

Long Range Finance Plan Rate Refinement Discussions

Meeting #5
November 14, 2011

Agenda

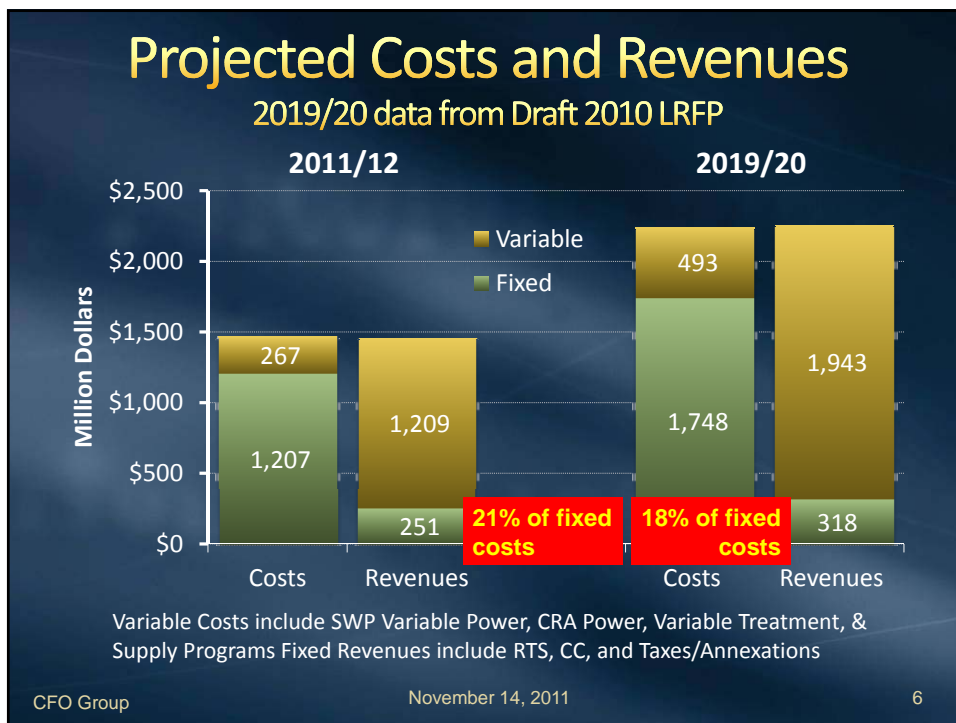
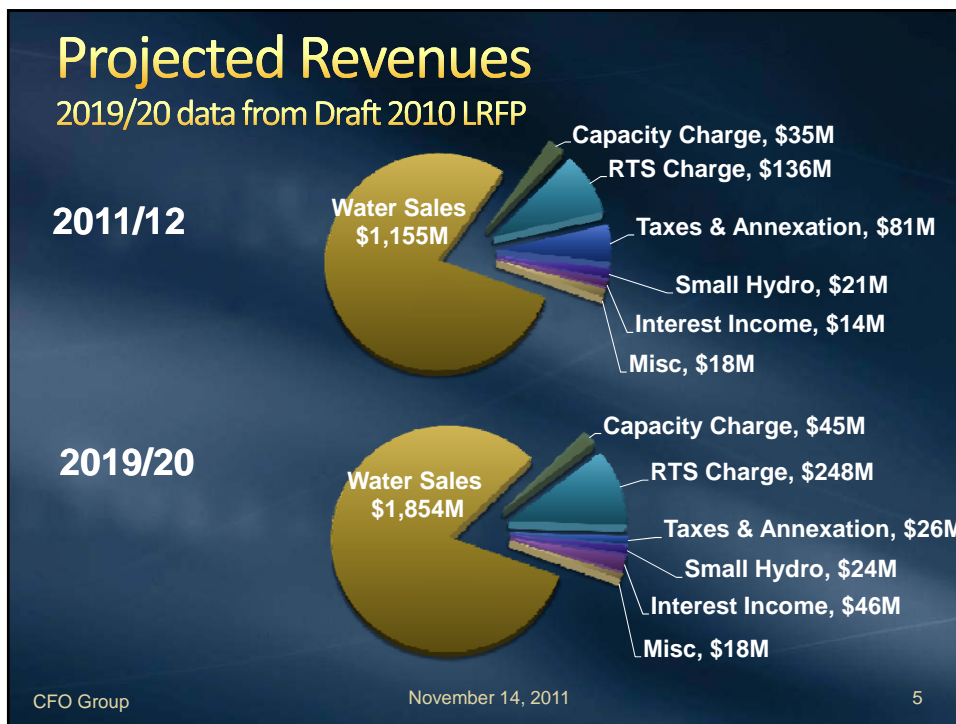
- Appropriate level of fixed charges
- Fixed charge options
- CUWCC Best Management Practice 1.4
- Sales and Reserves
- Discussion of Purchase Order structure
- Next Steps

Revenue Volatility – Not One Answer, Many Possible Solutions

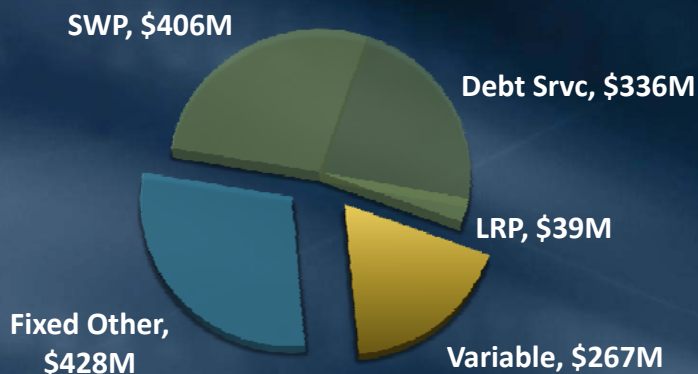
- Increase Amount of Fixed Revenues
 - Adjust Existing Charges
 - Consider New Charges/Fees
 - Adjust Property Tax Rate
- Rates Based on More Conservative Water Sales Estimates
- Increase/Redefine Reserve Levels, Adjust Reserve Policies
- Adjust Purchase Order Terms

Fixed Revenues – How Much?

- MWD Fixed Revenue as a % of:
 - Fixed Costs – now 21%
 - Total Revenues – now 17%
- Fitch Downgrade (May 2011)
 - Weakened financial profile and demand volatility
 - Expenditure flexibility is limited
 - Bay-Delta could put further pressure on MWD rates
 - Member agencies are not required to buy minimum amounts of water
 - Rate structure is heavily weighted towards volumetric pricing



2011/12 Projected Costs



Variable Costs include SWP Variable Power, CRA Power, Variable Treatment, & Supply Programs
 Fixed Costs include Debt Service, SWP, and Local Resources Program
 Fixed Other includes O&M, PayGo, Required Reserves and Conservation Credits

Summary of Fixed Costs and Fixed Revenues

Fixed Cost Category	Cost FY 2011/12	Fixed Charge Revenue	Fixed Charge Revenue Source
SWP	\$406.5M	\$41.8M	Ad Valorem Taxes
Debt Service	\$332.8M	\$209.2M	Ad Valorem Taxes, RTS, CC
LRP Contracts	\$39.4M	\$0.0M	None
Fixed Other	\$428.0M	\$0.0M	None

Fixed Charge Options

Fixed Charge Options

- Increase existing fixed charges
- Establish new fixed charges Consider new fixed charges/fees
- Fix Ad Valorem tax rate
- Establish a Benefit Assessment

Fixed Charge Options: Increase Existing Charges

- Readiness to Serve Charge
 - Costs recovered: standby and emergency service
 - Basis for member agency allocation: 10-year rolling average firm demands excluding Replenishment and IAWP
- Capacity Charge
 - Costs recovered: peaking capacity on Metropolitan system
 - Basis for member agency allocation: 3-year trailing peak summer flow excluding Replenishment
- Assign O&M to average and peak system use

New Fixed Charges

- “Customer Charge”:
 - Recover costs associated with member agency support, billing, administrative costs, etc.,
- Water Quality/Source Protection Charge
 - Recover costs associated with water quality testing, Quagga mussel control, facility access control, and capital improvements associated with these activities
 - Applicable to treated and untreated water

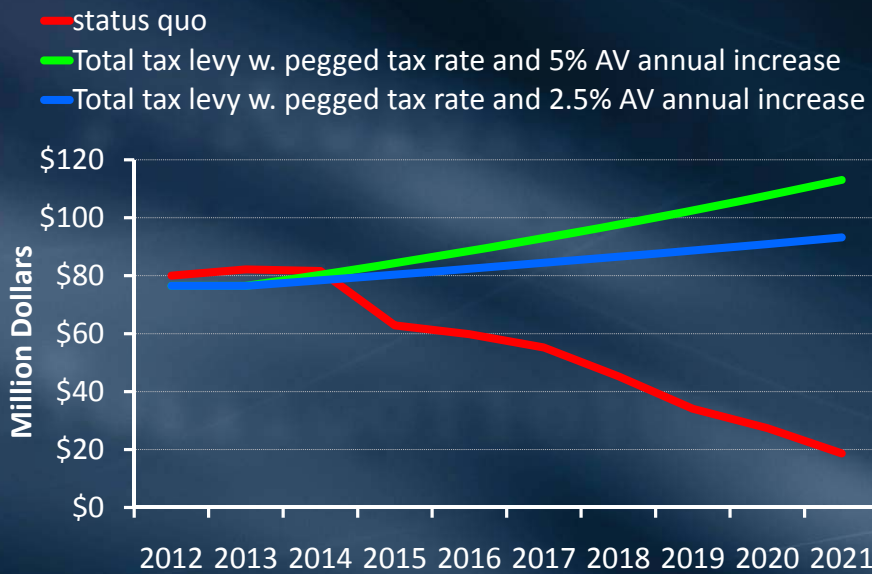
New Fixed Charge Options

- SWP Fixed Cost recovery:
 - Primarily recovered in the System Access Rate and Supply Rates, which are volumetric
 - Only 10% currently recovered through property taxes
 - Recover existing Transportation and Delta minimums, capital and O&M
- LRP Contract Commitments
 - Currently recovered in the Water Stewardship Fee
 - Recover on a fixed basis

Ad Valorem Tax Rate Could Generate Greater Revenues

- General limitation:
 - Metropolitan's general obligation bond debt
 - Metropolitan's share of Burns-Porter bonds
- Historically, tax rate has been reduced as assessed values have increased over time
- Status quo: tax revenues will continue to decline
- Even holding the tax rate constant could lead to revenue benefits

Ad Valorem Tax Rate Scenarios



CFO Group

November 14, 2011

15

Benefit Assessment

- Authorized by Section 134.6 of the Act
- Must meet the process requirements of the California Government Code §53753 (Proposition 218) and Article XIII D §4 (special benefit)
 - Requires Engineer's Report specifying the benefits to each parcel
 - Mailed notice to property owners
 - 45 day notice of public hearing
 - Majority protest process
 - Repeat process for each increase

CFO Group

November 14, 2011

16

Benefit Assessment: DHCCP

- Current estimated cost in FY 2014/15 of \$5M, FY2025/26 of \$236M
- Parcels, or acreage if parcel is over 1 acre, equals 5,859,457 parcels or acres
 - Estimates for Los Angeles, West Basin MWD, Beverly Hills and Santa Monica
 - Exemptions may differ from Standby Charge
- FY 2014/15 parcel charge of \$1/parcel or acre, FY 2025/26 parcel charge of \$40/parcel or acre
 - Actual amount of the per parcel or acre charge may be limited to what is acceptable to property owners
 - Current Standby Charge varies from \$6.94 to \$14.20

Combined AV/Assessment Approach

- Fixing the Ad Valorem Tax rate at .0037% of assessed valuations and adding a Benefit Assessment to cover the cost of the DHCCP would generate approximately \$140 million additional fixed revenues by FY 2020
 - Does very little in the near term
- Increases percent of fixed revenues versus fixed costs from 18% to 26% in FY 2020
- Could be combined with additional actions
- Administratively challenging

CUWCC Best Practices BMP 1.4

BMP 1.4 - Retail Conservation Pricing

- “...the goal of this BMP is to recover the maximum amount of water sales revenue from volumetric rates that is consistent with utility costs (which may include utility long-run marginal costs), financial stability, revenue sufficiency, and customer equity.”
- Compliance Options

$$\frac{V}{V + M} \geq 70\% \quad \text{OR} \quad \frac{V}{V + M} \geq \frac{V'}{V' + M'}$$

V = Revenue from volumetric rate(s)

M = Revenue from customer meter/service (fixed) charges

BMP 1.4 – Inclusion/Exclusion

- *“This calculation shall only include utility revenues from volumetric rates and monthly or bimonthly meter/service charges.”*
- Revenues to be excluded from the calculation:
 - New service connection charges
 - Special rates and charges for temporary service
 - Fire protection or other irregular services
 - Grants or contributions from external
 - Property or other utility taxes

BMP Exemptions/ Compliance Options

- Signatory will be exempt from specific BMPs if they demonstrate one of the following:
 - Program would not be cost-effective
 - Adequate funds are not reasonably available
 - Implementation not within legal authority & supplier has made effort to work with others to implement
- Alternative Compliance Options
 - **Flex Track** - accomplishing a set of measures which achieves equal or greater water savings
 - **GPCD** - accomplishing set water savings goals as measured in gallons per capita per day consumption

Water Sales and Reserve Levels

CFO Group

November 14, 2011

23

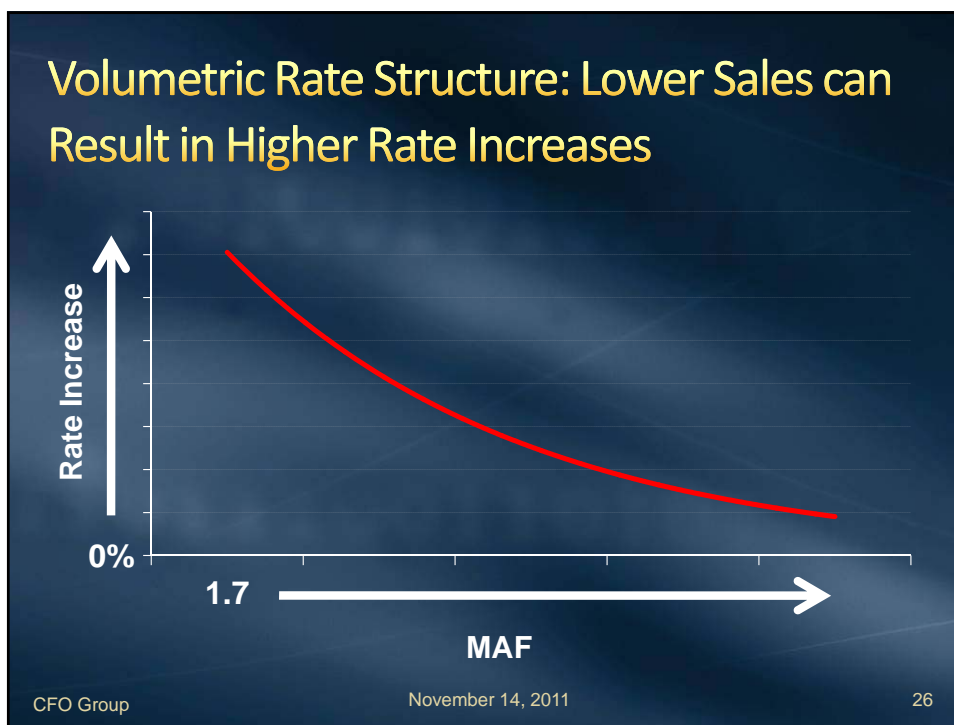
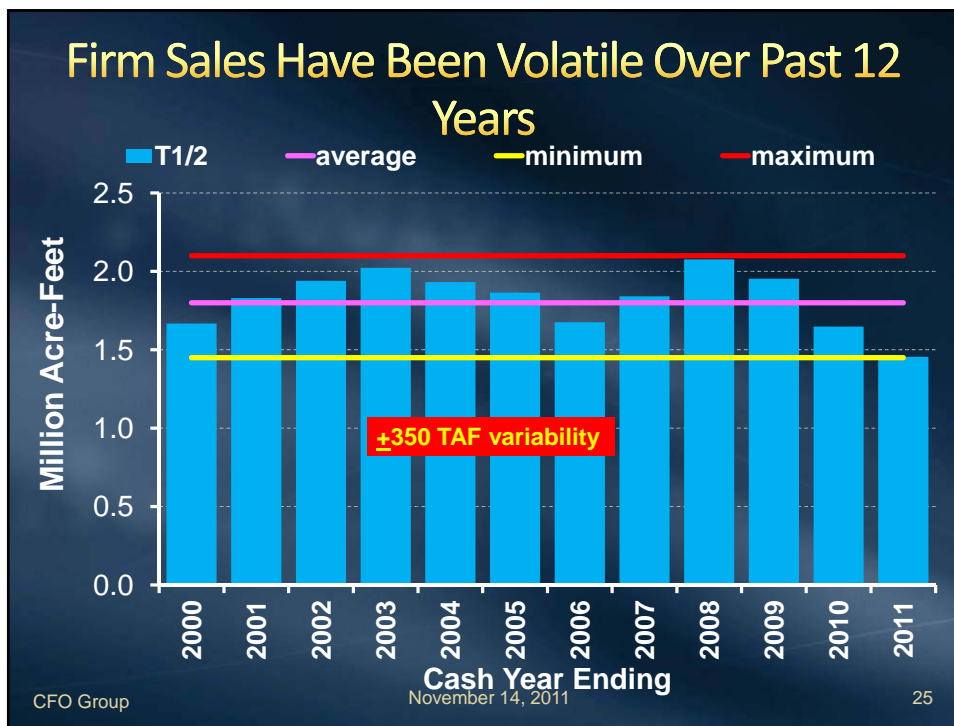
Rates Based on More Conservative Water Sales Assumptions

- Increases the likelihood of meeting revenue estimates
- Reduces need to manage current year costs and use reserves to meet revenue shortfalls
- Results in higher rate increases versus more optimistic sales forecasts
- Sales in excess of forecast generate additional revenues that can be used to improve reserves, fund PAYGo, fund OPEB

CFO Group

November 14, 2011

24



Reserve Fund Policy

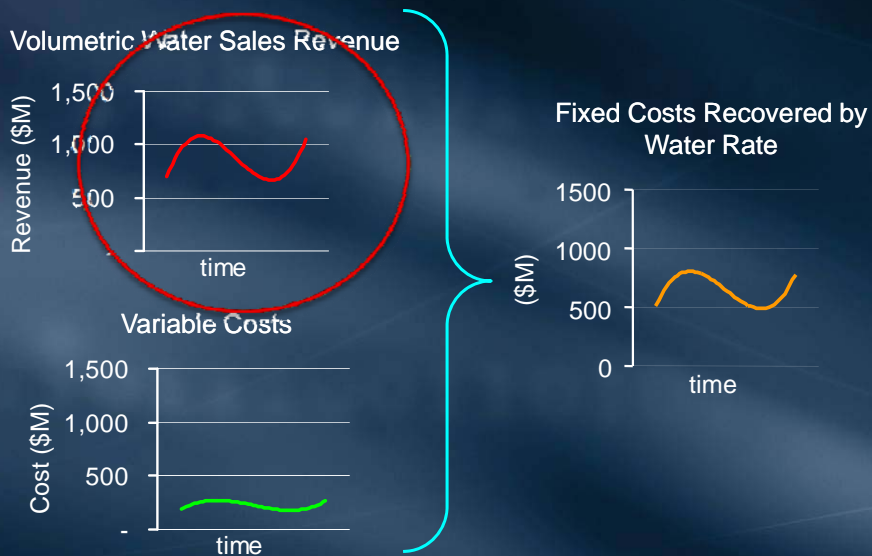
- Current policy was adopted with the 1999 LRF
 - Minimum of 18 months of rate protection
 - Maximum of 3.5 years of rate protection
 - Based on then analysis of sales volatility
- Review Reserve Policy calculation
 - Addition of fixed charges reduces need for reserves
 - Sales volatility is greater than what was used in 1999 policy development

CFO Group

November 14, 2011

27

Reserve Calculation



CFO Group

November 14, 2011

28



Purchase Orders

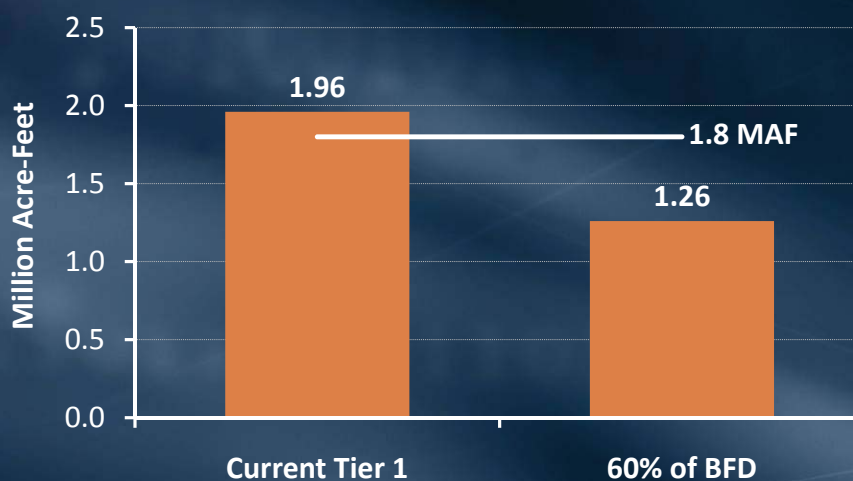
Overview of Current Purchase Orders

- Component of rate structure effective January 1, 2003
- 10-year term, January 1, 2003 to December 31, 2012
- Aspects of the Purchase Order
 - Voluntary
 - Offered price incentives; allowed more water sales to be purchased at the lower Tier 1 Supply Rate
 - Additional level of financial commitment to Metropolitan
 - Not tied to reliability
- 24 member agencies executed Purchase Orders
 - Growing agencies met their commitments within 6 years
 - All but 1 agency fulfilled their commitments by mid-2011

Upcoming Issue

- Purchase Orders expire December 31, 2012
- Path to move forward
 - Continue Purchase Orders?
 - Adjustments to rate structure?
- Under the current Administrative Code provisions, without Purchase Orders, the Tier 1 limit drops to 60% of Base Firm Demand
- Action is required to change the default outcome

Impact of No Extension of Purchase Orders, CY 2012 Tier 1 Limits



Potential Benefits of Future Purchase Orders

- Benefits will depend on how PO's are structured
- Provide more cost certainty to member agencies
 - Rate increases less influenced by volatility of sales volumes; more predictable future increases
 - Reduces need to maintain higher levels of reserves
 - Provides greater access to Tier 1 rate (possibly replenishment rate also)
- Provide more revenue certainty to Metropolitan
 - Better align with cost structure
 - Improves coverage ratios in low sales years
 - Helps maintain credit ratings

Considerations for Future Purchase Orders

- Should they continue to be voluntary?
- How to measure the basis for the commitment?
 - Historical purchases (similar to current PO's)
 - Account for 20% by 2020 agency targets
 - Account for adjustments under the allocation plan
 - Voluntary sign-up for a given quantity
- How does the PO relate to:
 - Access to the Tier 1 supply rate/Exposure to Tier 2?
 - Access to discount rate(s)?
- Additional questions to tackle:
 - Should access to the Tier 1 rate be tradable?
 - Annual payments vs. payment over 10 years?

Straw Man Poll:

- RTS
- Capacity Charge
- Customer Charge
- Water Quality-Source Protection
- SWP
- LRP
- Fixed Ad Valorem
- Benefit Assessment
- Reserves
- Conservative Sales Assumptions

Next Steps

- Workgroup meeting December 5, 2011
 - 1 to 3 pm, US1-101
- Board Workshop December 12, 2011
 - Finance and Insurance Committee, Board Room, 8:30 am
- Future meeting dates