



● **Board of Directors**
Water Planning and Stewardship Committee

6/12/2018 Board Meeting

9-2

Subject

Information on the proposed State Water Project Contract Extension Amendment

Executive Summary

Metropolitan's State Water Project (SWP) contract with the California Department of Water Resources (DWR) ends on December 31, 2035. The proposed SWP contract extension amendment (Proposed Amendment) would extend Metropolitan's SWP contract term 50 years to 2085. The Proposed Amendment also would adjust the methodology for paying Metropolitan's contracted share of some SWP charges. The Proposed Amendment will secure SWP supplies for an additional 50 years, lower Metropolitan's annual debt service for the SWP between now and 2035 and provide a smoother trend of SWP costs that will assist in managing Metropolitan's future rates.

Details

In 2008, the SWP Public Water Agencies (PWAs) notified DWR of their interest to extend their water supply contracts and address some of the repayment provisions. Negotiations commenced in May 2013 and were completed in June 2014, resulting in an Agreement In Principle (**Attachment 1**). A Draft Environmental Impact Report (EIR) was released in August 2016, and contractual language changes for the Proposed Amendment were finalized in February 2018.

The Proposed Amendment would extend the contract term 50 years and change how some costs are repaid in order to lessen the repayment burden and make the process easier to understand and more transparent. A number of financial accounts would be established to improve the financial stability of the SWP. The general operating reserve would be increased substantially to provide an adequate level of funds to address emergencies. Additionally, a systems revenue reinvestment account would be established to provide a continuing source of investment revenue from reimbursable project facilities. Earnings from the reinvestment account would go to a support account to pay for system costs not reimbursable by SWP PWAs.

Benefits to Metropolitan

Extension of the SWP contract will:

- Secure an additional 50 years of water supply from the SWP, contributing to meeting the goals of the 2015 IRP for SWP supplies;
- Lower annual debt service payments for the SWP, maintaining better financial integrity of the SWP;
- Allow Metropolitan to better manage rates based on more consistent SWP expenditures through time; and,
- Provide continued influence into DWR's budget planning and capital investment processes.

Key points

The Proposed Amendment would:

- Restore the long-term financing flexibility that the SWP PWAs once enjoyed. Currently, DWR will not finance capital facilities beyond the end of the contract period, 16 years. Extending the contract to 2085 would allow for financing over longer periods. Before 2006, capital facilities were repaid over a period of 30 years or more. The financing period of capital improvements began to decrease (known as financial compression) in 2006 as the remaining contract term approached the end of the 2035 repayment period;
- Standardize the methodology used for calculating capital charges for facilities. Three different methods are currently used. Under the Proposed Amendment, one standardized approach would be adopted;
- Discontinue the practice of financing annual conservation minimum operating and maintenance expenses over the remaining contract period at the project interest rate. This approach is a very expensive method of paying annual operations and maintenance costs because unnecessary finance charges are incurred years after the costs are incurred. On a go forward basis, all SWP operations and maintenance costs would be paid on a pay-as-you-go cost basis;
- Provide a more robust general operating reserve;
- Increase rate reduction credits (RRC) up to \$7.5 million per year through 2035 in return for discontinuing RRC entirely after 2035;
- Discontinue use of the historical project interest rate and use DWR's actual weighted average cost of capital for debt repayment;
- Discontinue the practice of restating all past costs on a present value basis at the project interest rate;
- Establish a DWR and SWP PWA Finance Policy Committee to jointly address finance policy issues related to the SWP; and
- Develop reporting principles for the financial reporting of DWR's SWP activities to the Finance Policy Committee.

Implementation Provisions

Before the Proposed Amendment can take effect, a number of administrative steps must be followed and certain criteria must be met. The legislature will hold informational hearings to review the proposed action. Following legislative review, DWR would complete a Final EIR and issue a Notice of Determination. The Proposed Amendment would then be sent to the SWP PWAs for signature. The effective date for implementing the amendment will be based on criteria related to the cumulative amount of Table A supplies that signatories approve, as summarized below:

- The Proposed Amendment takes effect provisionally when 15 or more SWP PWAs with an aggregate of 3,200,000 acre-feet of Table A have signed it and 60 days after a final judgment has been made by a court validating the Proposed Amendment;
- If after 60 days, 24 or more SWP PWAs with an aggregate of 3,950,000 acre-feet of Table A have signed the Proposed Amendment the provisional date becomes the effective date. If after 60 days, 24 contracting SWP PWAs with an aggregate of 3,950,000 acre-feet of Table A have not signed the Proposed Amendment, after consultation with PWAs that have executed the Proposed Amendment, the state at its discretion may make the provisional date the effective date;

Metropolitan staff will return to the Board to seek action on this item following DWR issuing a Notice of Determination for the Amendment.

Policy

Metropolitan Water District Administrative Code Section 8121 (a): General Authority of General Manager to Enter Contracts


Brad Coffey
Manager, Water Resource Management

5/24/2018
Date


Jeffrey Kightlinger
General Manager

5/30/2018
Date

Attachment 1 – Agreement in Principle Concerning Extension of the State Water Project Water Supply Contracts

Ref# wrm12661924

**Illustration of the Difference between
the Current and Proposed Cost Recovery Methodology**

\$ Millions

Year	Current	Proposed	Difference
2020	263	256	6
2025	281	253	28
2030	312	242	70
2032	368	259	109
2033	406	267	140
2034	467	270	197
2035	589	278	311
2036	106	168	(63)
2040	197	207	(9)
2050	269	302	(32)
2060	368	414	(46)
2070	502	609	(107)
2075	586	779	(193)
2080	685	1,086	(400)
2085	801	2,323	(1,522)
2086	827	517	310
2090	936	963	(27)

These estimates are for illustrative purposes only. The estimates shown are only for those categories of charges that will change under the proposed terms and do not include all of Metropolitan's charges for the State Water Project. Under the current method payments after 2035 are on a pay-as-you-go basis and are not financed.