THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

BOARD ACTION

- **Board of Directors**
  Finance and Insurance Committee

6/13/2017 Board Meeting

8-1

Subject

Adopt CEQA determination and adopt Ordinance No. 150 determining that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $400 million to finance a portion of capital expenditures

Executive Summary

The Metropolitan Water District Act (MWD Act) authorizes Metropolitan to finance its capital expenditures through use of revenue bonds, so long as the voters within Metropolitan's service area have previously approved such a financing mechanism, and so long as the Board by a two-thirds vote determines that the interests of the district require use of revenue bonds to finance capital expenditures, the costs of which will be too great to be paid out of the district's ordinary annual income and revenue (operating revenues). The voters approved such financing pursuant to a vote in 1974 and this letter proposes that the Board find that the current interests of Metropolitan require use of revenue bonds to finance a portion of capital expenditures in the aggregate principal amount of $400 million.

The $400 million figure represents an estimate of revenue bond financing currently anticipated for approximately five fiscal years. The last adopted biennial budget for the current biennial period (fiscal years 2016/17 and 2017/18), which includes a capital investment plan, and the last approved ten-year financial forecast (Ten-Year Financial Forecast), projects annual capital expenditures of $200 million per year, of which 40 percent ($80 million annually) is anticipated to be debt-financed. As has happened in the past, the Board may also approve other capital expenditures not anticipated in the adopted budget, the capital investment plan, or ten-year financial forecast.

The Board's adoption of Ordinance No. 150 (**Attachment 1**) would allow Metropolitan to fund a portion of board-approved capital expenditures using up to an aggregate principal amount of $400 million of revenue bonds. Funding a portion of capital expenditures with revenue bonds instead of exclusively using operating revenues is consistent with sound financial policy and provides flexibility to finance a portion of board-approved capital expenditures. Adopting Ordinance No. 150 is a prerequisite to the Board approving separate resolutions authorizing specific revenue bond issues of up to an aggregate principal amount of $400 million. Ordinance No. 150 does not alone authorize any specific revenue bond issue.

Details

The MWD Act provides that Metropolitan may borrow money, incur indebtedness and issue bonds or other such indebtedness. The MWD Act has two prerequisites for the issuance of revenue bonds, which include bonds, notes, loans or other evidences of indebtedness, to finance capital expenditures. In 1974, the voters in Metropolitan's service area approved the use of long-term revenue bonds as an alternative to funding capital expenditures exclusively with operating revenues, which fulfills the first requirement. The MWD Act also requires that the Board, by a two-thirds vote, authorize the issuance of revenue bonds by adopting an ordinance finding the interests of the district require use of the revenue bonds for the purposes set forth in Section 237 of the MWD Act, the cost of which will be too great to be paid out of operating revenues. Section 237 provides for the use of revenue bonds for financing the acquisition, construction, or completion of capital projects "necessary or

convenient to carry out the objects or purposes of the district," including "any preliminary and incidental expenses." This letter proposes that the Board determine the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $400 million to finance a portion of capital expenditures, consistent with the current biennial budget and the approved capital expenditure forecasts.

Revenue bonds are required because the Board anticipated certain capital expenditures in the capital investment plan in the last adopted biennial budget. The capital funding requirement could change depending upon the Board's approval of future capital projects and the degree to which the spending plan is realized. The Board intended debt financing for 40 percent of capital projects. The costs of financing projected capital expenditures in the Ten-Year Financial Forecast are estimated at $200 million per year increasing to $228 million per year by 2026. Operating revenues to fund capital expenditures for the corresponding period are estimated at $120 million per year increasing to $137 million per year (see Figure 1). Therefore the costs of planned capital expenditures exceed the amount to be generated from operating revenues in all years of the Ten-Year Financial Forecast. Without revenue bonds to fund capital expenditures, either rates must increase more than expected or less capital projects than are planned can go forward. The interests of Metropolitan require the issuance of revenue bonds, as contemplated in the board-adopted biennial budget for FY 2016/17 and 2017/18, to support funding of the projects in the capital investment plan and the average rate increases contemplated in the Ten-Year Financial Forecast.

Current Revenue Bond Authority

On October 13, 2015, the Board adopted Ordinance No. 149 finding that the interests of Metropolitan required the use of revenue bonds in an amount not to exceed $500 million, which was based on a reasonable estimate at that time of the required revenue bond financing through fiscal year (FY) 2017/18. The $500 million in revenue bond financing was anticipated to be used to reimburse the district for certain capital expenditures paid out of operating revenues in FY 2014/15, to pay for certain capital expenditures projected for FY 2015/16 that were previously budgeted to be paid out of operating revenues and the Replacement and Refurbishment Fund, and to pay certain capital expenditures in each of FYs 2016/17 and 2017/18. To date, the Board has authorized the issuance of revenue bonds under Ordinance No. 149 as described in Table 1 below.

Table 1: Revenue Bonds Issued under Ordinance No. 149

Issue Date	Financing	Amount Issued (millions)	Purpose	Interest Rate
12/9/2015	Water Revenue Bonds, 2015 Authorization Series A	$208.3	Reimburse capital expenditures funded from operating revenues in FY 2014/15 (mid-May 2015 through the end of FY 2014/15) and in FY 2015/16. Finance portions of FY 2015/16 and 2016/17 capital expenditures.	3.11% all-in true interest cost
12/21/2016	Subordinate Water Revenue Bonds, 2016 Authorization Series A (Taxable)	$175.0	Reimburse reserves, which were used to purchase land from Delta Wetlands Properties (Delta Islands).	1.20% average interest rate from issue date to 5/1/2017
3/1/2017	Water Revenue Bonds, 2017 Authorization Series A	$80.0	Finance a portion of capital expenditures for FY 2016/17. Remaining balance to be used in FY 2017/18.	0.92% average interest rate from issue date to 5/1/2017 (includes remarketing and bank liquidity fees)
Total		**$463.3**		

A balance of $36.7 million remains under the authority of Ordinance No. 149. It is anticipated that this remaining balance will be utilized in FY 2017/18 to support the partial financing of the budgeted $200 million of capital expenditures for FY 2017/18, as discussed below under Proposed Revenue Bond Authority.

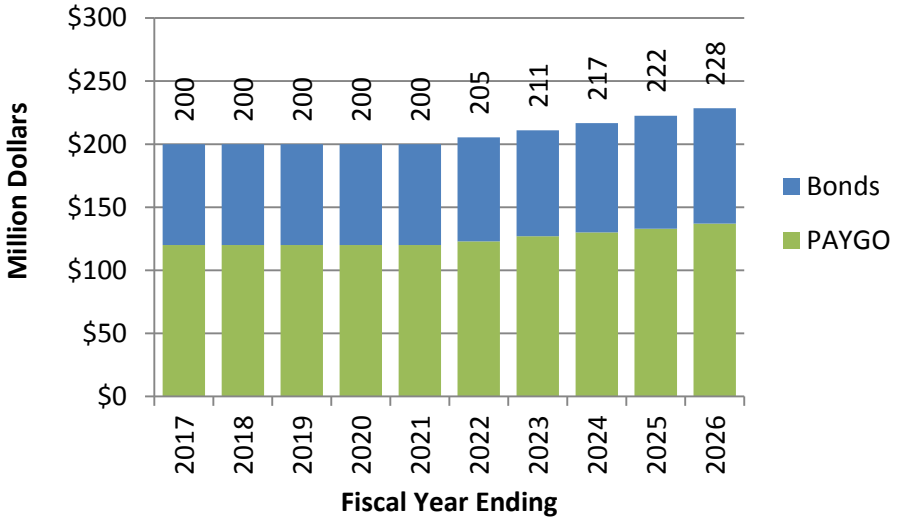
Notably, the authority of Ordinance No. 149 was used to bond-finance approximately 43.5 percent of the total capital expenditures over the last three fiscal years, providing the district much needed flexibility. Metropolitan capital expenditures for FYs 2014/15 and 2015/16 totaled $211.0 million and $477.2 million, respectively. The capital expenditures for FY 2015/16 included $256.4 million for the purchase of land in Riverside and Imperial Counties to support the reliability of supplies from the Colorado River. Capital expenditures for the current FY 2016/17 are expected to total $376 million, which includes the purchase of the Delta Islands as approved by the Board after the adoption of the current biennial budget. These strategically important Delta Islands, located in the Sacramento-San Joaquin Delta, were purchased when they became available as an investment with multiple potential values.

California entered 2016 on the heels of four years of unprecedented drought conditions, which significantly impacted demands on Metropolitan's water resources and on its financial resources. As a result of Metropolitan's prudent reserve policy and the flexibility permitted by the Board's debt-financing authority, Metropolitan was able to respond to unprecedented state-mandated restrictions, take advantage of investment opportunities to support the reliability of imported supplies, and position itself to better respond to potential emergencies and to environmental needs.

Proposed Revenue Bond Authority

The $400 million authority proposed through Ordinance No. 150 is based on an estimate of revenue bond financing anticipated for approximately five fiscal years. On April 12, 2016, through its multi-month budget and rates board process, the Board approved an annual capital expenditure budget of $200 million for each of FYs 2016/17 and 2017/18. The Board's adopted budget anticipated 40 percent of debt financing ($80 million annually for the following five years) to fund its capital expenditure budget and to maintain modest rate increases. The ratio of operating revenues and debt-financing (60/40) will result in lower capital financing costs in the future and provides increased financial flexibility and resiliency. As shown in Figure 1 below, the Board also considered and approved a capital investment plan and the Ten-Year Financial Forecast that projected $2.1 billion in capital expenditures over a ten-year period (approximately $200 million per fiscal year), 40 percent of which would be funded by revenue bonds (approximately $80 million per fiscal year). Accordingly, it is estimated that under current projections, the $400 million authority under proposed Ordinance No. 150 would provide the approximately $80 million yearly revenue bond financing required to meet the current board-adopted budget for FY 2017/18 and four additional fiscal years. Since $36.7 million in revenue bond authority remains from Ordinance No. 149, the $400 million authority of Ordinance No. 150 may last longer.

Figure 1: Capital Expenditures, Biennial Budget for FY 2016/17 and 2017/18 and Ten-Year Financial Forecast (operating revenues = PAYGO)[1]



Additionally, from time to time, when expenditures are necessary or convenient to carry out the purposes of the district, the Board may approve capital expenditures other than, or in addition to, those contemplated by the capital investment plan at the time of the then-current biennial budget and may approve the issuance of revenue bonds to finance all or a portion of those capital expenditures. Ordinance No. 150 would provide the foundational authorization to allow for the Board's consideration of revenue bond issuances to finance any capital expenditures approved by the Board.

Bond financing, through the authorization of Ordinance No. 150, increases Metropolitan's flexibility to finance capital expenditures that carry out the purposes of the district by using revenue bond proceeds, rather than operating revenues or financial reserves. A balanced approach to financing future capital expenditures with both operating revenues and revenue bond funding will help mitigate increases in water rates, provide financial flexibility, and support sound revenue bond debt service and fixed charge coverage ratios. These factors will help Metropolitan maintain strong bond credit ratings, which provide tangible benefits to ratepayers in the form of reduced debt service cost. Strong credit ratings provide better access to capital markets, lower interest rates and better terms on a broad range of debt products. Prudent financial management policies have resulted in bond ratings of AAA from Standard & Poor's, Aa1 from Moody's, and AA+ from Fitch Ratings for Metropolitan's senior lien revenue bonds.

The use of revenue bonds to fund capital assets is an accepted and appropriate method of financing capital projects authorized by the MWD Act and the Board. The Board has utilized this method of financing since voters approved the use of long-term revenue bonds as an alternative to pay-as-you-go financing in 1974. Metropolitan has a manageable debt load which has declined in recent years, compared to overall assets. Without the ability to bond finance a portion of capital expenditures, Metropolitan may have to curtail funding capital projects, use additional reserves to fund capital costs, and/or increase water rates higher than projected in the Ten-Year Financial Forecast. The Board's adoption of Ordinance No. 150 is a prerequisite to the Board's future adoption of revenue bond resolutions authorizing the issuance of up to an aggregate principal amount of $400 million of revenue bonds.

[1] *Proposed Biennial Budget and Revenue Requirements, Fiscal Years 2016/17 and 2017/18; and Ten-Year Forecast*, Finance & Insurance Committee, February 8, 2016, slide 62.

Policy

Metropolitan Water District Act Section 61: Ordinances, Resolutions and Orders

Metropolitan Water District Act Section 63: Roll Call on Ordinances

Metropolitan Water District Act Section 64: Ordinances; Introduction; Adoption

Metropolitan Water District Act Section 65: Ordinances – Effective Date

Metropolitan Water District Act Section 123: Borrowing, Limitation

Metropolitan Water District Act Section 237: Revenue Bond Purposes. The ordinance in this item is subject to a two-thirds vote requirement.

By Minute Item 50438, dated April 12, 2016, the Board approved the FY 2016/17 and 2017/18 biennial budget, approved appropriations and funding of capital expenditures, and approved a Ten-Year Financial Forecast

California Environmental Quality Act (CEQA)

CEQA determination for Option #1: 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 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). Finally, where it can be seen with certainty that there is no possibility that the proposed actions may have a significant impact on the environment, those actions are not subject to CEQA pursuant to Section 15061(b)(3) of the State CEQA Guidelines.

The CEQA determination for Option #1 is: Determine that the proposed action is not defined as a project and is not subject to CEQA pursuant to Sections 15378(b)(2), 15378(b)(4), and 15061(b)(3) of the State CEQA Guidelines.

CEQA determination for Option #2: None required.

Board Options

Option #1

Adopt the CEQA determination that the proposed action is not defined as a project and is not subject to CEQA, and, by a two-thirds vote,

Adopt Ordinance No. 150, determining that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $400 million to finance a portion of Metropolitan's capital expenditures. (**Attachment 1.**)

Fiscal Impact: Adoption of Option #1 will have no direct financial impact to Metropolitan, but will allow the Board to take future actions to finance a portion of Metropolitan's capital expenditures with revenue bonds. Future board action is required for approving future revenue bond issuance.
Business Analysis: Option #1 will enable the Board to authorize revenue bond issuance, through future adoption of revenue bond resolutions, to finance future capital expenditures.

Option #2

Do not adopt Ordinance No. 150.
Fiscal Impact: Option #2 may have a negative financial impact on Metropolitan by precluding the use of revenue bond proceeds to fund a portion of capital expenditures. The Board may not consider the approval of future revenue bond issues, without making the determinations in the proposed Ordinance. Metropolitan may have to use additional reserves to fund capital costs, and/or increase water rates higher than projected in the Ten-Year Financial Forecast.

Business Analysis: Option #2 will reduce Metropolitan's financial flexibility, by precluding the use of revenue bond proceeds to finance future capital expenditures. Metropolitan may have to curtail funding capital projects.

Staff Recommendation

Option #1

5/31/2017

Gary Breaux
Chief Financial Officer/
Assistant General Manager

Date

6/1/2017

Jeffrey Kightlinger
General Manager

Date

Attachment 1 - Ordinance Of The Board Of Directors Of The Metropolitan Water District Of Southern California Determining That The Interests Of The District Require The Use Of Revenue Bonds In The Aggregate Principal Amount Of $400,000,000 To Finance A Portion Of Capital Expenditures

Ref# cfo12653432

THE METROPOLITAN WATER DISTRICT OF
SOUTHERN CALIFORNIA

ORDINANCE 150

ORDINANCE OF THE BOARD OF DIRECTORS
OF THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
DETERMINING THAT THE INTERESTS OF THE DISTRICT REQUIRE THE USE OF
REVENUE BONDS IN THE AGGREGATE PRINCIPAL AMOUNT OF $400,000,000 TO
FINANCE A PORTION OF CAPITAL EXPENDITURES

The Board of Directors of the Metropolitan Water District of Southern California (the "Board") hereby finds that:

1. Pursuant to Chapter 1.6 of Part 5 of the Metropolitan Water District Act (California Statutes 1969, Chapter 209, as amended, hereinafter sometimes referred to as the "Act"), the Board of The Metropolitan Water District of Southern California (the "District"), on March 12, 1974, adopted Ordinance No. 126, calling a special election to be held within the District on June 4, 1974, for the purpose of submitting to the qualified voters of said District the following proposition:

> To permit use of long-term bonds backed by water revenues as an alternative to pay-as-you-go financing, shall the Board of Directors of the Metropolitan Water District of Southern California be authorized to issue and sell revenue bonds under Chapter 1.6, Part 5, Metropolitan Water District Act?

2. Said election was duly and regularly held and said proposition received the affirmative vote and assent of a majority of all of the qualified voters of the District voting on said proposition, and therefore the Board is authorized to issue and sell revenue bonds under Chapter 1.6 of Part 5 of the Act.

3. Revenue bonds means bonds, notes, loans or other obligations or evidences of indebtedness, as provided for in the Act and California Government Code.

4. The ability to ensure a reliable supply of high quality water for the District's 26 member agencies depends upon the District's ongoing ability to fund operations and maintenance, maintain and augment local and imported water supplies, fund replacements and refurbish existing infrastructure, and invest in system improvements.

5. Ordinance 149 was adopted by the Board on October 13, 2015, finding that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $500,000,000 to fund a portion of the District's capital investment plan expenditures, the cost of which is too great to be paid out of the ordinary annual income and revenue of the District.

6. Of the $500,000,000 aggregate principal amount of revenue bonds authorized under Ordinance 149, all but $36.7 million have been issued and the remaining $36.7 million is anticipated to be issued in fiscal year (FY) 2017/18 to finance a portion of the District's capital expenditures.

7. On April 12, 2016, the Board approved a biennial budget for FY 2016/17 and FY 2017/18, containing capital expenditures of $200 million for each of FY 2016/17 and FY 2017/18, of which 40 percent is anticipated to be funded by debt proceeds.

8. On April 12, 2016, the Board approved a ten-year financial forecast for FY 2016/17 through FY 2025/26 (the "Ten-Year Financial Forecast"), forecasting annual capital expenditures of $200 million for FYs 2016/17 through FY2020/21 and increasing to amounts of $205.4 million to $228.5 million in FYs 2021/22 through FY 2025/26, of which some portion of each year is anticipated to be funded by debt proceeds. The Ten-Year Financial Forecast provides an estimated forecast of future capital expenditures.

9. On April 12, 2016, the Board approved the use of $240 million in operating revenues to partially fund the capital investment plan for FY 2016/17 and FY 2017/18. The capital investment plan identifies the capital priorities of the District for the fiscal years of the adopted budget.

10. In order to fully fund the capital investment plan adopted by the Board on April 12, 2016, $80 million in revenue bonds would be required in FY 2017/18. To support the issuance of such $80 million in revenue bonds, a capacity of $36.7 million under Ordinance 149 is available. This Ordinance would provide support for the remaining balance of $43.3 million.

11. Debt financing in future FYs of the Ten-Year Financial Forecast is assumed at amounts ranging from $80 million to $91.2 million per fiscal year.

12. The Board may, from time to time, approve capital expenditures other than or in addition to those contemplated by the capital investment plan at the time of the then current biennial budget.

13. From time to time, capital projects that have been undertaken are delayed, redesigned or deferred by the District for various reasons.

14. This Ordinance would support future board actions for debt financing over several years for capital expenditures approved by the Board as provided in the then current biennial budget, capital investment plan, ten-year financial forecast and as otherwise approved by the Board, which collectively would not exceed $400,000,000.

15. Using debt to finance a portion of capital expenditures will provide the District with additional financial flexibility to fund capital expenditures that are necessary or convenient to carry out the purposes of the District while mitigating increases in water rates and charges.

16. This Ordinance was introduced at the regular meeting of the Board held on May 9, 2017.

NOW, THEREFORE, the Board of Directors of the District, DOES HEREBY RESOLVE, DETERMINE AND ORDER as follows:

The interests of The Metropolitan Water District of Southern California require the use of revenue bonds in the aggregate principal amount of $400,000,000 to finance a portion of the District's capital expenditures, the cost of which is too great to be paid out of the ordinary annual income and revenue of the District.

I HEREBY CERTIFY that the foregoing is a full, true and correct copy of an Ordinance adopted by a two-thirds (2/3) vote of the total vote of the Board of Directors of The Metropolitan Water District of Southern California at its meeting held on June 13, 2017.

_____

Secretary of the Board of Directors
of the Metropolitan Water District
of Southern California