



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

8/17/2010 Board Meeting

8-2

Subject

Approve proposed budget for fiscal year 2011/12

Description

In April 2010, the Board adopted the revenue requirement for 2010/11 and 2011/12, as well as water rates and charges reflecting an increase in the overall rates of 7.5 percent in 2011 and 7.5 percent in 2012. As part of that action, the Board directed staff to develop the 2011/12 budget for the Board's consideration. Both the proposed 2010/11 and proposed 2011/12 budgets were presented to the Board in April, at which time the Board requested additional time and detail to consider the 2011/12 budget. The proposed 2011/12 budget was discussed at a board workshop on July 27, 2010. The proposed budget is consistent with the board-approved revenue requirement and rates. As shown in Table 1, the proposed 2011/12 expenditure budget totals \$1.82 billion, including state water contract payments, supply and demand management programs, operating expenditures, capital expenditures, and debt service. This is \$187.4 million higher than the 2010/11 budget.

Table 1. 2011/12 Budget Summary – Total Expenditures (Dollars in Millions)

	2008/09 Actual	2009/10 Actual	2010/11 Budget	2011/12 Proposed Budget	2011/12 Proposed vs. 2010/11 Budget
Expenditures					
State Water Contract	\$ 394.7	\$ 438.2	\$ 488.5	\$ 517.1	\$ 28.5
Supply Programs	84.1	121.9	101.4	119.1	17.7
Colorado River Power	37.4	42.4	59.6	61.5	1.9
Debt Service	287.1	293.7	331.7	351.9	20.2
Demand Management	75.6	62.4	58.2	59.1	0.8
Departmental O&M	291.5	293.8	294.8	313.8	19.0
Treatment Chemicals, Solids & Power	28.4	23.1	26.5	29.4	2.9
Other O&M	24.8	18.5	15.4	30.8	15.3
Sub-total Expenditures	1,223.6	1,294.0	1,376.3	1,482.6	106.4
Capital Investment Plan	416.7	316.4	259.9	341.0	81.1
TOTAL Expenditures, CIP & Fund Deposits	\$ 1,640.3	\$ 1,610.3	\$ 1,636.2	\$ 1,823.7	\$ 187.4

Totals may not foot due to rounding.

BUDGET ISSUES AND CHALLENGES

Metropolitan continues to manage its overall budget in response to economic conditions, water supply constraints, and board priorities. As examples of the actions taken, departmental budgets were reduced three consecutive years, 149 positions have been eliminated since 2007/08, capital projects have been deferred including \$68 million in projects for 2010/11, and draws on reserves have dropped financial ratios below board objectives. These necessary actions permitted Metropolitan to manage the impact of short term challenges.

The proposed budget for 2011/12 recognizes the Board's desire to control expenditures funded by rates and charges and continue to ensure reliable water deliveries while covering the full cost of service. Major drivers and assumption included in the 2011/12 budget include:

- a. **Water Sales** – Water Sales are projected to reach 2 million acre-feet based on Colorado River diversion of 1.2 million acre-feet and an increase in SWP allocation from 40 percent to 45 percent, which are expected to be supported by interim Delta improvements.
- b. **State Water Contract** – The budget estimate for State Water Project costs is \$517 million, reflecting a \$13.6-million increase in power costs and a \$14.4-million increase in SWP fixed costs.
- c. **Supply Program** – The proposed budget of \$119.1 million includes a \$14.7-million increase for new water transfers.
- d. **Operations & Maintenance (O&M)** – The proposed budget of \$374 million is an increase of \$37.3 million compared with the 2010/11 budget. This increase is driven primarily by initial funding of \$10 million for Other Post-Employment Benefits (OPEB), a \$4.9-million increase in operating equipment, a \$1.6 million increase in water treatment chemicals, and \$1.4 million for the first phase of the PC Replacement Program. Although labor costs include a \$6.6-million dollar increase to cover projected merit and benefit cost increases, it does not include any increase in base salaries. The 2011/12 budget also reflects elimination of three more positions, bringing the total of positions eliminated from the budget to 149. Finally, the proposed budget includes a 2 percent budget contingency of \$7.3 million to reflect the additional uncertainty associated with longer-term budgeting. A summary of the operations and maintenance budget is provided in Table 2 below.
- e. **Operating Equipment** – As indicated above, operating equipment expenditures increased by \$4.9 million from the 2010/11 budget. The 2008/09, 2009/10, and 2010/11 budgets for operating equipment totaled \$9 million, \$5.3 million, and \$2.1 million, respectively. As mentioned during the extensive review of the 2010/11 budget, this reduced level of operating equipment purchases would not be sustainable over the long term. Operating equipment purchases in 2011/12 and beyond were anticipated to be higher than in the proposed 2010/11 budget to make up for the deferred replacements.
- f. **CIP** – Proposed capital expenditures are projected to be \$341 million, an \$81-million increase as compared to 2010/11. Replacement and Refurbishment (R&R) projects total \$179 million, or about 53 percent of the total CIP, reflecting the need to repair, replace, and rehabilitate Metropolitan's aging infrastructure.

Table 2. Budget Summary – Operations and Maintenance

	2008/09 Actual	2009/10 Actual	2010/11 Budget	2011/12 Proposed	Change from 2010/11 Budget
Salaries & Benefits	208,025,600	212,319,770	212,976,500	218,779,200	5,802,700
Chemicals, Solids, and Power	28,381,871	23,128,078	26,493,300	29,406,000	2,912,700
Outside Services	39,455,100	40,175,825	37,519,200	40,054,600	2,535,400
Materials & Supplies **	22,749,536	21,073,662	22,559,300	22,777,200	217,900
Cargill Settlement / OPEB	3,765,000	600,727	500,000	10,500,000	10,000,000
Other	33,309,194	32,551,457	34,504,900	45,409,500	10,904,600
Operating Equipment	8,932,478	5,520,268	2,091,500	7,035,600	4,944,100
Total	344,618,779	335,369,787	336,644,700	373,962,100	37,317,400
Total Budgeted Positions	2,052	2,019	1,924	1,921	(3)

USES OF FUNDS

As shown in Table 3, the total FY 2011/12 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 \$1.82 billion. This is \$187.4 million (11.4 percent) greater than the 2010/11 budget due primarily to an increase of \$81.1 million in the CIP, a \$37.3 million increase in O&M, a \$28.5 million increase in SWC payments, and a \$20.2-million increase in debt service. Under this financing package, \$125 million of water revenues will be used to fund a portion of the R&R work in the CIP.

SOURCES OF FUNDS

As shown in Table 3, sources of funds will total \$2.02 billion in 2011/12. This includes receipts of \$1.66 billion, with water sales receipts of \$1.33 billion accounting for 80 percent of receipts. These receipts are based on projected water sales of 2 million acre-feet and include an increase in rates and charges of 7.5 percent, effective January 1, 2012. Other revenues include readiness-to-serve charge revenues of \$135.5 million, revenues from the capacity charge of \$35.8 million, and tax and annexation revenues of about \$82 million. Interest earnings are expected to be \$41.4 million, about \$4.2 million higher than the 2010/11 budget, reflecting higher estimated fund balances. Power and other miscellaneous receipts are expected to generate about \$35.3 million.

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

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

	2009/10 Actual	2010/11 Budget	2010/11 Projected	2011/12 Proposed Budget	2011/12 Proposed Budget Compared to	
					2010/11 Budget	2010/11 Projected
USES OF FUNDS						
Expenditures						
State Water Contract	\$ 438.2	\$ 488.5	\$ 488.5	\$ 517.1	\$ 28.5	\$ 28.5
Supply Programs	121.9	101.4	101.4	119.1	17.7	17.7
Colorado River Power	42.4	59.6	59.6	61.5	1.9	1.9
Debt Service	293.7	331.7	331.7	351.9	20.2	20.2
Demand Management	62.4	58.2	58.2	59.1	0.8	0.8
Enhanced Regional Programs	-	-	-	-	-	-
Departmental O&M	293.8	294.8	294.8	313.8	19.0	19.0
Treatment Chemicals, Solids & Power	23.1	26.5	26.5	29.4	2.9	2.9
Other O&M	18.5	15.4	15.4	30.8	15.3	15.3
Sub-total Expenditures	1,294.0	1,376.3	1,376.3	1,482.6	106.4	106.4
Capital Investment Plan	316.4	259.9	259.9	341.0	81.1	81.1
Fund Deposits						
Water Transfer Fund	-	-	-	-	-	-
R&R and General Fund	36.7	95.0	95.0	125.0	30.0	30.0
Revenue Bond Construction	44.9	199.1	199.1	-	(199.1)	(199.1)
Water Stewardship Fund	0.0	4.2	4.2	3.0	(1.2)	(1.2)
Interest for Construction & Trust Funds	5.4	7.0	7.6	7.8	0.8	0.2
Increase in Required Reserves	27.6	62.6	68.5	57.1	(5.5)	(11.4)
Increase in Rate Stabilization Fund	-	-	-	-	-	-
Other Fund Activity	11.8	-	-	-	-	-
Sub-total Fund Deposits	126.4	367.9	374.4	192.9	(175.1)	(181.5)
Member Agency Credit	-	-	-	-	-	-
TOTAL USES OF FUNDS	\$ 1,736.7	\$ 2,004.2	\$ 2,010.6	\$ 2,016.5	\$ 12.4	\$ 5.9
SOURCES OF FUNDS						
Receipts						
Taxes	\$ 96.6	\$ 80.8	\$ 80.8	\$ 81.0	\$ 0.3	\$ 0.3
Annexations	0.7	1.0	1.0	1.0	-	-
Interest Income	23.9	37.2	38.6	41.4	4.2	2.8
Hydro Power	18.8	22.4	22.4	22.1	(0.2)	(0.2)
Fixed Charges (RTS & Capacity Charge)	135.3	154.4	154.4	171.3	16.9	16.9
Water Sales Revenue	1,011.1	1,199.9	1,199.9	1,331.6	131.7	131.7
Miscellaneous Revenue	31.6	8.8	8.8	13.2	4.4	4.4
Bond Proceeds and Reimbursements	342.5	384.0	384.0	-	(384.0)	(384.0)
Sub-total Receipts	1,660.3	1,888.4	1,889.8	1,661.7	(226.7)	(228.2)
Fund Withdrawals						
Water Transfer Fund	11.9	-	-	-	-	-
R&R and General Fund	36.7	95.0	95.0	125.0	30.0	30.0
Bond Funds for Construction	-	-	-	216.0	216.0	216.0
Water Stewardship Fund	-	-	-	-	-	-
Decrease in Required Reserves	-	-	-	-	-	-
Decrease in Rate Stabilization Fund	27.8	20.8	25.8	13.9	(6.9)	(11.9)
Sub-total Fund Withdrawals	76.4	115.8	120.8	354.9	239.1	234.1
TOTAL SOURCES OF FUNDS	\$ 1,736.7	\$ 2,004.2	\$ 2,010.6	\$ 2,016.5	\$ 12.4	\$ 5.9

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. Given the approved 7.5 percent increase in rates and charges in January 2011 and 2012, the debt service coverage ratio is expected to be about 1.9 and 2.0 times, respectively. Metropolitan’s fixed charge coverage ratio is expected to be 1.3 and 1.4 times, meeting the board-adopted objective of 1.2 times coverage.

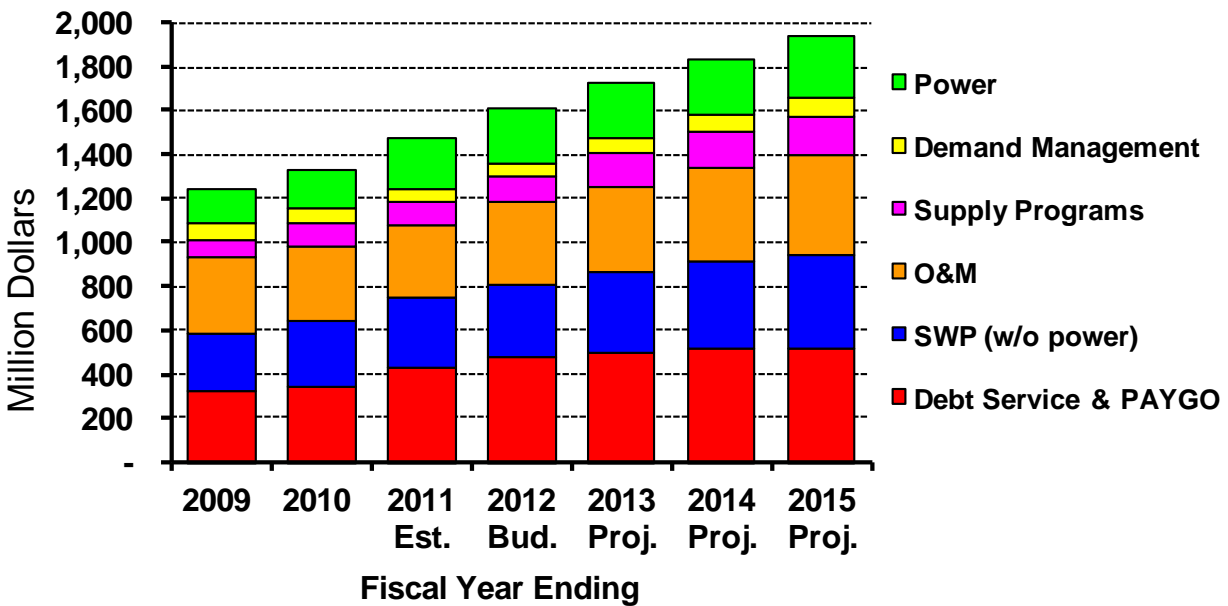
RESERVES

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 \$295.1 million, about \$49 million above the minimum level set by the Board. Total restricted and unrestricted reserves are estimated to be \$1.18 billion on June 30, 2012.

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 2010/11 through 2014/15, expenditures are forecast to increase by about \$463 million, or about 7.1 percent annually. The primary cost drivers from 2010/11 to 2014/15 are a \$118 million increase in fixed State Water Project Costs, a \$112 million increase in departmental O&M, an \$84-million increase in debt service and R&R expenditures funded from revenues, and a \$73-million increase in supply programs.

Figure 1. Seven-year Expenditure Trend



TWO-YEAR BUDGET

Metropolitan budgets and appropriates funds for operation and maintenance expenditures 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 a project by project basis in accordance with section 5108 of the Administrative Code.

Approval of the 2011/12 Proposed Budget will initiate transition of Metropolitan's budget process to a two-year (i.e. biennial) cycle. Beginning in January 2011, the Board will be provided an opportunity to refine this budget to reflect more currently available information while focusing on the longer term initiatives and budget for fiscal year 2012/13. In February 2011, there will be an opportunity to review these proposals in detail at a board workshop. A public hearing on the proposed rates will be conducted in March 2011. The process will conclude with board consideration and action on the proposed budgets and rates in April 2011 resulting in approval of Metropolitan's first true biennial budget for fiscal years 2011/12 and 2012/13.

In January 2012, a mid-term review of the 2012/13 budget will be conducted. The 2012/13 budget will be refined to reflect any significant changes in the assumptions used to develop the budget, again focusing primarily on strategic issues. The Board would consider and act on any revisions to the 2012/13 budget in April 2012. The next full biennial budget cycle would then begin again in January 2013 with the development and presentation of proposed budgets for fiscal years 2013/14 and 2014/15, culminating in their consideration and action by the Board in April 2013.

Policy

Metropolitan Water District Administrative Code Section 5107: Annual Budget

California Environmental Quality Act (CEQA)

CEQA determination for Options #1 and #2:

The proposed action is not defined as a project under CEQA, because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves 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 action is 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 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, \$351.9 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 R&R expenditures in 2011/12.

Fiscal Impact: \$1.61 billion in FY 2011/12

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

Option #2

Adopt the CEQA determination and approve the 2011/12 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



Brian G. Thomas
Chief Financial Officer

8/4/2010

Date



Jeffrey Kightlinger
General Manager

8/4/2010

Date

Ref# cfo12606730