



San Diego County Water Authority

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February 11, 2013

John (Jack) V. Foley and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90065-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Board Memo 8-1: Authorize the execution and distribution of Official Statements in connection with the issuance of the Water Revenue Refunding Bonds, 2013 Series A, 2013 Series B, and 2013 Series C, and amendment and termination of interest rate swaps – OPPOSE

Dear Chairman Foley and Members of the Board:

Before we address the comments we have on draft Appendix A, we have questions we would appreciate staff addressing at today’s meeting and in a detailed written report to the board at next month’s meeting of the Finance and Insurance Committee. The questions are prompted by the disclosure in the PowerPoint presentation (“Part 1”) posted on the MWD web site, that MWD ratepayers will be funding as much as \$20 million in termination penalties associated with the proposed “financing plan” for which these bonds are being sold.

- 1) What have MWD's savings or “gains” been over the course of the entire time it has invested in swaps? Please include a summary of all costs associated with these transactions.
- 2) What are the net cumulative savings or loss since inception?
- 3) What swaps remain outstanding, and what is MWD's potential exposure to termination, either by MWD or the counter-parties?

There are many new board members who were not on the board when MWD’s September 11, 2001 board resolution was passed authorizing the execution of interest rate swap transactions and related agreements according to a master swap policy. This resolution and subsequent amendments are described on page A-66. We request a detailed report to the board on the swap policy and on the MWD Board’s broader investment policy for the protection of water ratepayer funds. We believe that it is important for the Finance and Insurance Committee and Board of Directors to receive a more robust and detailed report of

OTHER REPRESENTATIVE

County of San Diego

A public agency providing a safe and reliable water supply to the San Diego region

these activities, as well as to look at the Board's investment policies and consider whether they should be updated or changed to be more conservative.

REVIEW OF DRAFT APPENDIX A

We have reviewed February Board Memo 8-1, including its attachments, and determined that we must again vote against the staff recommendation to authorize execution and distribution of the Official Statement in connection with the sale of bonds. We have also reviewed and taken into account the PowerPoint presentations ("Parts 1 and 2") posted on the MWD web site. We appreciate certain disclosures that have been added to the draft Official Statement, noted below, and, that the staff is taking additional measures to inform the board during the Finance and Insurance Committee meeting of its responsibilities associated with its review and approval of draft Official Statements. However, as we have stated in prior correspondence, we believe that in addition to disclosure of material facts, it is also required that information be presented in a manner that tells the "whole truth," that is, in a manner that is not misleading. In addition to specific factual issues that have been raised in the past and not addressed by MWD, this is where we believe MWD's Offering Statement falls short.

EDITS THAT ADDRESS CONCERNS STATED IN PRIOR LETTERS

We attach and incorporate by reference our letters to you and Assistant General Manager/Chief Financial Officer Gary Breaux dated November 5, 2012 and October 8, 2012, respectively (Attachments 1 and 2). We wish to acknowledge the following improvements in the draft Official Statement, which respond in small part to concerns stated in prior letters. All page references are to *Appendix A dated January 30, 2013, to the draft Official Statements for Metropolitan's Water Revenue Refunding Bonds, 2013 Series A, B and C [marked to show changes from 10/24/12 draft]*.

A-12: The disclosure of preliminary cost estimates for the BDCP and the 25% share that MWD anticipates it would pay.

A:17: The disclosure that the 80,000 acre-feet of conserved water from the lining of portions of the All-American and Coachella Canals is actually delivered to the San Diego County Water Authority.

A-31: The disclosure that the Los Angeles Department of Water and Power has filed litigation challenging environmental mitigation requirements relating to its Owens Valley imported water supply; and, acknowledgement of its need to purchase an equivalent amount of replacement supplies from MWD.

A-58: The disclosure that, under Proposition 26, taxes imposed by a special district such as MWD are subject to approval by two-thirds of the voters voting on the ballot measure for

authorization.

With the exception of these additions, the concerns expressed in our letters, Attachments 1 and 2, have not been addressed.

**ADDITIONAL COMMENTS AND QUESTIONS ON THE APPENDIX A DATED JANUARY 30, 2013,
TO THE DRAFT OFFICIAL STATEMENT FOR METROPOLITAN'S WATER REVENUE REFUNDING
BONDS, 2013 SERIES A, B AND C [MARKED TO SHOW CHANGES FROM 10/2412 DRAFT]¹**

A-10: State Water Project operational constraints. Why is the last sentence of the first paragraph being deleted (the information is not outdated and remains relevant to July 2012 storage levels through July 2012)? Also, please reconcile the numbers reported in this paragraph with those contained in this month's Water Planning and Stewardship Committee, Item 6a, PowerPoint Presentation slide 21 of 27, Attachment 3.

A-18: Sale of water by Imperial Irrigation District to SDCWA and MWD Exchange Agreement. The last sentence should be updated and corrected to reflect that IID did in fact meet its 2012 conservation obligation of 90,000 acre-feet, and, also delivered the additional 16,722 acre-feet of conserved water which MWD agreed to exchange and did exchange in 2012.

A-26: Discrepancies between the draft Official Statement and MWD's January 2013 WSDM staff report to Board of Directors RE MWD's storage capacity and actual water in storage. The draft Official Statement reports MWD's storage capacity to be 113,000 acre-feet lower and water in storage 4,000 acre-feet higher than MWD January 2013 Water Surplus and Drought Management report to the board of directors, Attachment 4. Please clarify the discrepancies.

A-33: Replenishment and the sale of discounted water. It would be misleading to delete the discussion about a new storage program to replace the Replenishment Service Program unless these plans have in fact been abandoned by MWD and the member agencies. Just a few months ago, before the "rate refinement" process was terminated, MWD and the other member agencies had identified the sale of discounted water as a "top priority." See Attachment 2, page 3 at A33 and A-52 and Attachment 1, page 6 at A-53.

A-44: Growth in number of unbudgeted MWD employees. Based on the edited numbers, MWD has added 93 employees since last October. Based on the presentation to the Board Budget Workshop on February 12, 2012, this number exceeds the budgeted employees by 45 employees (see slide, Attachment 5). What is the source of funding being used to pay the costs of the unbudgeted positions?

A-48: Revised ("extended") purchase orders as evidence of MWD's projected water sales revenues. We believe it is misleading to discuss the revised Purchase Orders in the context of disclosures about MWD's projected water sales revenues, for the reasons described in the

letter from the Water Authority's General Counsel to MWD's General Counsel dated December 27, 2012, Attachment 6. Given that at least 19 of the 22 member agencies executing the revised Purchase Orders had already met the minimum revised purchase order commitment even before the extension, the revised Purchase Orders provide no meaningful assurances to investors about MWD's future sales revenues.

A-50: Source of funding to pay SDCWA to the extent it prevails in the litigation. MWD has not changed the following statement: "If Metropolitan's rates are revised in the manner proposed by SDCWA in the complaint, other member agencies may pay higher rates unless other actions are taken by the board." The Water Authority inquired about the basis of this statement when it was changed by MWD, because it is inconsistent with the claims being published by many MWD member agencies and at times by MWD itself. See Attachment 2, page 3 at A-50. Neither MWD nor its member agencies has explained why this change was made to the last draft Official Statement, which previously stated that, "If Metropolitan's rates are revised in the manner proposed by SDCWA in the complaint, other member agencies would pay higher rates." The language in the current draft Official Statement is inconsistent with the expectations described in the Fitch ratings that have just been assigned to MWD bonds²:

CASH RESERVES FOR RISK

The unrestricted cash amount above excludes additional restricted cash of \$67.5 million that is set-aside for disputed amounts paid by the San Diego County Water Authority (SDCWA), which are the subject of ongoing litigation. ***To the extent the litigation is decided in favor of SDCWA and Metropolitan Water District must make a payment to SDCWA, Fitch anticipates that any settlement would be collected from other member agencies in a timely manner.*** The litigation relates to the rate methodology used to allocate costs between members. (Emphasis added.)

The expected source of money that would be used to pay SDCWA is a material fact; at a minimum, it is something we believe an investor would be interested in knowing when considering whether to invest in MWD bonds.

A-51: More on MWD purchase orders. See comments above at A-48. In addition, MWD should disclose during the discussion at A-51 that its largest customer (see footnote 1 at page A-2) – the Water Authority – signed the revised Purchase Order under protest, and why. Further, MWD should note that it rejected SDCWA's execution of the revised Purchase Order. See Attachment 7, letter from MWD General Counsel to SDCWA General Counsel dated January 4, 2013.

A-52: Inaccurate, ex post facto characterization of how Replenishment Service Program was operated. The edits to the first sentence of the Replenishment section change the prior statement describing program *objectives* to an inaccurate statement of fact about purported

benefits of the sale of discounted water as replenishment. See discussion at Attachment 1, page 6 at A-53 and Attachment 2, page 3 at A-33 and A-52.

A-55: MWD's financial reserve policy, the use of "unrestricted reserves" as "collateral" and failure to establish a separate interest bearing account for SDCWA litigation deposits. It is not possible to confirm from the information and commingled descriptions provided at A-55 whether MWD is in compliance with its financial reserve policies. One thing that is clear is that MWD has failed to establish a separate interest bearing account for SDCWA litigation deposits as required by the Exchange Agreement. The very purpose of the requirement of a "separate interest-bearing account" was to *restrict* MWD's use of those monies for other purposes. MWD has also failed to explain how reserve balances that are held as collateral can be described as "unrestricted." See Attachment 1, page 8 at A-81. No response to this question has been provided by MWD.

A-72: Inclusion of Bay Delta Conservation Plan construction costs in projected costs of MWD for State Water Project water. Please identify what construction costs have been included in the 2016 and 2017 projected costs for anticipated construction of additional State Water Project facilities.

A-74: Failure to raise rates to fund pension and Other Post Employment Benefits (OPEB) liabilities. As of January 1, 2011, MWD's combined unfunded retiree health care obligation and unfunded pension liability is at least \$757 million. When this number is next updated, the number will likely approach the \$1 billion mark. Although there are many disclosures of fact in the draft Official Statement, the burden of this liability on future water ratepayers and the cost of water are not described. MWD's plan to "begin OPEB funding above annual pay-as-you-go amounts with \$5 million in the fiscal year 2012-13 budget" and statement that it "intends" to increase this amount by \$5 million per fiscal year to an annual funding amount of \$25 million beginning in fiscal year 2016-17 defies the reality of other statements that it will, at the same time, begin construction of the BDCP and hold rate increases to 3%. This estimate pales in comparison to MWD's average annual rate increases of 5.6% over the past 30 years (1984-2014), and its average annual rate increases of 7.9% over the past 10 years (2004-2013). It is difficult to imagine that MWD will impose far lower annual rate increases, while at the same time invest billions of dollars more on its Bay Delta water supplies and begin modest payments to its unfunded OPEB liability. Further, given that the MWD board has not been willing to raise water rates now to pay for these liabilities, one is left to wonder why it will be willing to do so in the future at a time when MWD's BDCP costs are substantial.

A-80: Management's projections and assumptions concerning future events and circumstances that may impact MWD's revenues and expenditures are unreasonable. Based on all of the detailed comments we have provided in regard to past draft Official Statements, and other resource planning and financial issues at MWD, we do not believe that management's projections and assumptions as described in the draft Official Statement are reasonable. MWD's continued reference to long-outdated planning documents in its Official

Statement is a matter of concern to us and should be a matter of concern to investors, not the least of which is the 1999 Long Range Finance Plan which even MWD has abandoned as a planning document for board planning purposes. Aside from all of the data, simple common sense suggests that there is no way that MWD can do everything that it says it will do beginning in 2016 (IRP projects, construction of BDCP and increase payments to OPEB) and at the same time, hold rate increases to 3 percent – all at the same time its sales are down 25% and its member agencies are constructing and planning more local water supply projects throughout Southern California to reduce their demand for increasingly expensive imported water supplies.

For the reasons stated above, the Water Authority's delegates cannot support staff's recommendation to authorize execution and distribution of the Official Statement.

Sincerely,



Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director



Doug Wilson
Director

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Authority Board of Directors and Member Agencies

Attachment 1: Water Authority letter dated November 5, 2012 Re MWD OS

Attachment 2: Water Authority letter dated October 8, 2012 Re MWD OS

Attachment 3: MWD February 2013 WP&S Committee item 6a, PowerPoint Slide 21

Attachment 4: MWD January 2013 Water Surplus and Drought Management Report
Attachment 1

Attachment 5: MWD Slide Dated February 13, 2012, Budget Workshop

Attachment 6: Water Authority General Counsel letter dated December 27, 2012 to MWD
General Counsel re Purchased Order

Attachment 7: MWD General Counsel letter dated January 4, 2013 to Water Authority
General Counsel re Purchase Order

¹ It is unclear why the edits would be made to an October 24, 2012 *draft* rather than the last Official Statement actually used by MWD. We assume that the October 24, 2012 draft is in fact the last Official Statement issued by MWD; to the extent that is not the case, we reserve the right to submit additional comments. Please clarify this point.

² Friday, February 8, 2013 3:37 pm EST.