MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

INFORMATION

- **Board of Directors**
  Business and Finance Committee

December 9, 2008 Board Meeting

9-2

Subject

Status of the 2008 Long Range Finance Plan

Description

The ability to ensure a reliable supply of high quality water for Metropolitan's 26 member agencies depends largely on Metropolitan's ongoing ability to finance operations and maintenance, fund replacements and refurbishment of existing infrastructure, and invest in system improvements. Metropolitan's Long Range Finance Plan (LRFP) serves two primary purposes. First, it is a planning document upon which Metropolitan and its member agencies can base future capital and operating decisions. As such, it includes a forecast of future costs and the revenues necessary to support operations, capital investments, and supply investments derived from the Five-Year Supply Plan. Second, the LRFP communicates: (1) the application of financial policies that enable Metropolitan to most effectively accomplish its mission; (2) the expected financial performance and conditions; and (3) the risks to the certainty and predictability of future water rates.

A critical element in the long-term planning process is the input from the member agencies and their agencies. This is particularly important since Metropolitan's water rates play a role in local investment decisions regarding those agencies' resources. This update of the LRFP is being developed with input from the member agencies, the Business and Finance Committee, and the Board. Beginning in May 2007, a series of member agency meetings have been held to solicit input into the development of the LRFP. In addition, three briefings have been provided to the Business and Finance Committee and numerous presentations have been provided to member agency governing bodies. Due to dramatic changes in water supply conditions, the current effort will require some significant changes in cost, revenue, and rate assumptions.

Metropolitan's cost structure has been permanently altered by the shift in water supplies resulting from dry conditions, legislation, litigation, and regulation. As a result of the Quantification Settlement Agreement and prolonged dry periods, half of the Colorado River Aqueduct will be filled with water that will cost $250/AF to $350/AF (or more), rather than Metropolitan's basic apportionment and surplus supplies (which cost $0.25/AF). Similarly, on the State Water Project (SWP), restrictions due to environmental regulations and judicial actions have reduced the quantity and reliability of supplies. As a result, Metropolitan's access to relatively low cost water from the Feather River system in the form of Table A or Article 21 supplies has been reduced, forcing more investments in storage and water transfers. These supplies range in cost from $200/AF to $400/AF (approximately). In addition, the majority of future growth in retail demands is expected to be met by developing local supply resources, offsetting any significant long-term increases in Metropolitan's expected sales. Costs are expected to increase at an annual average rate of 4.5 percent from 2008/09 to 2017/18 under relatively conservative assumptions. During this same period, capital investments are expected to range between $270 million and $470 million per year. To finance these capital investments, the LRFP anticipates Pay-As-You-Go funding to increase from $95 million in 2009 to $180 million in 2018, and issuing at least an additional $1.9 billion in revenue bond debt.

<u>Near-term Challenges</u>
The water conditions that Metropolitan faces in 2009 are the result of water supply conditions and resource actions that have occurred over the preceding years, including several extraordinary events, such as:

- An extended 8-year drought in the Colorado River watershed that resulted in storage levels in Lake Mead and Lake Powell going below 50 percent of capacity in 2007 and early 2008;

- Record dry hydrology in Southern California leading to groundwater basins and local reservoirs at near record lows;
- A federal court order to restrict SWP deliveries due to Delta smelt resulted in the loss of about one-third of the available SWP supplies in 2008, and ongoing actions to protect endangered and threatened fish species that will reduce the likelihood that regional storage can be refilled in the near term; and
- The SWP watershed suffered from the driest spring on record this year, leading to forecasts of end-of-year water supplies in Lake Oroville and San Luis Reservoir at the lowest operating levels since 1976.

These supply conditions, along with increasing demands on Metropolitan, have led to significant withdrawals from Metropolitan's storage, including Diamond Valley Lake (DVL), groundwater banking, and conjunctive use programs to meet all scheduled water deliveries. To illustrate this point, from January 2007 through December 2008, an estimated 1.1 million acre-feet (MAF) of storage will be withdrawn to meet about one quarter of Metropolitan's demands over this period.

A Five-Year Supply Plan has been prepared to identify specific resource and conservation actions that would be implemented over the next five years to manage water deliveries under continued drought conditions and court-ordered restrictions. Since April 2008, staff has been working with the member agencies through a series of meetings and workshops to develop and implement the Five-Year Supply Plan. The Plan was initiated in response to the events noted above, particularly regulatory actions that reduced water supplies from the SWP to protect Delta smelt and other fish, as well as the record-dry spring hydrology.

The long-term trends addressed above will drive the rate forecast and planning approach defined by the LRFP. But, the conditions Metropolitan faces in 2009 and 2010 present short-term financial hurdles that Metropolitan must overcome in the next two years. As discussed at the past several Business and Finance Committee meetings, Metropolitan's Rate Stabilization reserves have been reduced below previously set minimums. Further, debt service coverage levels are falling below the 2.0 times objective. As a result, significant rate increases are required in 2010 (20% to 25%), even if Metropolitan is not required to curtail deliveries. If Metropolitan is forced to curtailed deliveries the necessary rate increases will be higher in both 2010 and 2011 due to the resulting low water sales. Staff will be presenting options to address these issues for the Board's consideration and action as the Board deliberates the proposed budget and LRFP over the three-month period from January through March.

Policy

Submitted per request of the Board

Fiscal Impact

None

Brian G. Thomas 11/26/2008
Brian G. Thomas *Date*
Chief Financial Officer

Debra C. Man 11/26/2008
Debra C. Man *Date*
for Jeffrey Kightlinger
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