**San Diego County Water Authority**
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July 9, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

RE: Board Memo 8-4: Adopt a resolution for the reimbursement with bond proceeds of Capital Investment Plan projects funded from the General Fund and Replacement and Refurbishment Fund -- **OPPOSE**

Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed the July 14, 2015 board memo 8-4 seeking the Board's authorization to declare MWD's intent to issue up to $300 million of debt to "reimburse" capital expenditures for projects funded from the General Fund and Replacement and Refurbishment (R&R) Fund. We oppose this item because staff's recommendation will obligate MWD to increase water rates by at least $15 per acre- foot without an actual board vote for the rate increase, and for the reasons further stated in this letter.

Staff's practice of presenting board actions piecemeal has paralyzed the board's ability to make sound public policy decisions. This month's action is another example. The board memo states that the debt issuance would provide MWD the "financial flexibility" desired because of the projected draw down of reserves as a result of the May action to pay for the unbudgeted conservation programs,[i] and that "expenditures for water management activities such as replenishing storage and funding transfer and exchange programs could significantly [further] draw down financial reserves in the near future." But it was staff's own recommendation in May to spend $350 million on unbudgeted conservation expenditures – namely turf removal -- that placed MWD in this precarious fiscal position. This situation was completely foreseeable.

The May action not only spent MWD's not-yet-realized excess revenue collection,[ii] it also completely drained the Water Management Fund (WMF) – established for the very purpose of covering future costs associated with replenishing storage and water transfers – to fund turf removal, an expense for which the WMF was not intended. Staff expressed no concern when it recommended to spend down the WMF. The Board was repeatedly told in May that staff's recommendation would not result in any rate impacts. But this month's action, which was precipitated entirely by May's unbudgeted expenditures, will in fact result in increases in MWD water rates by at least $15 per acre-foot. (MWD staff reported in the past that every $20 million in debt issuance equates to $1 per acre-foot increase in water rates based on 2 million acre-feet of water sales; the rate increase will be higher for lower water sales volumes.) What has changed so drastically that is causing staff to be so concerned with the lack of financial flexibility triggered by an action it recommended just only six weeks ago? Did staff not foresee when it made the recommendation to spend down the WMF in May that its "flexibility" to purchase transfer supplies and to replenish depleted dry-year storage accounts would be more limited?

We disagreed with staff's assessment in May that the increase in conservation funding would not result in rate impacts. However, we believe staff's assertion that the action would have no rate impact persuaded many Board members to support the unprecedented and unbudgeted spending. While this month's action clearly has rate implications, the board memo yet again makes no reference to the rate increases.

Since fiscal year 2012, MWD collected more than $800 million in revenues that exceed actual expenses. And since 2013 and in each year following, these over-collections have caused MWD's reserves to exceed the Board established maximum limits by hundreds of millions of dollars -- largely caused by staff's strategy, endorsed by this Board's votes of approval -- to set rates based on artificially deflated sales amounts, which staff said would be exceeded seven out of 10 years.[iii] Rather than using the over-collections to manage rate and tax increases, MWD kept and spent the monies on unbudgeted items.

Nearly as quickly as MWD amassed more than $800 million in over-collected revenues, they are now nearly all gone, and MWD is resorting to budget shell games of taking cash from the capital investment plan to cover massive spending on turf removal. It is obvious that this proposal to issue $300 million in new debt is a post-facto, 30-year debt financing of turf removal subsidies approved just weeks ago. This is not sound fiscal management.

When the biennial budget for fiscal years 2015 and 2016 was adopted, we asked that MWD use the revenue over-collection to reduce rate increases and not raise taxes, staff instead recommended using part of the over-collections to cash-fund capital projects to "avoid future rate increases." This month's 8-4 recommendation is an about-face from staff's earlier rationale in support of cash-funding the capital program.

Finally, MWD's Administrative Code (Section 5200(b)) clearly restricts the use of monies from the R&R Fund to capital program expenditures. It is unclear how staff's proposal to issue debt would afford MWD the ability to use R&R funds for operational costs related to water transfers or purchases of water to replenish storage.

For reasons stated in this letter, we oppose staff's recommendation. We urge our fellow Board members to vote no on this action as well. This action is an inappropriate attempt to debt-finance very expensive turf rebates that produce no significant immediate supply relief during the drought.

Sincerely,

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| Michael T. Hogan<br>Director | Keith Lewinger<br>Director | Fern Steiner<br>Director | Yen C. Tu<br>Director |

[i] MWD increased conservation spending in May by an additional $350 million and was to be funded by the following sources: 1) Water Stewardship Fund ($50 million), 2) Water Management Fund ($140 million), and 3) projected excess revenue collection that exceeded maximum reserves target ($160 million); however, board memo 9-1 this month indicates that the projected excess revenue collection is trending at $120 million, requiring the use of $40 million from Water Rate Stabilization Fund.

[ii] The May action authorized the expenditures of anticipated over-collection of $160 million, which is trending now at $120 million (see also footnote ii).

[iii] Fiscal year 2016 is a good example; according to staff, MWD's water sales at the reduced Level 3 supply allocation (15 percent reduction) will still exceed the budgeted assumption of 1.75 million acre-feet.