



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

June 18, 2013

Director Keith Lewinger
Director Vincent Mudd
Director Fern Steiner
San Diego County Water Authority
4766 Overland Avenue
San Diego, CA 92123

Dear Directors:

Your letter dated June 7, 2013, regarding Board Memo 8-5

This letter responds to your letter to Chairman Foley and Members of the Board dated June 7, 2013, providing comments on the May 31, 2013, draft of Appendix A to the Official Statement for Metropolitan's Special Variable Rate Water Revenue Refunding Bonds, 2013 Series E, attached to board letter 8-5. It also responds to your additional questions on investments and swap policy. These were addressed in my letter of May 22, responding to your May 13 comments on the draft Official Statement for Metropolitan's Water Revenue Refunding Bonds, 2013 Series D. Chairman Foley asked me to respond to your letter.

Investment Policy. Your June 7 letter again requests a detailed report on the swap policy and investment policy, focusing on risk. Metropolitan's Statement of Investment Policy for the coming fiscal year was unanimously approved by the Finance and Insurance Committee on June 10 and the Board on June 11. The Statement of Investment Policy approved last week renews the prior year's policy (including its priorities of safety, then liquidity, then investment return) with only one change: It adds restrictions on the use of reverse repurchase agreements.

A detailed report on the swap policy will be presented in July, when the next quarterly swap report will be available, as promised in my May 22 letter and reported at the June 10 Finance and Insurance Committee meeting. This presentation will address your concerns expressed in your letter.

Interest-bearing account. Your letter requests account information for the interest-bearing account that holds the disputed amount under the Exchange Agreement. The aggregate disputed amount allocated to this account as of May 31, 2013 is \$83,276,848. Interest earnings from inception of the account in January 2011 through May 31 is \$1,087,137.17 and the account balance at May 31 is \$84,363,985.17.

SDCWA Directors

June 18, 2013

Page 2

Your most recent comments on Appendix A and our responses are set forth below.

Frequency of editorial changes to the Official Statement. In general, we are concerned with the frequency of editorial changes being made to the Official Statement that do not reflect updates to describe material events that have occurred since the last distribution of the Official Statement.

We continually strive to clarify the disclosure in the Official Statement. Many changes, editorial and otherwise, are the product of comments from outside professionals on the financing team, which bring fresh eyes to each financing, as well as Finance and Legal staff and board members.

A-30: Level of water sales estimated by MWD. The redline deletes the following sentence:

The level of water sales estimated in Metropolitan's adopted biennial budget and revenue requirements for fiscal years 2012-13 and 2013-14 reflect local supplies from the Los Angeles Aqueduct system and other systems at higher than normal levels based on hydrologic conditions that occurred in 2010 and 2011.

Why is this statement being deleted, given that there cannot possibly have been a change in the level of water sales estimated in the biennial budget?

Describing hydrologic conditions in 2010 and 2011 had become stale and was unnecessary.

A-32 Conjunctive Use. As in the case of past edits to the Official Statement relating to the Replenishment Service Program, the edits to the first full paragraph change the prior statement describing objectives to statements of fact about the purported benefits of discounted water sales. We have stated many prior objections and provided extensive comments on the inaccurate and unsupported characterizations of purported benefits from MWD's sale of discounted water.

These edits provided the termination date of the Replenishment Service Program. Because the program has ended, the program description changed from present tense to past tense.

A-32 Seawater Desalination. We have commented previously that MWD's description of Regional Water Resources and Local Water Supplies is generally misleading, because it is written in a manner that suggests MWD is, or must somehow be involved in local projects, through the payment of subsidies or otherwise. As requested in past correspondence, we believe that the Official Statement should be corrected to include discussion about the local water supply development plans that all of the member agencies have, not just the City of

SDCWA Directors

June 18, 2013

Page 3

Los Angeles. See, for example, our letter dated November 5, 2012 at page 3, *Discrepancy for standard of reporting local water supply development*.

Given that the MWD Seawater Desalination Program incentive agreement referenced in the statement was not signed, we suggest that the last paragraph on page A-32 be edited to read as follows:

In November 2012, SDCWA approved a water purchase agreement with Poseidon Resources LLC (Poseidon) for a seawater desalination project in Carlsbad (the “Carlsbad Project”) for a minimum of 48,000 acre-feet and a maximum of 56,000 acre-feet per year. The Carlsbad Project is under construction and is anticipated to be completed in 2016.

The rest of the paragraph is not relevant; what the investor needs to know is that MWD sales will be reduced by the Carlsbad Project.

The intent of the entire “REGIONAL WATER RESOURCES” section is to describe sources of water, other than supplemental supplies from Metropolitan, that are available to water users in our service area. We will remove information about the now-superseded desalination program agreement for the Carlsbad project.

A-45: MWD Revenues – ad valorem property taxes. We recommend you delete the last sentence because it does not accurately reflect the legislative history of the statutory limitation on MWD’s authority to levy ad valorem property taxes.

The legislative history of section 124.5 of the MWD Act shows that the Legislature gave a majority of Metropolitan’s Board the discretion to determine whether to suspend the tax rate limit. The sentence describes factors to be considered by the Board. This paragraph will be updated to reflect the Board action last Tuesday.

A-58: Investment of moneys in funds and accounts. What changes have occurred since the last Official Statement in May requiring MWD to add the disclosure that, “the market value of Metropolitan’s investment portfolio is subject to market fluctuation and volatility and general economic conditions?”

This sentence merely was moved from the body of the Official Statement to Appendix A.

SDCWA Directors

June 18, 2013

Page 4

A-79: Financial projections that take into account actual results of operations and assumed water sales. The following text, which describes the basis of the projected revenues and expenditures, is deleted:

The projected financial information relating to fiscal year 2012-13 in the following table is based on a financial projection as of December 31, 2012 which takes into consideration actual results of operations through December 31, 2012, projections for the period of January through June 2013 and assumes sales of 1.74 million acre-feet. Based on actual results of operations through March 31, 2013 and projections for the period of April through June 2013, Metropolitan now projects for fiscal year 2012-13 that water sales will increase to 1.81 million acre-feet, Parity Bonds Debt Service Coverage will be 2.24, Debt Service Coverage on all Obligations will be 2.23, and Fixed Charge Coverage will be 1.70.

Footnote (a) now states:

Projected revenues and expenditures are based on assumptions and estimates used in the adopted 2012-13 and 2013-14 biennial budget and reflect the projected issuance of additional bonds. Projected revenues and expenditures for fiscal year 2012-13 include actual financial results for July 2012-March 2013 with revised projections for the balance of the fiscal year.

What necessitated this change in the description of the basis of MWD's statement of historical and projected revenues and expenditures? Or, please confirm if no change in the process has been made or is intended to be described.

The paragraph quoted above introduced a table of historical and projected revenues and expenditures that showed financial information based on projections that took into account actual results through December 31, 2012. The lead-in paragraph provides additional projections based on actual results through March 31, 2013. The March 31 projections were incorporated in the table contained in the May 31 Official Statement draft, as explained in footnote (a), making it unnecessary to include these same projections in the introductory paragraph.

A-82: Cost of service. MWD should disclose that it does not believe that statutory and constitutional requirements limiting how much a utility may charge for its services apply to MWD. This could be done by adding the following sentence at the end of the second full paragraph:

Metropolitan contends that this is the sole legal requirement affecting the setting of its rates and charges and that cost-of-service industry standards and legal limitations,

SDCWA Directors

June 18, 2013

Page 5

including but not limited to Proposition 26, do not apply to Metropolitan. See “METROPOLITAN REVENUES—Litigation Challenging Rate Structure” in this Appendix A.

We decline your suggestion to revise the reference to cost of service on page A-82. First, your proposed language is inapt in that the paragraph that you seek to revise discusses near-term historical and projected financial performance, whereas your language purports to address generally Metropolitan’s cost-of-service approach to rates and charges and the litigation. Second, even if the discussion were apt, it is unnecessary. The Official Statement already informs investors regarding Metropolitan’s cost-of-service approach to rates and charges, as well as the principles underlying that approach and Metropolitan’s understanding that the approach is lawful. (See “METROPOLITAN REVENUES—Rate Structure” and “MANAGEMENT’S DISCUSSION OF HISTORICAL AND PROJECTED REVENUES AND EXPENDITURES.”) And, as you acknowledge, it already includes a substantial discussion of the litigation and an assessment of its possible effects on rates, charges and revenues. (See “METROPOLITAN REVENUES—Litigation Challenging Rate Structure.”) It is quite clear to investors that Metropolitan and SDCWA disagree on the relevant law. Third, and perhaps most important, your proposed language is inappropriate because it would mislead, not inform, investors. The proposed language mischaracterizes the record in the litigation and misstates Metropolitan’s cost-of-service approach.

We appreciate your careful review of the Official Statement.

Sincerely,



Gary Breaux
Assistant General Manager/Chief Financial Officer

cc: J. Kightlinger
M. Scully
MWD Board of Directors
SDCWA Board of Directors and Member Agencies