THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

INFORMATION

- Board of Directors
  Water Planning and Stewardship Committee

11/8/2011 Board Meeting

9-1

Subject

Report on Local Resources Development Strategy Task Force

Description

Since April 2011, staff has been working with member agencies through the Local Resources Development Task Force (Task Force) to develop a program to advance local resource development. Program changes could apply to local resource projects including recycled water, groundwater recovery, seawater desalination and stormwater capture. Through the process, the Task Force is:

- Assessing both financial and non-financial incentive approaches to help the development of local resources;
- Identifying Local Resources Program (LRP) improvements and alternative mechanisms consistent with the goals in Metropolitan's 2010 Integrated Water Resources Plan (IRP); and
- Investigating approaches that are most cost-effective and sustainable based on the net financial impact on Metropolitan and its rates.

In response to board direction, the Task Force has also begun the process of reviewing Metropolitan's recycled water policy principles. These principles help guide program development and administrative actions related to recycled water and other local projects. These principles also focus on non-financial approaches including public education and outreach, regulation, legislation and research.

In August, staff presented an information board letter on this process. This letter presents the updated work of the Task Force to further define nine potential financial approaches for the future of the program.

<u>Financial Analysis Model</u>

Since staff's August informational board letter, the Task Force has more fully developed the eight approaches previously presented and identified a ninth approach; these are:

1. Status quo
2. Reduced maximum incentive
3. Reduced agreement term
4. Competitive proposals
5. Construction fund (revolving fund)
6. Co-ownership
7. Full ownership
8. Metropolitan water rates (no incentives)
9. Design-Build-Own-Operate-Transfer (DBOOT)

Approaches 1 through 4 are incentive based. Approaches 5, 6, 7, and 9 are cost recovery approaches. Approach 8 assumes that Metropolitan's water rates could serve as a catalyst for local resource development without additional financial incentives. A detailed description of each approach follows:

Approach 1: Status Quo: Metropolitan would continue its current LRP by providing sliding-scale incentives up to $250 per acre-foot of water produced over 25 years. The LRP incentive would continue to be based on the actual project unit cost in excess of Metropolitan's prevailing water rate. A cost reconciliation analysis would be conducted every year to determine the actual incentive rate for that year.

Approach 2A: Reduced Maximum Incentive (Sliding Scale): Metropolitan would provide sliding-scale incentives up to an amount less than $250 (e.g., $180) per-acre foot of water produced over 25 years. The LRP contribution would be based on the actual project unit cost in excess of Metropolitan's prevailing water rate. A cost reconciliation analysis would be conducted every year to determine the actual incentive rate for that year.

Approach 2B: Reduced Maximum Incentive (Fixed Incentive): Metropolitan would provide a fixed incentive of less than $250 (e.g., $139) per acre-foot of water produced over up to 25 years. The LRP incentive and agreement term would be agreed upon by Metropolitan and the member agency. In contrast to Approach 2A, no annual cost reconciliation analysis would be needed.

Approach 3: Reduced Agreement Term: Metropolitan would provide sliding-scale incentives up to $250 per acre-foot of water produced over a term less than 25 (e.g., 15) years. The LRP contribution would be based on the actual project unit cost in excess of Metropolitan's prevailing water rate. A cost reconciliation analysis would be conducted every year to determine the actual incentive rate for that year.

Approach 4: Competitive Proposals: Metropolitan would issue a request for proposal (RFP) for member agencies to compete for Metropolitan incentives at a fixed rate up to $250 per acre-foot of production and an agreement term of up to 25 years. Proposals that request lower overall financial incentives, through a lower incentive rate and/or agreement term, would score higher under the competitive process. A review panel would evaluate proposals and select projects that best meet the region's needs consistent with the RFP.

Approach 5: Construction Fund (Revolving Fund): Metropolitan would provide a loan of up to 50 percent of project capital cost to the agency with a repayment obligation to Metropolitan within a set period of time. The loan from Metropolitan could carry interest ranging from zero to Metropolitan's full cost of capital financing. Repayment to Metropolitan will be at an agreed upon fixed payment or variable payment based on project production or agreed schedule.

Approach 6: Co-ownership: At the request of a member (or another public) agency, Metropolitan would provide up to 50 percent of the capital and operation and maintenance costs of a project in exchange for a proportional equity position in the project. Metropolitan would own a portion of the water produced and the revenue created by the water sale. The co-owner agency would commit to buy Metropolitan's project water at an agreed-upon price.

Approach 7: Full Ownership: Metropolitan would develop, own, and operate a project directly as a component of its own water supply.

Approach 8: Metropolitan Water Rates (No Incentive): Under this alternative, Metropolitan's water rates could serve as a catalyst for local resource development without additional financial incentives.

Approach 9: Design-Build-Own-Operate-Transfer (DBOOT): At the request of a member agency, Metropolitan would design, build, own and operate a project within the requesting member agency's service area. The requesting member agency would agree to buy the project water at an agreed upon price. After recovering its investment from project water sales, Metropolitan could transfer the project to the requesting member agency for an agreed-upon price.

The Task Force is evaluating the pros and cons of each approach based on the following criteria:

- Ability to meet the IRP goal;
- Net financial impact to Metropolitan; and

- Financial or other risks to Metropolitan.

Staff, in collaboration with member agencies, is developing a financial model to determine potential net financial impacts to Metropolitan and member agencies for each of the financial assistance approaches. The model utilizes representative data from a groundwater recovery and recycled water project currently participating in the LRP. The model is sensitive to several assumptions such as Metropolitan's prevailing water rate, project revenue, capital financing, and inflation/discount rates. Financial analysis on these various approaches will be the subject of an additional information item once the analysis is completed.

Next Steps

Staff will incorporate board comments and continue to work with member and retail agencies to develop a local resources development strategy recommendation. Staff will provide periodic updates to the Board as the Task Force works to produce a recommendation for board consideration by the end of the fiscal year.

Policy

By Minute Item 48449, dated October 12, 2010, the Board adopted the 2010 Integrated Water Resources Plan.

By Minute Item 47049, dated April 10, 2007, the Board adopted the Local Resources Program provisions including a goal of 174,000 acre-feet per year of new production.

Fiscal Impact

None

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