

Long Range Finance Plan / Rate Refinement Discussions Update

Finance & Insurance Committee

Item 7-a

October 10, 2011

Activities to Date

- August 2011
 - First Rate Refinement Workgroup meeting
 - Oral Report at F&I on process
- September 2011
 - Second and third Workgroup meetings
- October 2011
 - Oral Report at F&I
 - Fourth Workgroup meeting scheduled for the Member Agency Managers' meeting on October 14

List of Issues - Categorized

- Issues related to fixed revenue:
 - Fixed revenue generation
 - Tier 1 limit / trading Tier 1 limits
 - Fixed commitment to pay for the system (contracts)
 - Purchase Order status, Compton
 - Review of financial policies
- Issues related to specific programs:
 - Replenishment (report at WP&S)
 - Aligning the WSAP and T1/T2 rates
- Issues related to cost causation
 - Growth charge for infrastructure
 - Treated water cost recovery
 - Look back period for Capacity Charge

Issues to Move Forward

- List of Issues
 - Consensus of majority
- Compton Purchase Order
 - Board Action in November
- Align Water Supply Allocation Plan and Tier 1/
Tier 2 calculation
 - Option: Tier 2 calculation performed on a fiscal year basis, not calendar year
 - Transition to be worked out

Framing the Discussions: Background Information

Costs versus Revenues

- Variable: costs or revenues that vary directly with the amount of water delivered/sold
 - Costs: SWP On Aqueduct and CRA Power, Power and chemicals for Treatment processes, Supply Programs
 - Revenues: volumetric rates for unbundled services, including Treatment Surcharge
- Fixed: costs or revenues that do not vary with volumes of water sold
 - Costs: everything not listed above
 - Revenues: Readiness-to-Serve Charge, Capacity Charge, Ad Valorem Taxes

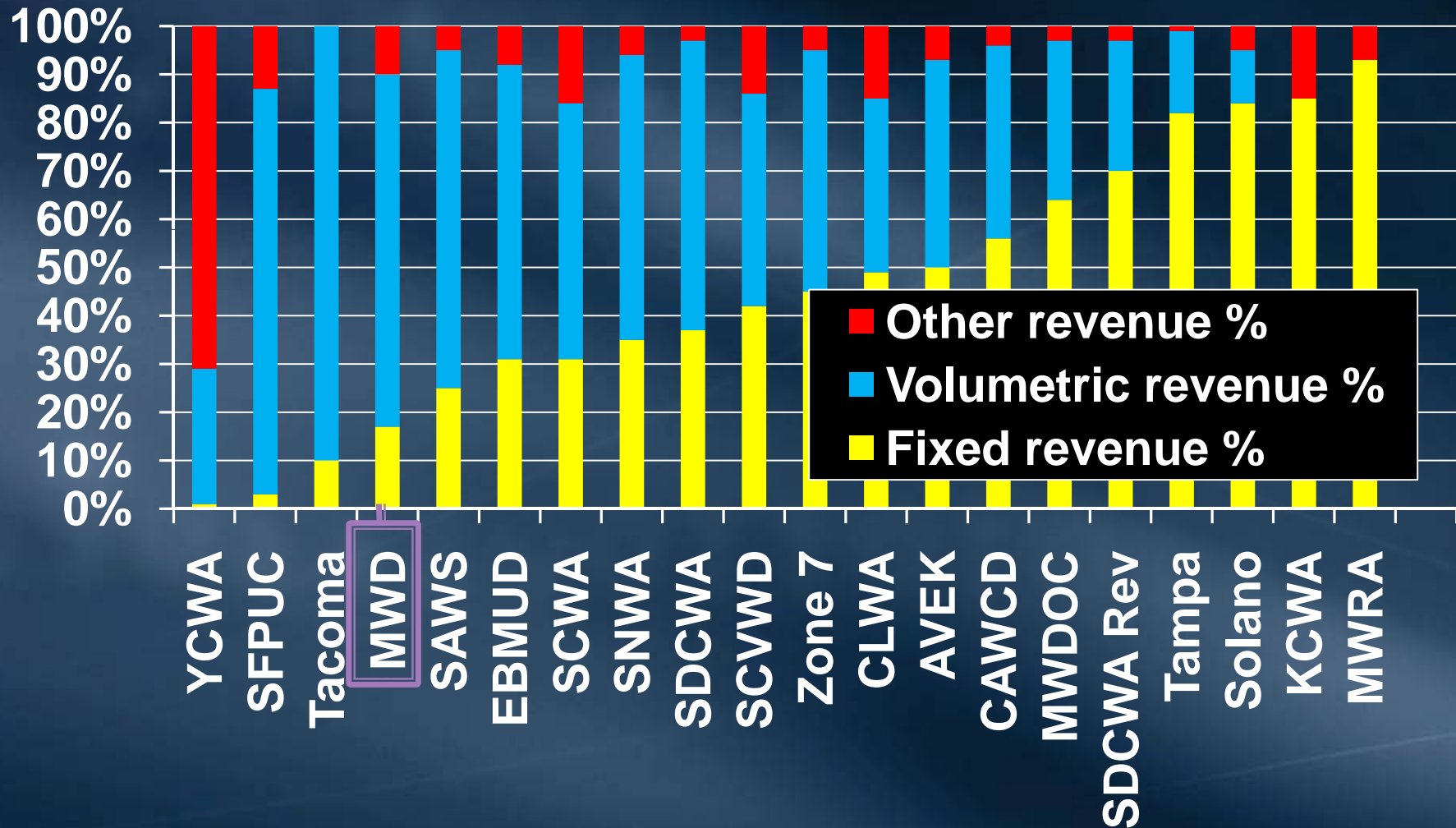
Projected Costs and Revenues

2019/20 data from Draft 2010 LRF

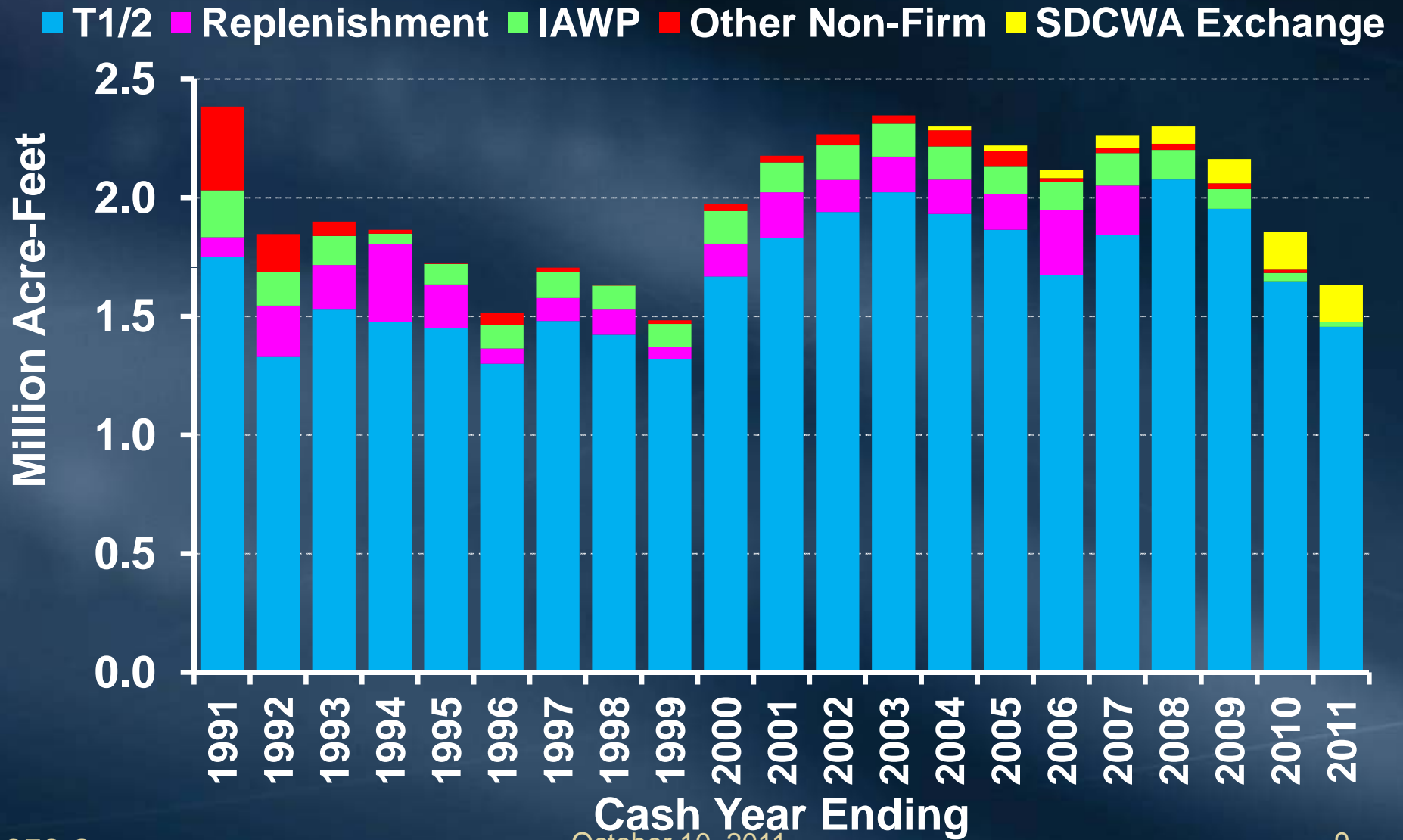


Variable Costs include SWP Variable Power, CRA Power, Variable Treatment, & Supply Programs
Fixed Revenues include RTS, CC, and Taxes/Annexations

Metropolitan's Fixed Revenues Are Lower Than Most Other Agencies



Revenue-Generating Sales Have Been Volatile Over Past 20 Years



Metropolitan Sales Variability is Higher Than Most Retail Agencies

- Metropolitan is a supplemental supplier
 - Sales vary as retail demands increase/decline
 - Sales vary as local supplies increase/decline
- Revenue structure is highly dependent on variable revenues
 - ~ 80% of revenues are based on volumes sold
- Result is a highly volatile revenue stream

Revenue Challenges: A Nationwide Issue

Industry Approaches to Revenue Challenges: Water Research Foundation Project #4405 Rates and Revenues

- Working group established of utility executives
- Strategies to bridge revenue gap faced by water utilities to address:
 - Public Health
 - Environmental
 - Community Development
- Challenge:
 - Gap between future needs and revenues
 - Continued decreased water use per account

Water Research Foundation

Project #4405 Rates and Revenues (cont'd)

- Strategies :
 - Pricing and Sales Innovation
 - Financial Policies and Guidelines
 - Enhanced Integrated Planning and Cost Control
 - Community Outreach
 - Communication
- Papers available

Examples of Fixed Revenue Enhancements Within Metropolitan Service Area

- City of Newport Beach (Retailer)
 - '09 - 90% commodity/10% monthly service charge
 - '12 - 72% commodity/28% monthly service charge
- City of Pasadena (Retailer)
 - Increase in Fixed Distribution and Customer Charge
- SDCWA (Wholesaler)
 - Fixed revenues to fixed costs ratio going from 67% to 80%
- MWDOC (Wholesaler)
 - Moving to 100% fixed revenues

Industry-Wide Trends/Considerations

- Take-or-pay provisions for contract-wholesale customers
- Variability in revenue – potential sales “swings”
- Increased reserve levels
 - Rate stabilization funds
- Greater pay-go for capital
- Fixed charges for fixed costs
 - El Paso: Water Supply Replacement Charge
 - Phoenix: Environmental Charge
 - Charlotte: 20% of debt service in Fixed Availability Fee

Benefits of Increased Fixed Charges to Metropolitan

- Reduces revenue volatility
 - Reduces need to maintain high reserves
- Reduces rate spikes resulting from low sales
 - More predictable rate increases
- Improves MWD's financials
 - Improves coverage in low sales years
 - Helps maintain credit ratings

Downside of Increased Fixed Charges to Member Agencies

- Transitions risk of revenue volatility to member agencies
 - Could require greater reserves at the local level, depending on how agencies structure cost recovery
- Pass-through charges not as big a challenge
 - Agencies without pass-through charges may have more volatility in their own rates, and could trigger Proposition 218 notice processes

Next Steps

- Rate Structure Review continues
 - Member Agency meeting on October 14
 - Additional meetings to be scheduled
 - Periodic reports back to the Board on progress
- Compton Purchase Order consideration in November