



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

5/11/2010 Board Meeting

8-1

Subject

Approve proposed budget for fiscal years 2010/11 and 2011/12

Description

The proposed 2010/11 budget reflects significant input from and participation by the Board and member agencies over the past five months. This was facilitated by three Board workshops on January 26, February 16, and March 23, 2010; discussion at the January 11, February 8, March 8, and April 11 Business and Finance Committee meetings; and several other presentations and caucuses with member agencies. In April, the Board adopted the revenue requirement and water rates and charges reflecting an increase in the overall rates of 7.5 percent in 2011, and 7.5 percent in 2012 and directed staff to reduce expenditures funded by rates and charges by an additional \$20 million in 2010/11 to ensure Metropolitan's ability to meet its full cost of service objective. The proposed budget includes actions to meet the Board's direction. As a result, the proposed 2010/11 expenditure budget, including capital, has been reduced by a total of \$94 million as compared to the January proposal for 2010/11. In addition, it is \$154 million less than the 2009/10 budget and \$224 million less than the 2008/09 budget. The proposed expenditures shown in Table 1 total \$1.64 billion, including state water contract payments, operating expenditures, capital expenditures, and debt service.

Table 1. 2010/11 Budget Summary – Total Expenditures (Dollars in Millions)

	2008/09 Actual	2009/10 Budget	2009/10 Projected	2010/11 Proposed Budget	2010/11 Proposed	
					2009/10 Budget	2009/10 Projected
Expenditures						
State Water Contract	\$ 394.7	\$ 478.8	\$ 436.5	\$ 488.5	\$ 9.7	\$ 52.0
Supply Programs	84.1	125.5	117.1	103.2	(22.3)	(14.0)
Colorado River Power	37.4	49.8	45.0	59.6	9.8	14.6
Debt Service	287.1	330.7	304.1	338.9	8.2	34.8
Demand Management	75.6	59.8	68.2	56.2	(3.6)	(12.0)
Departmental O&M	291.5	289.3	294.2	295.2	5.9	1.1
Treatment Chemicals, Solids & Power	28.4	32.8	29.5	26.5	(6.3)	(3.0)
Other O&M	24.8	18.7	15.8	15.3	(3.4)	(0.4)
Sub-total Expenditures	1,223.6	1,385.5	1,310.4	1,383.5	(2.0)	73.1
Capital Investment Plan	416.7	412.1	300.3	259.9	(152.1)	(40.4)
TOTAL Expenditures, CIP & Fund Deposits	\$ 1,640.3	\$ 1,797.6	\$ 1,610.7	\$ 1,643.4	\$ (154.1)	\$ 32.7

Totals may not foot due to rounding.

ACTIONS TO REDUCE THE BUDGET

As a result of the Board's direction to reduce expenditures funded by rates and charges in 2010/11, the budget includes the following actions:

- a. **Reduced State Water Project cost estimate** – The budget estimate for State Water Project costs was reduced by \$8.8 million, reflecting credits anticipated to be received in the next fiscal year rather than in 2009/10.
- b. **Reduced debt service** – Capital expenditures in 2010/11 were reduced by \$68 million, resulting in a debt service savings of about \$9 million as a result of deferring a \$400 million debt issue. About 75 projects were deferred or reduced to achieve these savings. Deferred capital projects included those that would not impinge on Metropolitan's ability to continue to meet water quality regulations, safety requirements, and reliability objectives. As such, projects that were demand driven or outside Metropolitan's core mission were deferred for up to one year.
- c. **Reduced conservation incentive budget** – The conservation incentive budget was reduced by \$2 million to a total of \$17.1 million. The initial budgets for residential and agricultural incentives were reduced by \$1 million each, although the use of incentives will be monitored throughout the year and monies can be moved among and between the programs depending on demand.
- d. **Reduced outreach and conservation administration costs** – Metropolitan's operations and maintenance budget was reduced by \$420,000 to reflect a reduction of \$100,000 in each of the following three programs: Community Partnering, Landscape Education, and IRP Outreach. In addition, since the conservation incentive budget was reduced by \$2 million, the associated vendor administration fees have also been reduced by \$120,000.

These changes result in an expenditure budget that will meet the Board's cost of service objective and are reflected in the line items shown in Table 1.

In addition to the above actions, Metropolitan continues to manage its departmental budget at levels lower than the prior year. This will be the third year in a row that the departmental budget has been reduced. In 2010/11, additional operating and maintenance activities associated with Bay-Delta initiatives totaling \$2.4 million, as well as another \$2.8 million to maintain the aging distribution and treatment system, were offset by actions in other areas, including:

- a. **Zero increase in base salaries** - The proposed budget does not include an increase in base salaries with the exception of a previously negotiated increase for employees in the Supervisors Association totaling \$0.4 million. The budget includes increases in the cost of benefits of \$2.3 million, including retirement and medical. In addition, an allowance for merit increases is included in the budget leading to another \$2.2 million increase in labor costs. Pending the outcome of ongoing labor negotiations, any change in base salaries will be offset by reductions in labor costs to meet the approved budget. Managing any required reductions so as to avoid adverse impacts to the increasing maintenance workload will be challenging.
- b. **Reduced positions and vacancy rates** - The total personnel budget was reduced by \$2 million, reflecting \$8.3 million in savings by eliminating 63 positions offset by a reduction in the vacancy rate of \$6.3 million.

- c. **Reduced conservation and outreach expenditures** - The 2010/11 budget includes \$1.2 million for conservation advertising. This is about \$2.5 million less than in the 2009/10 budget. Given current water supply conditions, earned media is expected to provide a significant share of the conservation message over the next fiscal year. As a result, this area of Metropolitan's program has been reduced. As noted above, conservation incentives and the administrative costs of the conservation incentives programs have been reduced by \$2 million and \$0.12 million relative to the 2009/10 budget, or about \$17.1 million and \$1.6 million, respectively. Finally, Community Partnering Program sponsorship, California Friendly Landscape training, and IRP outreach support funding was reduced by about \$0.1 million each for a total \$0.3 million.
- d. **Operating Equipment** - Operating equipment expenditures will be reduced by almost \$3.2 million from the 2009/10 budget. This will be the second year operating equipment purchases have been reduced by this magnitude. The 2008/09, 2009/10, and 2010/11 budgets for operating equipment totaled \$9 million, \$5.3 million, and \$2.1 million, respectively. Staff will need to continue to optimize the use of equipment that has experienced lower utilization in an effort to limit replacements to the oldest, least reliable equipment and manage the potentially increasing maintenance cost on older equipment. As mentioned earlier, this reduced level of operating equipment purchases is not sustainable. Operating equipment purchases in 2011/12 and beyond will be higher than in the proposed 2010/11 budget to make up for the deferred replacements.

A summary of the operating and maintenance budget is provided in Table 2 below.

Table 2. Budget Summary – Operations and Maintenance

	2008/09 Actual	2009/10 Budget	2009/10 Projected	2010/11 Proposed	Change from:	
					2009/10 Budget	2009/10 Projected
Salaries & Benefits	208,025,600	204,714,300	205,974,400	212,976,500	8,262,200	7,002,100
Chemicals, Solids, and Power	28,381,871	32,837,200	29,492,300	26,493,300	(6,343,900)	(2,999,000)
Outside Services	39,451,600	36,695,900	38,200,000	37,719,200	1,023,300	(480,800)
Materials & Supplies **	22,749,536	21,673,300	22,138,300	22,559,300	886,000	421,000
Cargill Settlement	3,765,000	1,604,900	-	500,000	(1,104,900)	500,000
Other	33,312,694	38,079,100	38,297,400	34,704,900	(3,374,200)	(3,592,500)
Operating Equipment	8,932,478	5,252,800	5,300,000	2,091,500	(3,161,300)	(3,208,500)
Total	344,618,779	340,857,500	339,402,400	337,044,700	(3,812,800)	(2,357,700)
Total Budgeted Positions	2,052	2,019	-	1,956	(63)	-

Totals may not foot due to rounding.

TWO-YEAR BUDGET

Metropolitan appropriates funds for all expenditures, including PAYGO to fund refurbishment and replacement (R&R) projects, on an annual basis in accordance with Section 5107 of Metropolitan's Administrative Code, which also includes a provision that a three-year budget outlook be included in the annual budget. Funds for completion of projects in the CIP are appropriated by the Board on an individual project basis. The Metropolitan Water District Act does not specify any requirement with regard to the budget process.

At the April 27, 2010 Executive Committee meeting, several directors requested that staff provide a two-year budget. At that meeting, staff committed to providing the 2011/12 budget items at the line item level historically approved by the Board. In addition to the 2011/12 budget, Table 3 also shows a projection of expenditures and revenues for the third year, 2012/13. As part of the April board action on rates and charges, the Board also approved the revenue requirement associated with the second year of rates and charges. This revenue requirement is consistent with the expenditures shown in Table 3 that are funded from rates and charges.

USES OF FUNDS

As shown in Table 3, the total FY 2010/11 cash outlays for State Water Contract (SWC) payments, supply programs, Colorado River Aqueduct (CRA) power, debt service, demand management programs, O&M, and the CIP are budgeted at \$1.64 billion. This is \$154.1 million (8.6 percent) less than the 2009/10 budget and \$32.7 million (2 percent) greater than projected 2009/10 expenditures. Under this financing package, \$95 million of water revenues will be used to fund a portion of the Replacement and Refurbishment work in the CIP. For 2011/12, total expenditures are forecast at \$1.84 billion due primarily to an increase of \$81.1 million in the CIP, a \$36.7 million increase in O&M, a \$28.6-million increase in SWC payments, and a \$28.3-million increase in debt service.

SOURCES OF FUNDS

As shown in Table 3, 2010/11 sources of funds will total \$2.01 billion. This includes receipts of \$1.9 billion, with water sales receipts of \$1.2 billion accounting for 63 percent of receipts. These receipts are based on projected water sales of 1.93 million acre-feet and include an increase in rates and charges of 7.5 percent, effective January 1, 2011. Revenues include readiness-to-serve charge revenues of \$119.5 million, revenues from the capacity charge of \$34.9 million, and tax and annexation revenues of about \$81.8 million. Interest earnings are expected to be \$37.2 million, about \$3 million higher than the 2009/10 budget, reflecting higher estimated fund balances. Power and other miscellaneous receipts are expected to generate about \$22.4 million. For 2011/12, the total sources of funds are forecast at \$2.03 billion, including an increase in rates and charges of 7.5 percent, effective January 1, 2012.

Capital projects in 2010/11 will be funded from a combination of existing bond funds and revenues. Revenues will be used to fund about \$95 million of the capital costs. In addition, bond proceeds will provide about \$165 million toward the CIP. In 2011/12, \$125 million of the CIP will be funded from revenues while \$261 million will be funded from bond proceeds.

Table 3. Budgeted Uses and Sources of Funds – Cash Basis (Dollars in Millions)

	2008/09 Actual	2009/10 Budget	2009/10 Projected	2010/11 Proposed Budget	2011/12 Proposed Budget	2012/13 Forecast
USES OF FUNDS						
Expenditures						
State Water Contract	\$ 394.7	\$ 478.8	\$ 436.5	\$ 488.5	\$ 517.1	\$ 553.3
Supply Programs	84.1	125.5	117.1	103.2	119.1	151.4
Colorado River Power	37.4	49.8	45.0	59.6	61.5	64.3
Debt Service	287.1	330.7	304.1	338.9	367.2	385.7
Demand Management	75.6	59.8	68.2	56.2	59.1	66.8
Departmental O&M	291.5	289.3	294.2	295.2	313.8	327.8
Treatment Chemicals, Solids & Power	28.4	32.8	29.5	26.5	29.4	31.1
Other O&M	24.8	18.7	15.8	15.3	30.8	36.4
Sub-total Expenditures	1,223.6	1,385.5	1,310.4	1,383.5	1,497.9	1,616.8
Capital Investment Plan	416.7	412.1	300.3	259.9	341.0	385.8
Fund Deposits						
Water Transfer Fund	10.5	-	-	-	-	-
R&R and General Fund	30.1	36.7	36.7	95.0	125.0	125.0
Revenue Bond Construction	-	130.3	-	199.1	-	-
Water Stewardship Fund	-	-	-	4.2	3.0	-
Interest for Construction & Trust Funds	4.2	0.0	4.5	7.0	7.3	3.2
Increase in Required Reserves	44.0	61.3	33.3	62.6	57.4	53.3
Increase in Rate Stabilization Fund	-	-	-	-	-	6
Sub-total Fund Deposits	88.8	228.3	74.5	367.9	192.6	187.3
TOTAL USES OF FUNDS	\$ 1,729.1	\$ 2,025.8	\$ 1,685.2	\$ 2,011.4	\$ 2,031.5	\$ 2,189.9
SOURCES OF FUNDS						
Receipts						
Taxes	\$ 103.8	\$ 90.4	\$ 90.4	\$ 80.8	81.0	81.9
Annexations	1.4	1.0	1.0	1.0	1.0	1.0
Interest Income	36.4	34.2	21.5	37.2	40.3	40.1
Hydro Power	22.5	24.1	19.6	22.4	22.1	21.3
Fixed Charges (RTS & Capacity Charge)	119.7	136.3	136.4	154.4	171.3	186.8
Water Sales Revenue	988.1	1,078.6	1,016.7	1,199.9	1,331.6	1,433.7
Miscellaneous Revenue	8.4	8.8	29.3	16.0	28.4	30.0
Bond Proceeds and Reimbursements	367.0	528.0	-	384.0	-	211.2
Sub-total Receipts	1,647.3	1,901.5	1,315.0	1,895.6	1,675.7	2,005.9
Fund Withdrawals						
Water Transfer Fund	7.8	-	12.1	-	-	-
R&R and General Fund	34.3	36.7	36.7	95.0	125.0	125.0
Bond Funds for Construction	46.1	-	263.6	-	216.0	58.6
Water Stewardship Fund	24.7	0.9	-	-	-	0.4
Decrease in Required Reserves	-	29.9	-	-	-	-
Decrease in Rate Stabilization Fund	(31.2)	56.8	57.8	20.8	14.4	-
Sub-total Fund Withdrawals	81.7	124.3	370.2	115.8	355.4	183.9
TOTAL SOURCES OF FUNDS	\$ 1,729.1	\$ 2,025.8	\$ 1,685.2	\$ 2,011.4	2,031.5	2,189.9

Totals may not foot due to rounding.

FINANCIAL RATIOS

The revenue bond debt service coverage ratio is forecast to be just under the Board's adopted target of 2 times revenue bond debt service. Assuming consecutive 7.5 percent increase in rates and charges in January of 2011 and 2012, the debt service coverage ratio is expected to be about 1.9 and 2.0 times coverage, respectively. Metropolitan's fixed charge coverage is expected to be 1.3 and 1.4 times, which meets the board-adopted objective of 1.2 times coverage.

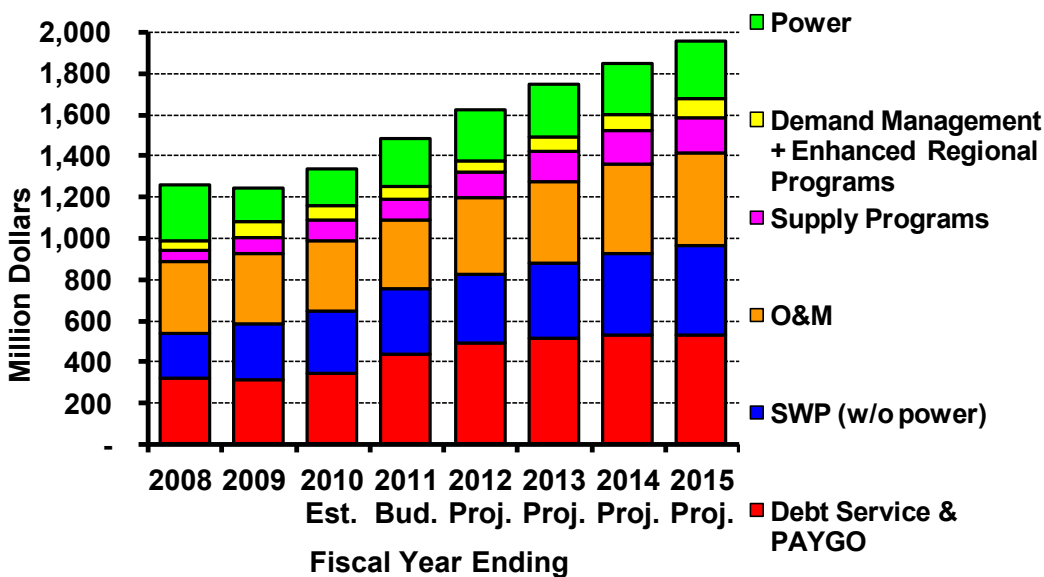
RESERVES

Based on projected receipts and expenditures, it is estimated that the total balance in the Water Rate Stabilization, Revenue Remainder, the Treatment Surcharge Stabilization Fund, and Water Stewardship funds will be about \$270.4 million. Total restricted and unrestricted reserves are estimated to be \$1,307.1 million on June 30, 2011.

LONG-TERM EXPENDITURE TREND

To provide a longer-term picture of Metropolitan’s costs, Figure 1 shows the major expenditure categories over the past two years, the estimate for the current fiscal year, as well as the projection for the following four years. From 2007/08 through 2014/15, expenditures are forecast to increase by about \$696 million, or about 6.5 percent annually. The primary cost drivers from 2009/10 to 2014/15 are a \$188-million increase in debt service and R&R expenditures funded from revenues, a \$131-million increase in fixed State Water Project Costs, a \$109-million increase in departmental O&M, and a \$99-million increase in power costs.

Figure 1. Seven-year Expenditure Trend



As part of the implementation process for the Integrated Budget Management System (IBMS) in 2007, staff conducted a peer review of the budget processes of comparable entities, including the City of Philadelphia, East Bay Municipal Utility District (EBMUD), Irvine Ranch Water District, Los Angeles DWP, Southern Nevada Water Authority, the San Francisco Public Utilities Commission, and the City of Anaheim. Among the findings of that peer review was that the majority of organizations surveyed prepare and approve a budget on an annual basis. Of the entities surveyed, only EBMUD indicated that they prepare a multi-year budget but perform a review and take a formal action on their operating budget annually.

A quick survey of related industry best practice recommendations by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB) found support for:

- a. Long term forecasting of major revenues and expenditures extending at least three to five years beyond the budget period.
- b. Determining the time period covered by the budget so as to meet an organization’s needs and priorities and positively impact its approach to planning, control, and overall management of its programs, services, and finances.

- c. Evaluating revenue and expenditure options together, and consider the implications of other financial indicators, prior to making specific choices with regard to the proposed budget.
- d. Adjusting the budget during the budget period should unforeseen events require changes to the original budget plan.

Staff will continue to work with the Business and Finance Committee on the long-term forecast and multi-year budgets for the future.

Additional Materials

The FY 2010/11 Proposed Budget book was provided to the Board the week of January 25, 2010 and is available on Metropolitan's website at www.mwdh2o.com.

Policy

Metropolitan Water District Administrative Code Section 5107: Annual Budget

California Environmental Quality Act (CEQA)

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

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 which 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

Option #1

Adopt the CEQA determination and

- a. Approve the 2010/11 Budget;
 - i. Appropriate \$1.04 billion for the projected annual 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;
 - ii. Appropriate as continuing appropriations, \$338.9 million for 2010/11 debt service on Metropolitan general obligation and revenue bonds; and
 - iii. Authorize the use of \$95 million in operating revenues to fund Replacement and Refurbishment expenditures in 2010/11.
- b. Approve the 2011/12 Budget;
 - i. Appropriate \$1.13 billion for the projected annual 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;
 - ii. Appropriate as continuing appropriations, \$367.2 million for 2011/12 debt service on Metropolitan general obligation and revenue bonds; and
 - iii. Authorize the use of \$125 million in operating revenues to fund Replacement and Refurbishment expenditures in 2011/12.

Fiscal Impact: \$1.48 billion in FY 2010/11 and \$1.62 billion in FY 2011/12

Business Analysis: Funds are necessary for the continuing business operations of Metropolitan.

Option #2

Adopt the CEQA determination and

- a. Approve the 2010/11 Budget;
- b. Appropriate \$1.04 billion for the projected annual 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;
- c. Appropriate as continuing appropriations, \$338.9 million for 2010/11 debt service on Metropolitan general obligation and revenue bonds; and
- d. Authorize the use of \$95 million in operating revenues to fund Replacement and Refurbishment expenditures in 2010/11.

Fiscal Impact: \$1.48 billion in FY 2010/11

Business Analysis: Funds are necessary for the continuing business operations of Metropolitan.

Option #3


Adopt the CEQA determination and approve the 2010/11 Budget with changes as recommended by the Board.

Fiscal Impact: Impact depends on adopted changes.

Business Analysis: Funds are necessary for the continuing business operations of Metropolitan.

Staff Recommendation

Option #1


 _____ 5/4/2010
 Brian G. Thomas Date
 Chief Financial Officer


 _____ 5/4/2010
 Jeffrey Lightlinger Date
 General Manager