Metropolitan-related tour groups to the CWE facility, and providing for a mutual exchange of office space between the two entities. CWE and its board would remain intact and independent of Metropolitan in its operations.

Option 3: Metropolitan Ownership and Contracts with CWE for Operations

The third option would require negotiations with the CWE regarding immediate transfer of the CWE facility and other assets to Metropolitan. With the agreement of CWE, Metropolitan would assume responsibility for finishing construction and could contract with the CWE to operate the facility. Under such an agreement, the CWE would have to demonstrate an ability to raise funds to support the CWE facility and meet specified performance targets. Should the CWE fail to meet its contractual obligations, Metropolitan would have the ability to terminate the contract and assume direct operations of the CWE facility using Metropolitan staff or to contract with a different organization to operate the facility. Under this option, Metropolitan could also explore with the CWE board the possibility that it assume a different role as an advisory group, providing input to Metropolitan on exhibits and operations, hosting special events, and raising funds for ongoing exhibits and events at the CWE facility. The cost of this option would include the $3.7 million required to pay off the liabilities of the CWE and the ongoing operating and maintenance costs of about $2 million.

Option 4: Monitor CWE

A final option would be to monitor the CWE's efforts to secure outside financing and continue to enforce all applicable provisions of the ground lease to protect Metropolitan's interests. In the event the CWE defaults under the ground lease, Metropolitan would then determine the next steps. This option is viable from a legal standpoint, given that the CWE is a separate entity. But, should CWE's financial difficulties continue, the CWE may be forced to close the facility and it may not be able to reopen until legal issues and claims are resolved. As a result, certain assets owned by the CWE could be removed or Metropolitan could be forced to negotiate their purchase from a commercial lender. This could mean that the facility would be unused for an extended period of time while claims and litigation are settled. In addition, maintenance of the facility would be deferred, increasing costs to operate if the facility were to reopen.

Policy

Section 126 of the Metropolitan Water District Act authorizes the expenditure of funds to disseminate information concerning Metropolitan's activities including its efforts to encourage responsible water resource management and conservation.

11/7/2006

Jill Wicke — *Date*
Manager, Real Property Development and Management

11/8/2006

Jeffrey Kightlinger — *Date*
General Manager

Attachment 1 – Estimated Funding Needs

Attachment 2 – Options Summary

Attachment 3 – Projected Operations and Maintenance Costs

BLA #5027

Estimated Funding Needs (1)

Outstanding Payables		
Construction	$	1,886,792
O&M and Start-up (2)		193,318
Exhibits		353,603
Balance to Complete Construction (3)		651,000
Bridge Loan		500,000
Retainage (4)		1,773,878
Contingency (5)		200,000
Total		5,558,591
Sources of Funds		
Cash		191,000
Western Center Receivable		675,623
State Grant Receivable		500,000
Bridge Loan Proceeds		497,500
Other Receivables		3,143
Total Sources		1,867,266
Balance Needed	**$**	**3,691,325**

(1) Payables are as of October 27, 2006, while receivables and cash balance are as of September 30, 2006.

(2) Includes salary payable, fees, utilities, etc.

(3) Estimate of costs still remaining on construction contracts.

(4) Approximately $339,000 for retainage has been paid to escrow and, as such, retainage does not reflect these amounts.

(5) Estimate of additional exhibit costs, café floor, piazza construction, contingency for payments from bank account in October.

Options Summary

Option 1: Grant additional funds, not to exceed $6.7 million, to The Center for Water Education (CWE)

- Funding provided to complete construction and operate & maintain the CWE facility for first two years
- CWE to update its business plan to include the following specific performance targets:
  1. Raise sufficient operating funds to be self-sufficient within three years on the following schedule: 1/3 of operating costs by end of year 1; 2/3's of operating costs at completion of year 2; and 100% of operating costs by end of year 3.
  2. Educate the public by meeting specified visitor goals – 20,000 by end of year 1; 40,000 by end of year 2; and, 60,000 by end of year 3.
- Grant would be phased and made subject to specific conditions including requiring the CWE to complete construction and open the CWE facility in a timely manner
- Metropolitan would contract with the CWE for some services including use of classrooms and storage space at the CWE facility, administration of Metropolitan's current docent program, mutual sharing of office space, and reduced admission price for Metropolitan-sponsored tours
- CWE board would remain independent of Metropolitan
- Funds would be provided by the DVL Recreation Appropriation (Approp. 15334)

Option 2: Loan the CWE sufficient funds (not to exceed $6.7 million) to complete construction, open and operate the CWE facility

- Approximately $3.7 million to complete construction and $3 million for first two years operation & maintenance
- Interest rate based on Metropolitan's current cost of funds (4.5 percent)
- It is recommended that the loan be structured as two loans:
  1. A construction take-out loan of $3.7 million would be amortized over 20 years with interest accruing during first two years of the loan (capitalized interest)– no principal or interest payments required during first two years of the CWE facility's operation
  2. A working capital line of $3 million would accrue interest at 4.5 percent, due monthly and would be due in full within 15 years of the initial date of the loan
- Loan agreement would require the CWE to pledge all assets as security
- CWE would have the option to prepay the loan without penalty
- CWE to update its business plan to include the following specific performance targets:
  1. Raise sufficient operating funds to be self-sufficient within three years on the following schedule: 1/3 of operating costs by end of year 1; 2/3's of operating costs at completion of year 2; and 100% of operating costs by end of year 3.
  2. Educate the public by meeting specified visitor goals – 20,000 by end of year 1; 40,000 by end of year 2; and, 60,000 by end of year 3.
- Metropolitan would have option to assume operation of the facility should CWE fail to meet business plan milestones and targets
- Metropolitan would contract with the CWE for some services including use of classrooms and storage space at the CWE facility, administration of Metropolitan's current docent program, mutual sharing of office space, and reduced admission price for Metropolitan-sponsored tours
- Funds would be provided from DVL Recreation Appropriation until repaid by CWE

Option 3: Potential Metropolitan Ownership of the CWE facility

- Negotiate with the CWE regarding immediate transfer of the CWE facility to Metropolitan
- Metropolitan would assume financial responsibility to complete construction – approximately $3.7 million
- Metropolitan could contract with the CWE to operate the CWE facility with specific requirements regarding fundraising and visitor attendance numbers
    1. Fundraise operating costs so as to be self-sufficient within three years on the following schedule: 1/3 of operating costs at year 1; 2/3's of operating costs at completion of year 2; and 100% self-sufficient at end of year 3
    2. Educate the public by meeting goals for visitors at the following levels – 15,000 by end of year 1; 30,000 by end of year 2; and, 50,000 by end of year 3
- Metropolitan would have ability to terminate agreement and assume operation or contract with another entity to manage the CWE facility if requirements not met (estimated annual operation costs of up $2 million)

Option 4: Monitor CWE

- Monitor the CWE's efforts to secure outside financing
- Continue to enforce all applicable provisions of the ground lease to protect Metropolitan's interests
- In the event of default, the CWE facility would become Metropolitan's responsibility, subject to encumbrances or other rights of outside lenders
- Metropolitan could assume operation or contract with another entity to manage the CWE facility

Projected Operations and Maintenance Costs

Category	Balance as of 2006/07	2007/08	2008/09	Total
Salaries and Benefits	$ 275,000	$ 600,000	$ 624,000	$1,499,000
Debt Service				
Interest on Bridge Loan	$ 7,535	-	-	7,535
Interest on MWD Loan	67,500	135,000	135,000	337,500
Principal on Bridge Loan	500,000	-	-	500,000
Subtotal	$ 575,035	$ 135,000	$ 135,000	$ 845,035
Operations				
Insurance	42,500	90,000	93,600	226,100
Repairs & Maintenance	75,000	160,000	166,400	401,400
Utilities	37,500	39,000	40,560	117,060
Office Equipment	5,000	15,000	15,000	35,000
IT Costs	7,500	20,000	20,800	48,300
Marketing/Advertising	100,000	200,000	200,000	500,000
Retail Store	46,000	200,000	200,000	446,000
Volunteers/Membership/Sponsorship	40,000	87,000	87,000	214,000
Administrative Expenses	75,000	150,000	156,000	381,000
Education Programs	7,500	30,000	30,000	67,500
Events	12,500	25,000	25,000	62,500
Subtotal	$448,500	$1,016,000	$1,034,360	$2,498,860
Contract Services				
Event Planner	12,500	25,000	25,000	62,500
Legal	25,000	30,000	31,200	86,200
IT Support	12,500	25,000	26,000	63,500
Payroll	9,000	20,000	20,800	49,800
Security	25,000	65,000	65,000	155,000
Marketing	15,000	20,000	20,000	55,000
Fundraising	65,000	150,000	175,000	390,000
Accounting	10,000	25,000	26,000	61,000
MWD Admin Support	50,000	50,000	50,000	150,000
Web site	2,500	7,500	7,800	17,800
Subtotal	$ 226,500	$ 417,500	$ 446,800	$1,090,800
Board of Directors	$ 6,000	$ 15,000	$ 15,000	$ 36,000
Total Operating Expenses	**$ 1,531,035**	**$ 2,183,500**	**$ 2,255,160**	$ 5,969,695