THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

INFORMATION

- Board of Directors
  Water Planning and Stewardship Committee

1/10/2012 Board Meeting

9-2

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 Strategy Task Force (Task Force) to review the current Local Resources Program (LRP) and identify program improvements and alternative mechanisms to support local resource development. Changes to the program could affect the way Metropolitan supports future local resource projects including recycled water, groundwater recovery, seawater desalination, and other local supplies. All Metropolitan member agencies have been invited to take part in this process. **Attachment 1** shows the agencies that have chosen to participate.

This board report is a follow-up to the report given in November 2011 and it focuses on the financial approaches under review by the Task Force. An additional report will be prepared for February 2012 to address the nonfinancial approaches that can be encouraged through a set of recycled water policy principles. The Task Force has completed a preliminary analysis of the nine potential financial assistance approaches that have been under review. Based on the analysis and preferences expressed by the Task Force, the following four approaches have been ranked highest:

- Approach 1: Status Quo; continue existing incentives-based approaches
- Approach 2B: Reduced Maximum Incentive (Fixed Incentive)
- Approach 6: Coownership of new projects
- Approach 9: Design-Build-Own-Operate-Transfer approach for new projects

<u>Financial Assistance Approaches</u>

In November, staff presented information on the following nine financial assistance approaches:

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

A description of each approach can be found in **Attachment 2**. Approaches 1 through 4 are based on incentives that would be paid once a facility is producing local supplies. Approaches 5, 6, 7, and 9 are based on Metropolitan's ability to recover the costs of different levels of participation in a project. Under Approach 8, Metropolitan would no longer provide direct financial incentives based on the assumption that Metropolitan's water rates alone would serve as a catalyst for local resource development within the service area.

Evaluation and Ranking Process

Metropolitan staff developed two models to help evaluate the nine financial assistance approaches. First, staff developed a yield model to estimate the potential need for Metropolitan's Local Resources Program. In conjunction with the model, staff conducted a survey of the member agencies based on the inventory of potential projects in the 2010 Integrated Water Resources Plan (IRP). This survey helped determine which member agency projects would likely move forward under the current regulatory conditions and without Metropolitan financial assistance. Staff is refining this model to account for recent reductions in observed demand. This analysis is ongoing and will be presented to the Board in a future update of the Task Force process. In 2007, the Board approved an LRP target to pursue an additional 174,000 acre-feet of annual production. To date, contracts have been signed for about 75,000 acre-feet of additional production, leaving almost 100,000 acre-feet remaining under the current authorization. Staff does not see a near-term need to increase this authorization at this time.

Second, staff developed a cost model which compared the net financial impact to Metropolitan for each of the nine financial assistance approaches. The model uses representative recycled water and groundwater recovery projects to estimate the financial impacts.

Using these models, the Task Force evaluated the pros and cons of each approach and ranked them based on the following criteria:

- Ability to meet the IRP goal for additional local resources;
- Net financial impact to Metropolitan; and
- Financial and other risks

Ability to meet the IRP goal

The first step of the evaluation process was to rank the nine financial approaches as "High", "Medium", or "Low" on their ability to meet the IRP goal. Approaches that ranked "High" or "Medium" were kept for further evaluation.

Approach 1 ranked "High" based on its historical success in encouraging local supply development. Approaches 2A, 3, 4, 5, and 8 were ranked "Low" and excluded from further analysis because they provide financial assistance that was not viewed as significant enough to encourage new projects. The Task Force ranked approach 2B (Fixed Incentive) as "Medium" because it provides a steady source of financial assistance to potential projects.

Approaches 6, 7, and 9 ranked "Medium" because of their ability to promote local project development through upfront capital funding by Metropolitan and shared responsibilities and risks between Metropolitan and the local agencies. The Task Force excluded approach 7 (Full Ownership) because this approach would develop an independent Metropolitan resource. The Task Force concluded that this should be an independent Metropolitan decision and not part of the Task Force effort.

In the end, approaches 1, 2B, 6, and 9 ranked "High" or "Medium" and were kept for the next step of evaluation. The results of this first step of the evaluation are presented in column 1 of **Attachment 3**.

Net financial impact and financial and other risks

The second step of the evaluation was to rank approaches 1, 2B, 6, and 9 as "High", "Medium", or "Low" based on their net financial impact and risk to Metropolitan. Approaches that ranked "Low" or "Medium" for cost and risk were kept for further evaluation. All four of the remaining approaches ranked similarly in either the "Low" or "Medium" categories for financial impact or other risks. The results of the second step evaluation are presented in Columns 2 and 3 of **Attachment 3**. Approach 1 (Status Quo) ranked the highest in meeting the IRP goal but the Task Force also recommended further analysis for approaches 2B, 6, and 9.

Next Steps

Staff will incorporate the Board's comments and continue to work with the member agencies to produce recommendations on potential improvements to the program for the Board's consideration by the end of fiscal year 2011/12. The next board update, scheduled for February, will focus on the development of updated recycled water policy principles.

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

12/28/2011
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12/28/2011
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Attachment 1 – Member Agencies Participating in Local Resources Development Strategy Task Force

Attachment 2 – Financial Assistance Approaches

Attachment 3 – Summary Evaluation

Ref# wrm12615354

Member Agencies participating in Local Resources Development Strategy Task Force

- City of Anaheim
- Calleguas MWD
- Eastern MWD
- Foothill MWD
- Inland Empire Utilities Agency
- City of Los Angeles
- MWD of Orange County
- San Diego CWA
- Three Valleys MWD
- Upper San Gabriel Valley MWD
- West Basin MWD
- Western MWD
- Las Virgenes MWD

Financial Assistance Approaches

The following is a description of the financial assistance approaches identified by the Task Force:

Approach 1: Status Quo: Metropolitan would continue its current LRP by providing sliding-scale incentives up to $250 per acre-foot for water produced over a term of 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 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 per-acre foot of water produced over a term of 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 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 per acre-foot of water produced over a term of 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 take place.

Approach 3: Reduced Agreement Term: Metropolitan would provide sliding-scale incentives up to $250 per acre-foot of water produced over a term of less than 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 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 or shorter agreement term, would score higher under the competitive process. A review panel would evaluate proposals and select projects that best met the region's needs as stated within 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 would 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 from 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 would 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 would transfer ownership and control of the project to the requesting member agency for an agreed-upon price.

Summary of the Evaluation and Ranking of the financial Assistance Approaches
(Based on ranking of workgroup participants)
(From Metropolitan perspective)

Approach	Criteria		
	Achieving IRP Goal *	Financial **	
		Net Impact	Risks
Approach 1: Status Quo	High	Med	Low
Approach 2A: Reduced Maximum Incentive (Sliding Scale)	Low	Med	Low
Approach 2B: Reduced Maximum Incentive (Fixed Incentive)	Med	Med	Low
Approach 3: Reduced Agreement Term	Low	Med	Low
Approach 4: Competitive Proposals	Low	Med	Low
Approach 5: Construction Fund (Revolving Fund)	Low	Low-High	High
Approach 6: Co-ownership	Med	Low	Med
Approach 7: Full Ownership	Med	Low	Med
Approach 8: Metropolitan Water Rates (No Incentive)	Low	Low	Low
Approach 9: Design-Build-Own-Operate-Transfer (DBOOT)	Med	Low	Low

* A ranking of "High" indicates a relatively better chance at reaching the IRP goal. A ranking of "Low" indicates serious doubt that the approach will achieve the IRP goal.

** A ranking of "Low" indicates a favorable approach for either net financial impact or risk from the perspective of Metropolitan. A ranking of "High" indicates a high potential cost or risk to Metropolitan.