



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

December 9, 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 90054-0153

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
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 8-1: Authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-1/A-3 and 2009 Series A-2

Dear Chair Foley and Members of the Board:

We have reviewed the December 10, 2013 Board Memo 8-1 and the redline copy of Appendix A, and have determined 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 request that staff and bond counsel respond to each of the issues and questions presented in this letter.

General Comments

At the outset, we note that a number of comments we have provided in the past have not been substantively addressed by changes in Official Statement; we do not repeat all of the points here, but have included a list of our lettersⁱ (copies of which have previously been provided to the MWD staff and board) at the end of this letter and incorporate herein points not previously addressed by MWD management.

All references are to the page numbers in the draft redline copy of the Appendix A dated November 25, 2013.

Inconsistent statements by MWD in its Official Statement and pleadings filed in Court. In describing the litigation challenging MWD’s rates, the Official Statement states that,

“to the extent that a court invalidates Metropolitan’s adopted rates and charges, Metropolitan will be obligated to adopt rates and charges that comply with any mandates imposed by the court. Metropolitan expects that such rates and charges would still recover Metropolitan’s cost of service. As such, revenues would not be affected.” (A-54)

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

In stark contrast to this representation, MWD has alleged in court filings that the Water Authority's lawsuit (or any member agency litigation) has a "destabilizing effect on MWD's rates and its ability to budget and plan." Further, that if the Water Authority were to prevail, it would, "threaten the current funding source for existing LRP, CCP and SDP project contracts and threaten future LRP, CCP and SDP contracts." Indeed, the impacts of the "destabilization" described in MWD's declarations and pleadings filed with the court is so great that MWD has alleged that it cannot ensure the continued administration of these programs or any of the long term investments described in its IRP if it should be required to change the cost allocation to its rates. See, for one example among many, the Upadhyay Declaration in Support of MWD's Opposition to SDCWA's Motion for Summary Adjudication at pages 7-8, (excerpt attached). Similarly, MWD's recent motion to exclude testimony by one of the Water Authority's experts states that, were the Water Authority's "proposed reallocation [of costs] to occur, member agencies would buy less water from MWD." Motion to Exclude Denham at pages 9-10 (excerpt attached).

There is no way to reconcile MWD's statements to bondholders on the one hand, and to the Court, on the other. It cannot at the same time be true that the Water Authority's rate litigation will have no impact on MWD's revenues, and at the same time, "destabilize" MWD and threaten its water supply programs and ability to budget and plan.

The real risk of destabilization. While we disagree as to the cause (it is not the result of the exercise of free speech by any member agency), we do believe that MWD is threatened by the kind of "destabilization" described in its court filings *as a result of its failure to have in place a long range finance plan and commitments by its member agencies to pay for the billions of dollars MWD is spending and plans to spend in the future.* This is not a new issue; it was well-described by an independent Blue Ribbon Task Force almost 20-years ago:

Reliability, quality and other water supply specifications cannot be made independently from the willingness of MWD customers to pay for such services. Member agencies may want, for example, the insurance provided by major investments to increase MWD standby capacity, but if forced to commit funds for such capabilities, they may actually prefer far lower levels of protection than a hypothetically "costless" water supply guarantee. (page 9; emphasis in original)

Derive IRP results starting from a willingness to pay perspective as well as from reliability and supply goals to assess whether current planning efforts adequately "loop back" and force the reappraisal of initial reliability and other operational assumptions. Member agencies, and other water users, may have a desire to improve reliability and performance capabilities beyond their willingness or ability to pay for such improvements. In the event of substantial divergences in various water users' willingness to pay for MWD capacities, Metropolitan may wish to consider more flexibly pricing wholesale

water supplies to reflect the levels of reliability and cost burdens that each user desires and is willing to bear. Effective planning can only occur after the maximum level of current and future investment member agencies will bear has been determined. (page 14; emphasis in original)

The peaking charge should recover the actual economic costs generated by peaking behavior and not be set by political considerations. (page 21; emphasis in original)

...MWD can no longer afford to build major facilities and hope that member agencies will buy enough water to pay for them over several years. The wide variation in member agency local water supply and project options means that each agency will differently value MWD water and facility investments, a fact that can frustrate needed revenue agreements...[t]he Task Force was troubled to learn...that some of the member agencies most strongly supporting big-ticket projects...also had the most aggressive plans to reduce their future MWD water purchases and develop independent supplies. In effect, such agencies appear to want MWD to develop costly backup capacity- or insurance-for their local supply strategies, while seeking to shift the costs for these benefits on to Metropolitan and other agencies and consumers. (page 23)

We have raised these issues repeatedly in the boardroom and in past letters commenting on MWD's Official Statements. Among all of the concerns we have, the single greatest concern is MWD's failure to describe in its Official Statement, the risk associated with its continued spending at the same time ***its member agencies are clearly unwilling to commit to pay for its programs.*** We also believe that the extraordinary lengths MWD and its member agencies are going to in order to impede the development of water supplies in San Diego, independent of MWD, is information that should be made available to bond counsel (it has not been) as well as present and future purchasers of MWD bonds.

Comments on Draft Appendix A dated November 25, 2013

A-1 Uniform rates for each of class of service. Appendix A states that, [m]ember agencies request water from Metropolitan...*and pay for such water at uniform rates established by the Board for each class of service*" (emphasis added). This is the only place in Appendix A where the words, "class of service" are used. Please confirm whether the water "categories" described at A-57-58 are the "classes of service" referred to in the recital at page A-1.

A-6 Standby or "dry-year peaking" demands of MWD member agencies. Due to the compartmentalization of the disclosures in Appendix A, the reader might fail to associate the withdrawals from storage described in the last paragraph on page A-6 with the Water Authority's rate litigation; specifically, the issue of MWD's failure to account for or properly

allocate the costs associated with having almost 6 million acre-feet of storage capacity and more than 3.3 million acre-feet of stored water available for withdrawal, which made possible the 300,000-500,000 acre-feet of water supply that MWD expects to draw upon to meet demands in 2013. The long-term negative impacts on MWD from its failure to identify and account for these costs are described in the Blue Ribbon Task Force Report, in the above excerpts and other portions of the Report. Appendix A should be revised to include a full discussion of this issue including potential impacts on MWD sales and rates.

A-11 Area of Origin litigation. Please provide us with a copy of the settlement agreement that is “currently being circulated among the parties for signature.”

A-18 Second supplemental agreement with Coachella. Please provide a copy of the second supplemental agreement with CVWD referred to in the second full paragraph.

A-28 Storage capacity and water in storage. What accounts for the reduction in the storage numbers since last reported in May 2013?

A-30 Preferential rights and water supply allocation plan. The second full paragraph under Water Supply Allocation Plan should be revised to include disclosure that – except in a water shortage emergency declared by the MWD board under Section 350 of the Water Code (which has never happened), or any other statutory basis MWD may believe would support limitations on the exercise of preferential rights – the MWD board has no statutory authority or ability whatsoever to diminish the statutory preferential right to water held by each of its member agencies. It is highly misleading in the context of current water rates and realities to state that, “historically, these rights have not been used in allocating Metropolitan’s water.” The historical record is clear that the cities of Los Angeles and Long Beach have every intention of calling upon their respective preferential rights to water should it be advantageous for them to do so. The Water Authority does not question these rights, which have also been confirmed by legal opinions of MWD’s General Counsel and the Court of Appeal.

A-32 Impact on MWD sales of Los Angeles updates reported in Appendix A. Two significant changes are made to Appendix A regarding the City of Los Angeles. First, that its “favored son” agreement executed by Ron Gastelum without the knowledge or consent of the board of directors, is expected to be completed six years sooner than previously disclosed. Second, that LADWP has reached a “major agreement” regarding future dust control on portions of Owens Lake. Please explain what has changed in the implementation of the AVEK agreement that accounts for the project now being completed before the end of next year (versus 2020 as previously reported in Appendix A). Please explain the impacts on MWD water sales as a result of each of these developments.

A-33 Local water supplies. The discussion of local water supplies generally is very confusing because it does not make clear to the reader what supplies are being developed by MWD (or

with subsidies from MWD) and which are not. There should also be a discussion here that ties in to later sections of the Appendix A disclosing the impact on MWD sales from the development of local water supplies by the member agencies (with and without subsidies from MWD).

A-34 Impact on MWD sales of Carlsbad seawater desalination project. We were unable to confirm whether MWD's future sales projections take into account the 48,000-56,000 acre feet of water supply expected to come on line in 2016. Please identify where that accounting is made.

A-35 MWDOC application for MWD subsidies for a seawater desalination project. Please provide us with a copy of the application. Also, please provide an analysis (facts) of the regional benefits MWD believes would support the payment of such subsidies.

A-42 Discussion of MWD's capital investment plan (CIP) illustrates the need for a long range finance plan and updated cost of service analysis. The short CIP discussion reflects the wild fluctuations as a result of poor estimations by MWD staff of capital spending and the need for pay-as-you-go funding and water rate increases. Every one of these highly inaccurate estimations results in further distortion of MWD's already improper allocation of costs to its member agencies and all MWD ratepayers. It is also unclear – except possibly for litigation purposes – why MWD is claiming that it will spend zero dollars on “supply” over the next five years. Please advise whether the words, “Cost of Service,” are used in a rate-setting context or, is intended to have some other meaning in this section of the Appendix A. Also, please advise why debt service for bonds MWD did not issue and does not expect to issue is included in the financial projections.

A-49 Risk management discussion is incomplete. As stated in multiple prior letters, we remain concerned with the inadequacy of MWD's overall risk disclosure. Many of the issues we have raised have not been addressed in the Appendix A. In particular, we remain concerned that MWD's long range finance plan is materially out of date (last updated in 2004). The draft Appendix A does not disclose that MWD is operating (by choice) without a long range finance plan because, after more than five years of working on it, MWD abandoned the effort (i.e., its member agencies could not agree on a long range finance plan to pay MWD's costs). Nor does MWD (by choice) have water rate projections that take into account and plan for all of MWD's projected costs and liabilities. These costs include, for example, some reasonable estimate of BDCP costs, other water supply programs included in the IRP, facility investments and retiree health. Almost 20-years has passed since the Blue Ribbon Task Force wisely cautioned MWD to develop and implement a plan for its fiscal sustainability; yet today, there remains **no plan** for how MWD expects to pay its costs over the long term. MWD's current ad hoc approach to financial planning is neither advisable nor sustainable and its continued spending creates a risk for all of Southern California including all of its bondholders.

A-50 MWD's actions in 2013 suspending the tax limitations in the MWD Act were not factually or legally justified. It is ironic that MWD chose to increase taxes (the net economic effect of suspending the limitation) at the same time that it was awash in cash from the over-collection of revenue from Southern California's water ratepayers. In June 2013, when MWD took the action to suspend the tax limitations, it had already collected \$314 million more than needed to pay 100% of its budgeted expenditures and caused its reserves to exceed maximum reserve level by at least \$75 million (see the Water Authority's June 5, 2013 letter RE Board Memos 8-1 and 8-2). As a matter of fact, additional tax revenue was most assuredly **not** "essential to the fiscal integrity of the district." The MWD board did not and could not make the findings necessary to support the suspension of the tax limitation, and any suggestion that the board considered in any meaningful or substantive way "factors" including the "balancing of proper mechanisms" for funding current and future State Water Project costs is unsupported by the record. If there is any document or record you believe supports this statement in the Appendix A other than the board memo, please provide copies to us in your response to this letter.

A-51 Wheeling revenues as an MWD "water sale." The Water Authority does not purchase its IID or canal lining water from MWD; it pays MWD to convey the water to San Diego. MWD's representation of these revenues as "water sales" are made for purposes of litigation only and are misleading bondholders, MWD's "disclosures" in the footnotes to its Summary of Receipts by Source notwithstanding.

A-52 Member agency purchase orders. The description of member agency purchase orders is misleading because it suggests that MWD's member agencies have made firm commitments to purchase water from MWD in the future when they have not. See discussion of this issue in prior letters commenting on the Appendix A.

A-53 Rate structure. Representations that uniform rates are collected "for every acre-foot of water conveyed by Metropolitan" are inaccurate because the rates do not take into account all of the discounted and special agreements MWD affords some but not all of its member agencies. Moreover, MWD fails to comply with cost of service legal requirements and its own act because it fails to properly acknowledge or account for different classes of service it provides to its member agencies (see comment at A-1 above, the only place in the Appendix A in which MWD mentions classes of service).

A-54 Litigation challenging rate structure. See general comments about the inconsistency between representations in the draft Appendix A and representations made to the Court.

A-60 Hydroelectric power recovery revenues. Why have the three paragraphs been deleted?

A-79 Tax increase to pay for additional payments under the State Water Contract. Please provide a copy of the opinion of MWD's General Counsel referred to in the first full

paragraph that the tax increase as described would be within the exemption permitted under Article XIII A of the State Constitution as a tax to pay pre-1978 voter approved indebtedness.

A-86 Projected revenues and expenditures. See question above, at A-34. Do these revenue projections assume that the Carlsbad seawater desalination facility comes on line in 2016? See also the questions above, at A-32. What assumptions are made about water sales to LADWP?

A-89 Long range finance plan. MWD's reserve policies are outdated, just as its 1999 Long-Range Finance Plan is. Is MWD staff relying upon and implementing all of the policies in the 1999 plan at this time?

Again, we incorporate by reference all of our prior comments which have not been corrected in this or past versions of Appendix A.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director

Attachments

1. Declaration of Deven Upadhyay (excerpt), December 3, 2013
2. Motion to Exclude Testimony of Daniel A. Denham (excerpt), December 10, 2013

cc: Jeff Kightlinger, MWD General Manager

San Diego County Water Authority Board of Directors and Member Agencies

ⁱ Water Authority comment letters on MWD's Official Statement dated: 9/22/2010, 12/9/2010, 5/16/2011, 8/22/2011, 2/13/2012, 4/9/2012, 6/11/2012, 8/20/2012, 8/29/2012, 10/8/2012, 11/5/2012, 2/11/2013, 5/13/2013, and 6/7/2013

1 were “to improve regional water supply reliability and avoid or defer MWD capital expenditures”
2 and to meet “IRP local resource targets[.]” In that letter, SDCWA also recommended that MWD
3 pay \$250 per acre-foot of water under the project contracts to “reduce future MWD capital
4 expenditures and water supply costs.”

5 III. MWD’s Integrated Rate Structure

6 26. MWD funds its demand management programs through revenue generated by its
7 current, integrated rate structure which was adopted by MWD’s Board of Directors in October
8 2001 and implemented as of January 2003 (“Existing Rate Structure”). Specifically, MWD’s
9 Water Stewardship Rate is set to recover costs related to its LRP, CCP, and SDP programs.

10 27. Piecemeal legal and/or legislative challenges to MWD’s Existing Rate Structure
11 would create a destabilizing effect on MWD’s rates and its ability to budget and plan. This is the
12 case because such challenges do not account for MWD’s overall costs and policy considerations
13 in setting its rates. In contrast, challenges to MWD’s Existing Rate Structure within the Board
14 process would allow for consideration of the larger picture by all of the relevant stakeholders. As
15 a result, such challenges would not threaten to destabilize MWD’s Existing Rate Structure in the
16 way piecemeal legal and/or legislative challenges would. The RSI provision therefore protects
17 the stability of MWD’s Existing Rate Structure by encouraging resolution of rate disputes within
18 the Board process.

19 28. Piecemeal legal and/or legislative challenges to MWD’s rates that threaten to
20 destabilize MWD’s Existing Rate Structure also threaten the current funding source for existing
21 LRP, CCP, and SDP project contracts and threaten future LRP, CCP, and SDP contracts.
22 Without a stable rate structure, MWD cannot ensure the continued administration of the LRP,
23 CCP, and SDP programs.

24 29. MWD relies on a stable rate structure to adequately plan, develop and budget for
25 LRP, CCP, and SDP projects and its other capital and operating costs. MWD’s MAs rely on a
26 stable MWD budget and rate structure to plan their budgets and to set their rates. Challenging
27 MWD’s rates outside the Board process is the type of destabilizing effect the RSI provision is
28 aimed at preventing. This kind of destabilization interjects uncertainty that interferes with long-

1 term planning and budgeting that is necessary to enter into the long-term LRP, CCP, and SDP
2 project contracts. For example, if MWD were required to eliminate its Water Stewardship Rate,
3 MWD would have to make fundamental changes to its Existing Rate Structure. In particular,
4 absent changes in MWD's budgeted costs, MWD would have to increase its other rates to cover
5 the cost of existing LRP, CCP, and SDP programs. This kind of unplanned for rate increase
6 would interfere with MWD's and its MAs' ability to properly plan and budget for the future. To
7 avoid such disruptive rate increases, MWD's Board would have to consider the possibility of
8 having to decrease or discontinue its future investments in local conservation and resource
9 development projects. This kind of uncertainty also inhibits MAs from investing in long-term
10 projects that MWD needs to meet its long-term goals set forth in MWD's IRP.

11 30. SDCWA's assertion that MWD has the ability to reset its rates and adjust its rate
12 structure to meet its costs does not obviate the need for the RSI provision. Resetting of MWD's
13 rates is exactly the type of destabilization that the RSI provision was intended to prevent. Even if
14 MWD's overall revenues would not be affected by a challenge to MWD's Existing Rate
15 Structure, that does not mean that a challenge to MWD's Existing Rate Structure would not affect
16 the revenues allocated to any particular program or service, including revenues available for
17 MWD's demand management programs.

18 31. SDCWA suggests that the RSI provision is unnecessary because MWD could have
19 simply increased its fixed rate charges to "provide a measure of revenue stability." The RSI
20 provision is not aimed at protecting MWD's "revenue;" rather, it is intended to protect the
21 stability of MWD's Existing Rate Structure to ensure continued funding of the LRP, CCP, and
22 SDP programs, not some other, alternative hypothetical rate structure that MWD's Board did not
23 adopt.

1 on MWD's supposed breaches of the Exchange Agreement. West Dec., Ex. H; *see also* West
 2 Dec., Ex. I at 332:22-333:20 (Mr. Cushman testifies that he has is testifying as to topics 7 and 8
 3 in Metropolitan Water District of Southern California's Amended Notice of Deposition of Person
 4 Most Knowledgeable for San Diego County Water Authority (Exchange Agreement), concerning
 5 alleged breaches of the 2003 Exchange Agreement). He testified that there is no way to know
 6 what MWD's rate structure would look like if this Court accepts SDCWA's argument that State
 7 Water Project costs and the Water Stewardship Rate should not be allocated to MWD's
 8 transportation rates, or whether such a revised rate structure would be any more favorable to
 9 SDCWA than the current one:

10 Presuming the Water Authority prevails [in the litigation], the
 11 judge will invalidate Metropolitan's rates, and Metropolitan will
 12 have to go back and set and adopt lawful rates. How Metropolitan
 13 goes back and adopts lawful rates and charges is at this point
 14 unknown. So how it might affect the Water Authority's payments
 15 is unknown.

16 West Dec., Ex. I at 443:20-444:2

17 Mr. Denham's assumption that MWD's rate structure would otherwise remain the same if
 18 State Water Project and Water Stewardship costs were moved from transportation rates to supply
 19 rates is completely speculative, which renders his opinion inadmissible. *Biren v. Equal*
 20 *Emergency Med. Grp., Inc.*, 102 Cal. App. 4th 125, 138 (2002) ("Damage awards may not be
 21 based upon the testimony of experts who rely on speculation.").

22 Indeed, this assumption is not only speculative, Mr. Denham's admissions and basic
 23 economics refute it. Mr. Denham admits that, were these costs reallocated from transportation to
 24 supply as his report envisions, many member agencies will pay more overall for water obtained
 25 from MWD.⁴ West Dec., Ex. B. at 183:12-15 ("It's reasonable to assume, as I've previously

26 _____
 27 ⁴ Member agencies' rates would inevitably increase if State Water Project costs and the Water
 28 Stewardship Rate are moved wholesale into the supply rate. This is because, under Mr.
 Denham's assumptions, MWD would collect substantially less revenue for providing SDCWA
 with Exchange Water, while the rest of MWD's business -- including its revenue from other
 sources and its total operating costs -- remains unchanged. MWD is under a legal obligation to
 recover its costs through the rates it charges. *See* MWD Act § 134 (requiring MWD to set water
 rates at a level which will recover MWD's operating costs).

1 mentioned that the misallocated components go to supply. And with the supply rate going up,
 2 member agencies pay more . . .”). Mr. Denham admits the existence of price elasticity, which
 3 in this context indicates that as MWD’s rates increase, member agencies will buy less water from
 4 MWD. *Id.* at 171:22-25 (“Q. And you agree with the concept that all else being equal, the
 5 quantity of a demand good falls when the price of a good rises, correct? A. That’s correct.”). He
 6 also admits that MWD member agencies -- particularly one of its largest, the City of Los
 7 Angeles -- exhibit such price elasticity with regard to their water purchases from MWD. *Id.* at
 8 174:13-22.

9 Thus, logically, were Mr. Denham’s proposed reallocation to occur, member agencies
 10 would buy less water from MWD. If that occurred, MWD would likely have to adjust its rate
 11 structure to address depressed sales, since it must recover all its costs through its rates. Mr.
 12 Denham’s opinion addresses this problem by simply pretending it does not exist:

13 Q. But you didn’t take this [effect of price elasticity] into account
 14 at all on your expert report, did you? A. I did not. MR.

15 BRAUNIG: Objection; vague and ambiguous. THE WITNESS:
 16 That’s not what I was asked to do.

17 *Id.* at 172:1-6. To the contrary, he assumes that the quantity of water purchased by the other
 18 member agencies will remain static,⁵ even as the price increases:

19 Q. So you were asked to assume that prices remain -- that sales
 20 volumes would remain the same although prices went up? A. I --

21 MR. BRAUNIG: Objection to the form. BY MR. WEST: Q.
 22 Yes? A. Yes, all things would remain equal.

23 *Id.* at 172:8-15. Here again, Mr. Denham’s opinion rests on a key assumption that he admits is
 24 false. Thus, Evidence Code Section 803 requires that the opinion be excluded. *See Maatuk v.*

25 _____
 26 ⁵ For each calendar year 2011-2014, Mr. Denham divided MWD’s “revised” revenue
 27 requirements by the total number of acre-feet estimated to be sold to member agencies in that
 28 year -- *e.g.*, in 2011: “When MWD’s revenue requirement of \$453,296,142 for these cost
 elements is **spread over the total number of acre-feet in the 2011 sales assumptions
 contained in the COS Report**, a bundled credit of \$236/AF should be returned to the Water
 Authority, or \$33,805,324 as an overcharge for transportation in calendar year 2011.” West
 Dec., Ex. A, at Ex. B Thereto (Denham Report), 7 (emphasis added). He performed the same
 calculation for 2012, 2013, and 2014 -- again using sales assumptions contained in the Cost of
 Service Reports for those years -- and then added together the results to arrive at a total
 “overcharge” of \$188,340,476. *Id.*



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

June 7, 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 90054-0153

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

**OTHER
REPRESENTATIVE**

County of San Diego

RE: Board Memo 8-5: Authorize the execution and distribution of the Official Statement in connection with the issuance of the Special Variable Rate Water Revenue Refunding Bonds, 2013 Series E (Flexible Index Mode) – OPPOSE

Dear Chair Foley and Members of the Board:

We have reviewed June 11, 2013 Board Memo 8-5, including the redline copy of Appendix A, and determined we must again vote against the staff recommendation to authorize execution and distribution of the Official Statement in connection with the sale of bonds. In making this determination, we have also considered the information provided by Mr. Breaux in his May 22, 2013 response to our last letter to you on this subject dated May 13, 2013.

Before we address the specific comments we have on the current draft Appendix A, we will address some of the comments and information provided by Mr. Breaux.

Investment Policy. Mr. Breaux states that, “[n]othing in the swap portfolio affects the investment policy,” and that, “the Statement of Investment Policy does not apply to interest rate swaps, which are governed by the Master Swap Policy.” Thank you for this technical clarification. However, to get the issue back in context, our initial question was prompted by MWD’s disclosure in a PowerPoint presentation, that MWD ratepayers would be funding as much as \$20 million in termination penalties associated with the proposed financing plan for which the bonds were being sold. In our February 11, 2013 letter we asked,

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 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.

Whether it’s the board’s investment policy or swap policy, the central question is one of risk – specifically, how much risk the board is willing to take with ratepayer dollars.

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

While the information provided to the board noted the potential rewards of interest rate swaps, we found it virtually devoid of any explanation of the risks associated with interest rate swaps. Failure to fully explain the risks associated with such a complex, structured financial product leaves MWD open to criticism when the actual facts evolve in such a way, as they have in this case, that MWD could have saved more by staying in variable debt. This is one of the reasons that many agencies and cities are unwilling to authorize interest rate swap agreements.

We look forward to your July presentation and hope that it will focus on the subject of risk, including whether the swap policy is consistent with the objectives of the board's overall investment and financial policy.

Interest-bearing account. Mr. Breaux states that, "the amounts that are in dispute are being set aside in a separate account..." Please provide the account information.

We respectfully disagree with the rest of the responses and conclusions stated in Mr. Breaux's letter.

Comments on Draft Appendix A

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.

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?

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.

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 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.

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.

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"?

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.

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

We incorporate by reference all of our prior comments which have not been corrected in this or past versions of the Official Statement.¹

Sincerely,



Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director

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

¹ Water Authority letters dated 9/22/2010, 12/9/2010, 5/16/2011, 8/22/2011, 2/13/2012, 4/9/2012, 6/11/2012, 8/20/2012, 8/29/2012, 10/8/2012, 11/5/2012, 2/11/2013 and 5/13/2013.



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

June 5, 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 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

June 5, 2013

RE: Board Memo 8-1 – Mid-cycle Biennial Budget Review and Recommendation for Use of Reserves over Target Water Rate Increases – OPPOSE AND REQUEST FOR REFUND TO RATEPAYERS OF EXCESS RESERVES

Board Memo 8-2 – Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal year 2013/14 – OPPOSE

Dear Chairman Foley and Board Members:

In April 2012, this Board voted to raise water rates by 5% for 2013 and 2014 based on the staff's report that limiting water rate increases to no more than 3% would leave MWD unable to pay for critical infrastructure needs on the Colorado River Aqueduct. At that time, MWD staff also represented that the rate increases were based on maintaining reserve levels from 2012 through 2017 at, or close to the board-adopted minimum target.

As in past years, MWD's estimations of water sales and actual expenditures have proven to be materially different than assumed for budget and rate-setting purposes. Far from being unable to pay for critical infrastructure, MWD ended fiscal year 2012 – less than three months after adopting rates -- with an extra \$97 million to add to its reserves. According to this month's board report, MWD will, before it ends fiscal year 2013 at the end of this month, add another \$217 million to its unrestricted reserves, causing the reserves to exceed the maximum limit by \$75 million. ***In less than 15 months, MWD has collected \$314 million more than needed to pay 100% of its budgeted expenditures.***

Many of the cities we serve are struggling with their own budgets to make ends meet and pay for critical infrastructure. Many of the ratepayers we serve are also struggling to make ends meet during a period of lower incomes and escalating costs. We owe it to our cities and ratepayers to be better stewards of the precious dollars water ratepayers entrust to us when they pay their water bills. We once again call on this Board to establish a ***Fiscal Sustainability Task Force*** to develop a long-range finance plan and accounting, budget, and rate-setting protocols to ensure that every dollar MWD collects is used for its intended purpose, and, that MWD does not collect more money than it really needs.

In the meantime, we call on the board to **REFUND the \$75 million in excess reserves**, rather than shift this money to unplanned, unbudgeted expenditures. Attachment 1 to this letter shows approximately¹ how much MWD could refund to each of its member agencies. We also once again call on the Board to act now to **REDUCE the planned water rate increase for 2014 from 5% to 3%**. Reliance on budget estimates proven to be materially incorrect is unwarranted in the face of the actual facts.

For the same reason, we **OPPOSE Board Memo 8-2 proposing to suspend the tax rate limitations** in Section 124.5 of the MWD Act. We have reviewed the legislative history of SB 1445. We disagree that it was “meant to increase Metropolitan’s financial flexibility.” The clear purpose of the legislation was to limit the imposition of future taxes by MWD, with the ultimate goal that the tax be eliminated. The Legislature instead provided different tools to allow MWD to cover its fixed costs including standby or readiness-to-serve charges and benefit assessments, as clearly acknowledged in the Board Memo. The fact that MWD has failed to better utilize these and other tools as part of a long-range plan to cover its fixed costs does not translate to a need for higher taxes.

MWD cannot credibly claim that additional tax revenues of \$4.4 million are “essential to the fiscal integrity of the District” at the very same time it has amassed \$549 million in unrestricted cash reserves, exceeding the projected reserve levels forecasted in the adopted biennial budget (\$220.8 million)² by \$328.2 million, and surpassing the board-adopted maximum reserve target by \$75 million. This issue should also be addressed as part of a long-range finance planning process in which all long term costs and sources of revenue may be considered, rather than the ad hoc decision-making that is being presented to this board.

Finally, there is no factual support for the statements in Board Memo 8-2 that the imposition of a tax increase is necessary to “preserve equity across member agencies” or that MWD’s current rates and charges have been assessed in a manner designed to reflect equity or the actual costs of the services MWD provides. While we support the fiscal objectives as described – balance between fixed costs and fixed revenues and equity across member agencies – we do not agree that the way to achieve this is to suspend the tax limitation for one year. Instead, MWD should conduct a cost-of-service study as part of a long-range financial planning process in order to ensure accomplishment of these important objectives.

Sincerely,



Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director

Attachment 1: Estimated refund of MWD over-collection

Attachment 2: Comparison of MWD reserves forecast

cc: Jeffrey Kightlinger
San Diego County Water Authority Board of Directors

¹ Based on 11 months (July 2012 through May 2013) of member agencies’ payment of rates and charges (data source: MWD WINS).

² Attachment 2 to this letter shows MWD’s projected reserves when the budget was adopted in April 2012 compared to reserves projected in April 2013 (data source: MWD PowerPoint dated 4/8/2013)

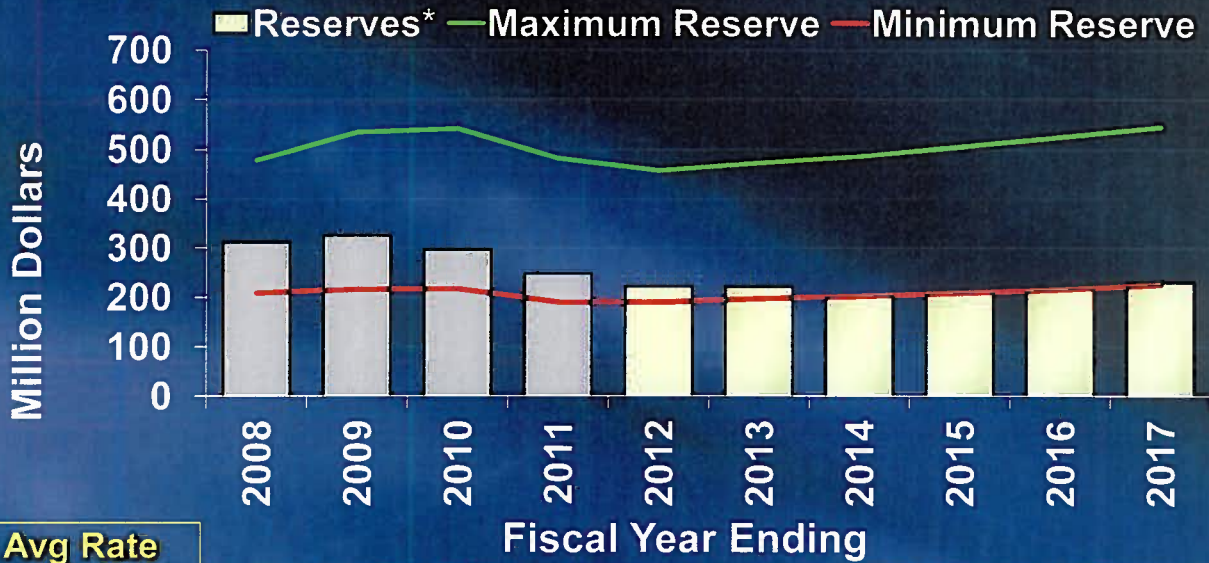
Estimated Refund of MWD Over-Collection

Fiscal Year 2013*			
MWD Member Agency	Total Contribution Rates and Charges (07/12 - 06/13)	Total Contribution (in %)	\$ 75,000,000
Anaheim	\$ 14,178,498.33	1.13%	\$ 847,769
Beverly Hills	\$ 9,133,714.68	0.73%	\$ 546,129
Burbank	\$ 9,864,635.91	0.79%	\$ 589,832
Calleguas	\$ 87,186,626.45	6.95%	\$ 5,213,115
Central Basin	\$ 28,231,187.87	2.25%	\$ 1,688,016
Compton	\$ 1,364,481.90	0.11%	\$ 81,586
Eastern	\$ 71,031,751.96	5.66%	\$ 4,247,173
Foothill	\$ 6,603,113.95	0.53%	\$ 394,817
Fullerton	\$ 7,611,689.48	0.61%	\$ 455,123
Glendale	\$ 14,894,768.04	1.19%	\$ 890,597
Inland Empire	\$ 30,355,607.00	2.42%	\$ 1,815,041
Las Virgenes	\$ 18,087,663.81	1.44%	\$ 1,081,508
Long Beach	\$ 25,055,739.11	2.00%	\$ 1,498,148
Los Angeles	\$ 261,368,067.87	20.84%	\$ 15,627,876
MWDOC	\$ 149,249,392.78	11.90%	\$ 8,924,009
Pasadena	\$ 14,646,995.66	1.17%	\$ 875,782
San Diego	\$ 273,850,600.54	21.83%	\$ 16,374,239
San Fernando	\$ 72,742.55	0.01%	\$ 4,349
San Marino	\$ 615,129.24	0.05%	\$ 36,780
Santa Ana	\$ 8,756,935.65	0.70%	\$ 523,600
Santa Monica	\$ 5,489,296.52	0.44%	\$ 328,219
Three Valleys	\$ 47,988,374.68	3.83%	\$ 2,869,350
Torrance	\$ 13,646,271.90	1.09%	\$ 815,946
Upper San Gabriel	\$ 8,975,149.06	0.72%	\$ 536,647
West Basin	\$ 94,668,219.86	7.55%	\$ 5,660,459
Western	\$ 51,409,167.96	4.10%	\$ 3,073,888
Total	\$ 1,254,335,822.76	100.00%	\$ 75,000,000

Note: Totals may not foot due to rounding

*Based on 11 months (July 2012 through May 2013) of member agencies' payment of rates and charges (data source: MWD WINS, June 5, 2013)

FY2013 & FY2014 Budget



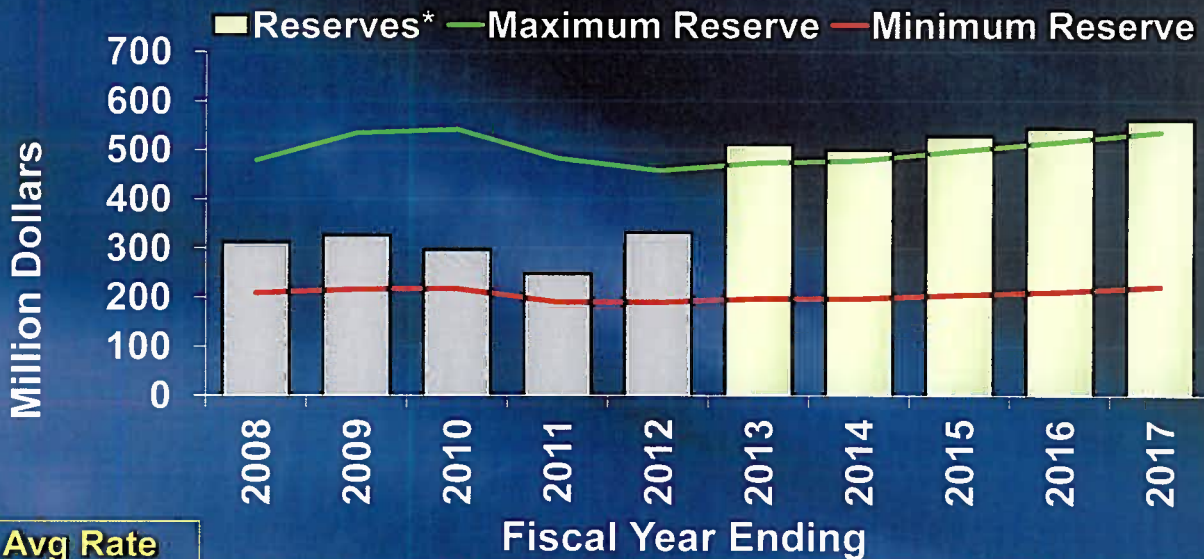
Avg Rate Increase	6%	14%	20%	7.5%	7.5%	5%	5%	← 3% to 5% →		
Sales, MAF	2.3	2.2	1.8	1.7	1.7	1.7	1.7	1.75	1.75	1.75
PAYGO, \$M	43	30	37	45	45	55	125	125	125	125
Rev. Bond Cvg	1.8	1.8	1.6	1.5	1.5	1.6	1.9	1.9	2.0	2.0
Fixed Chg Cvg	1.3	1.3	1.1	1.0	1.1	1.2	1.3	1.3	1.3	1.3

* Includes Water Stewardship Fund
 FY2013 and beyond are based on modified accrual

F&I Committee

April 2013

Updated Forecast



Avg Rate Increase	6%	14%	20%	7.5%	7.5%	5%	5%	3%	3%	3%
Sales, MAF	2.3	2.2	1.8	1.7	1.7	1.8	1.7	1.75	1.75	1.75
PAYGO, \$M	43	30	37	45	45	55	125	125	125	125
Rev. Bond Cvg	1.8	1.8	1.6	1.5	1.8	2.2	1.9	2.1	2.0	2.1
Fixed Chg Cvg	1.3	1.3	1.1	1.0	1.3	1.7	1.3	1.4	1.4	1.4

* Includes Water Stewardship Fund
 FY2013 and beyond are based on modified accrual

F&I Committee

April 2013



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

May 13, 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 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 8-3: Authorize the execution and distribution of Official Statements in connection with the issuance of the Special Variable Rate Water Revenue Refunding Bonds, 2013 Series D – OPPOSE

Dear Chair Foley and Members of the Board:

We have reviewed May Board Memo 8-3, including the redline copy of Appendix A, 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. In making this determination, we have also considered the information provided by Mr. Breaux in his February 19, 2013 response to our last letter to you on this subject dated February 11, 2013.

Before we address the comments we have on the current draft Appendix A, we would like to note in response to Mr. Breaux's letter that we were quite familiar with MWD's quarterly swap reports, and reviewed them before we asked the questions contained in our February 11 letter. However, those reports do not answer the central policy question we asked, namely, whether the Board should change its investment policy to be more conservative and consistent with the primary objective of safeguarding the principal of invested funds. We renew our request for a detailed report to the board on the risks and financial exposure presented by the current swap transactions and board policy.

Comments on Draft Appendix A

A-49: *Source of funding to pay SDCWA to the extent it prevails in the litigation.* The points raised in our February 11, 2013 letter to you on this subject have not been addressed (see page 4, A-50). The Exchange Agreement requires MWD to hold the amount of disputed funds in a separate interest-bearing account, not as part of MWD's financial reserves. Moreover, the use of financial reserves for this purpose is improper to the extent that the reserves are being funded by SDCWA. Any amounts that may be due to the Water Authority from the litigation must be paid by the other member agencies, not by the Water Authority itself. MWD is in breach of the

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

Exchange Agreement provision requiring it to deposit the disputed funds in a separate interest-bearing account.

A-50: Member Agency Purchase Orders. The description of Member Agency Purchase Orders is misleading. We attach and incorporate by reference our letter to you dated October 8, 2012 stating objections to both the form and substance of MWD's "Amended and Restated Purchase Order." Like all other public agencies, MWD is required to align its costs with the services it provides; the creation of a "purchase order" and characterization of it as a "voluntary" agreement will not immunize MWD from the application of Proposition 26.

A-51: Replenishment. The discussion of replenishment remains misleading because it fails to disclose material concerns with this discounted water program as described in our past letters to the board (including but not limited to those dated April 25, May 6, September 12, November 4 and December 12, 2011). The last time MWD authorized the sale of water at a discount, it said that the member agencies would not purchase water at the full service price due to "budgetary and fiscal constraints." MWD should disclose the relationship between discounted water sales (under any guise or program) and loss of full service sales, impacts on water rates and cost of service legal requirements.

5/14/2013 Board Memo 8-1 – Set public hearing to consider suspending Section 124.5 of the Metropolitan Water District Act to maintain the current ad valorem tax rate. MWD should certainly disclose in Appendix A that it believes that the fiscal integrity of the District is currently threatened. This is a material fact that investors need to be informed of.

In general, we remain concerned with the inadequacy of overall risk disclosure, for the reasons described in prior correspondence. Many of the issues we have raised have not been addressed. In particular, we remain concerned that MWD's long range finance plan is materially out of date (last updated in 2004). The draft Appendix A does not disclose that MWD does not have a long range financing plan, or, water rate projections that take into account and plan for all of MWD's projected costs and liabilities. This includes, for example, BDCP costs, other water supply programs identified in the Integrated Resources Plan, facility investments and retiree health. There is no plan for how MWD expects to pay these costs over the long term. MWD's current ad hoc approach to financial planning is not sustainable.

Sincerely,



Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director



Doug Wilson
Director

Attachment: Water Authority's letter dated October 8, 2012 re Purchase Order

cc: Jeff Kightlinger, MWD General Manager
Gary Breaux, Chief Financial Officer
San Diego County Water Authority Board of Directors and Member Agencies



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

October 8, 2012

Jack Foley, Chair of Board
and Members of the Board
Metropolitan Water District
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

OTHER REPRESENTATIVE

- County of San Diego

RE: Board Memo 8-3 – Approve the form of the amended and restated Purchase Order; and authorize amendment of section 4122 of the Administrative Code

Dear Mr. Foley and Board Members,

We have reviewed Board Memo 8-3 including Attachments. We are prepared to recommend to the Water Authority board of directors renewal of the purchase order commitment for two years, to December 31, 2014, “under the existing terms and conditions,” in accordance with the recommendation stated in the “Executive Summary” at page one, paragraph one of the board memo and as reflected in Attachment 3, Page 1 of 1, 2013, *Tier 1 Limit and 2003 – 2014 Purchase Order Commitment*. However, we are unable to recommend execution of the *new form of Purchase Order* which contains unexplained *changes to the existing terms and conditions*.

The “Details” section at page one, paragraph two of the board memo states that the new form of agreement contains amendments to definitions “to align the Purchase Orders with water programs implemented since the 2002 execution of the Purchase Order.” However, there is no explanation provided of the “alignment.” In fact, none of the definitional changes are necessary in order to achieve the stated objective of extending the purchase order for an additional two years under the existing terms and conditions or to “align” the Purchase Order to “new water programs.” The extension of the purchase order commitment could be accomplished simply by *amending* Section 4122 and the Purchase Order to reflect a “twelve-year” instead of a “ten-year” rolling average of deliveries of water (subject to adding one additional board policy change noted below).

Instead of presenting this simple amendment, however, an “amendment and restatement” of the Purchase Order is proposed. A contract amendment does not replace the whole original contract (just the part that’s changed by the amendment, here, a simple change from ten-years to twelve-years). Only when a contract requires extensive changes is it the common practice to create an entirely new agreement in the form of an “amendment and restatement.”

For example, a number of terms that are not defined in Metropolitan’s Administrative Code or included in its cost of service analysis are used in the new form of Purchase Order (e.g., “non-interruptible System Water supplies,” and “Recharge and Recovery Operating Agreement

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

Mr. Foley and Members of the Board

October 8, 2012

Page 2

water,” among others). The edits to the definitions are unnecessary and whatever the intent, the proposed amendments are inconsistent with the explanation being provided by staff that the Purchase Orders are being extended under the “existing terms and conditions.”

Finally, while staff has included a number of unexplained changes to the form of the Purchase Order, it has left out the only policy change that has actually been adopted by the board of directors. That is that any member agency may withdraw and terminate its Purchase Order commitment upon the payment of a \$5,000 administrative withdrawal fee. See November 8, 2011 Board Memorandum 8-3, adopted by the board on the same date. This provision should be included in the amended Purchase Order commitment.

In closing, we reiterate the concerns expressed in our September 10, 2012 letter to you RE Update on Rate Refinement (Board Information Item 7-b) (copy attached) including the inefficacy of Metropolitan’s Purchase Orders to achieve the objective of securing a revenue stream sufficient to pay Metropolitan’s costs, or, to provide a reasonable basis for the planning and provision of long term capital facilities and water supply programs. Metropolitan’s staff has acknowledged that Purchase Orders do not achieve these objectives, and yet, these critical financial decisions are being deferred for another two years. We are troubled by the continued spending patterns and practices at Metropolitan which do not provide sufficient fixed revenues at the same time the member agencies and board members are unable to agree how these fixed costs will be paid for over the long term. The trend and signals that we see are that Metropolitan’s member agencies intend to purchase less, not more water from Metropolitan. The continued spending could result in substantial stranded costs as well as massive rate hikes that would be necessary to pay for these programs with a declining sales base.

We assume other agencies will be required to obtain the approval of their governing boards. Our recommendations to the Water Authority’s board of directors will be as described in this letter.

Sincerely,



Keith Lewinger
Director



Fern Steiner
Director



Doug Wilson
Director

Attachment

cc: San Diego County Water Authority Board of Directors



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

September 10, 2012

John V. Foley, Chairman
and Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Update on “Rate Refinement” (Board Information Item 7-b)

Dear Mr. Foley and Members of the Board:

The board will be receiving yet another abbreviated, non-substantive report on “Rate Refinement” at this month’s board meeting. This month, staff is recommending a two-year extension of the Purchase Orders in spite of the fact that, less than two months ago, staff had concluded and reported to the board that the use of Purchase Orders failed to meet the board’s articulated objective of providing for an annual assured revenue stream sufficient to pay Metropolitan’s costs.

Staff recommendation, apparently driven by the continued unwillingness of the member agency managers to make any financial commitments to pay Metropolitan costs, is to once again “punt” any further board deliberation or discussion until 2013. This month’s power point presentation – the only information being provided to the board of directors – says that there just isn’t enough time to evaluate the most recent new idea to pay for Metropolitan projects, even though the discussions have been underway since mid-2007. Extension of the Purchase Orders creates the appearance of an interim solution but is in substance, nonsensical.

“Shifting” discussions about discounted water sales to the Water Planning and Stewardship Committee will not change the fact that there are important fiscal implications from the sale of discounted water that must be, but are not presently accounted for in Metropolitan’s cost of service. Indeed, no replenishment service was included in the biennial budget or taken into account in setting water rates and charges adopted by the board for the 2013 and 2014 fiscal years. Changing the label on or process to secure discounted water will not change the fact that there are cost of service and water rate implications that are required to be addressed by the board as part of its rate-setting process.

Finally, “Rate Refinement” is an artifice. This lingo, as well as other “housekeeping” and Administrative Code changes have all been designed to perpetuate the myth that Metropolitan’s “rate structure” has remained unchanged. In the final analysis, the facts will *A public agency providing a safe and reliable water supply to the San Diego region*

Mr. Foley and Members of the Board

September 10, 2012

Page 2

Speak for themselves and there will be no question but that there have been and continue to be implemented by Metropolitan, board actions that affect how Metropolitan's costs are being paid without regard to who benefits.

Attached is a copy of our July 9, 2012 letter regarding Update on Rate Refinement Discussions, along with Director Wilson's August 16, 2012 letter to the Chief Financial Officer, which we incorporate by reference. While we were surprised by the CFO's recent letter advising Director Wilson that all of these issues had been presented by the professional staff and discussed by the board, we will review our notes to see if there are board memoranda we have overlooked or meetings we have failed to attend and will be back in touch with you on that point.

Sincerely,



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director



Doug Wilson
Director

Attachment 1: Letter regarding Rate Refinement, July 9, 2012

Attachment 2: Letter from Director Wilson to Chief Financial Officer, August 16, 2012



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

July 9, 2012

Jack Foley
Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

RE: Update on Rate Refinement Discussions (Finance & Insurance Committee Item 7-a)

Dear Mr. Foley:

We have reviewed the PowerPoint presentation to the Finance & Insurance Committee, item 7-a, July 9, 2012 RE Update on Rate Refinement Discussions (the PowerPoint). After waiting more than five years – since the Long Range Finance Plan (LRFP) subgroup of member agency managers was formed in mid-2007 to discuss Metropolitan's Long Range Finance Plan and "Rate Refinement" – we believe the recommendations described in the PowerPoint fail to address the right priorities or solutions for Metropolitan.

Metropolitan's revenues have been insufficient to pay its expenses in five out of the last six years. Revenue stability and certainty should be a priority, and we agree with the belated conclusion now reached by Metropolitan staff and the member agency managers that the use of purchase orders has failed to meet this board objective over the past ten years. During this time, Metropolitan's fiscal stability has continued to deteriorate. "Use of the current rate structure" (however that is defined) will not address Metropolitan's need for revenue stability and cannot be relied upon to ensure that there will be a source of revenue for the multi-billion investments in the Delta and otherwise that Metropolitan is planning to make.

Rather than accepting the narrow "priorities" identified by staff and the member agency managers, we request that a board workshop be scheduled as part of next month's Finance & Insurance Committee meeting to consider the elements and priorities of a Long Range Finance Plan for Metropolitan – a plan that is now long overdue. Metropolitan should not continue to spend money on water supply projects without evidence describing the need for these projects, and its member agencies unwilling to pay for them over the long term. We ask that the subject of take-or-pay contracts be considered by the board of directors, along with any and all other proposed alternatives to reasonably ensure Metropolitan's recovery of sufficient revenues to pay its future costs and avoid stranded investments.

At a workshop, the board could consider all issues associated with a Long Range Finance
A public agency providing a safe and reliable water supply to the San Diego region

Mr. Foley
July 9, 2012
Page 2

Plan, including whether there is any support for ad valorem tax increases and any staff proposals to address the appropriate allocation of all standby service costs (not just treated water). We have distributed to the managers and attach to this letter a slide that depicts projected dry-year peaking by the Los Angeles Department of Water and Power, based on its Urban Water Management Plan. The staff's recent recommendation that all member agencies "share" this cost is not acceptable to the Water Authority because these costs are required to be charged to and paid by the member agencies that benefit from Metropolitan's expenditures to provide this service. The Water Authority expects to pay the costs associated with its own peaking – as all agencies should – but cannot and will not ask our ratepayers to "share" the costs of providing service to other agencies.

We ask that the board of directors take this issue up at the proposed workshop along with all other issues proposed for consideration by members of the board.

Sincerely,



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

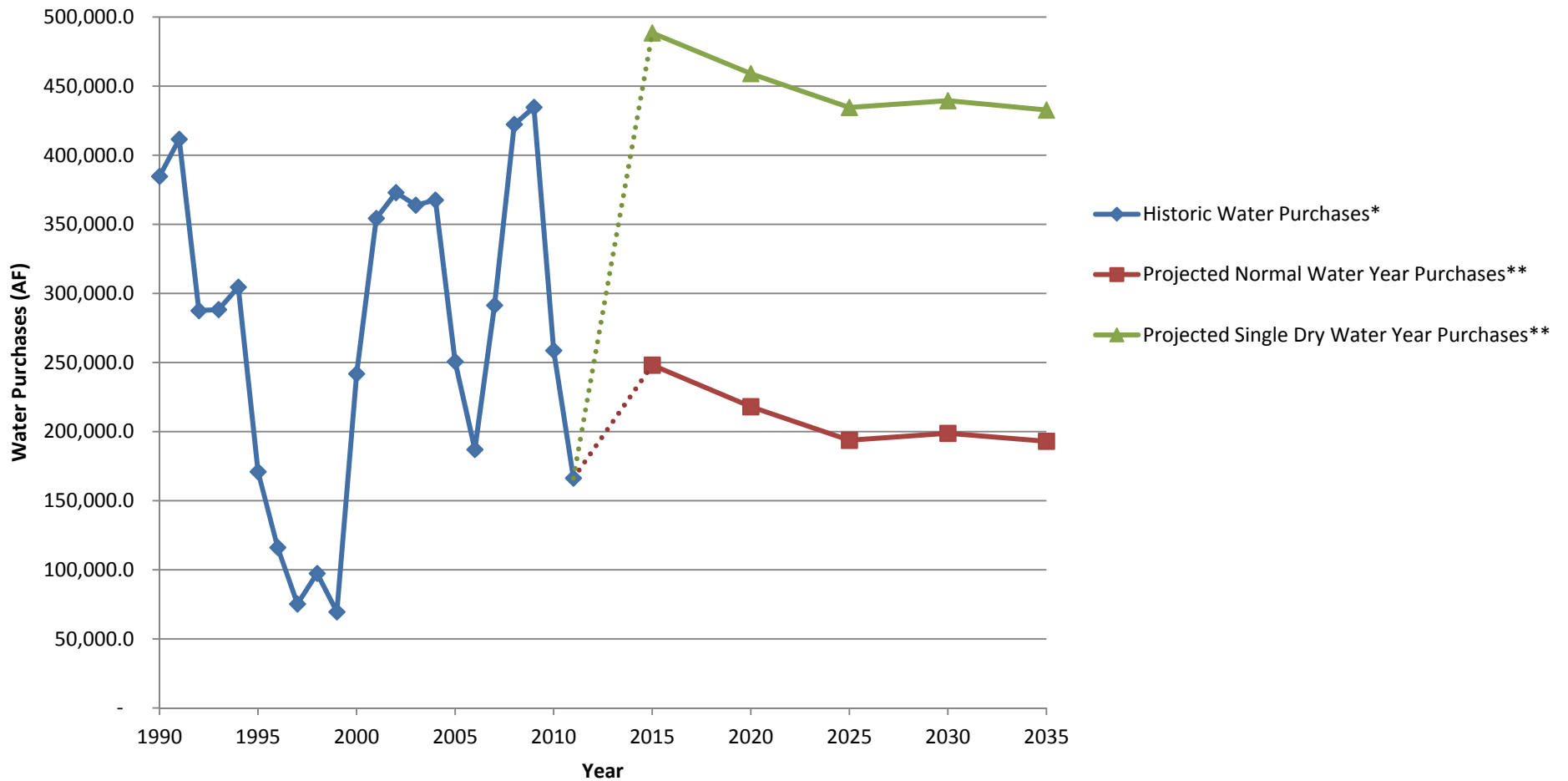


Doug Wilson
Director

cc: Metropolitan Board of Directors

Attachment: LADWP Historic & Projected Water Purchases from MWD

LADWP Historic & Projected Water Purchases from MWD



*Source: MWD Online Operations (1990-2007) and WINS Table A Report (2008-2011)

**Source: LADWP 2010 Urban Water Management Plan



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 16, 2012

Gary Breaux
Chief Financial Officer
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

Re: Rate Refinement Workshop

Dear Gary,

I wanted to give you some of my thoughts on the issues the rate refinement board workshop should include on MWD's finance plan and water rates. The "big picture" was described in the July 9, 2012 letter the San Diego board members sent to Chairman Foley requesting the workshop. That letter included concern for MWD financial stability given the high fixed costs versus low fixed revenues and questions how MWD will ensure sufficient revenues to pay its future costs and avoid stranded investments. Chairman Foley indicated that a workshop would be held. To assist in your preparation for the workshop, I went back through some of the other letters we have written to MWD on issues of concern and I thought it might help you to provide a short list of some of the key questions.

1. How can MWD execute a long term contract for the BDCP unless it has an assured source of revenue to make the payments?
2. Are ad valorem tax increases on a regular basis a real possibility? If so, what steps need to be taken to advance that approach? And, could this be the realistic solution to fund the BDCP?
3. Will the member agencies agree to sign take-or-pay contracts? If not, isn't MWD being asked to carry all of the risk of stranding the BDCP and other investments? Is that a reasonable risk for our board to agree to assume?
4. What will happen if MWD's sales continue to decline at the same time we continue to embark on new projects? How will MWD's liabilities be paid? What legal mechanism exists to recover stranded costs? Will MWD be required to sign so-called "step up" agreements on the remaining ratepayers could have to cover if the other State Water Contractors default?
5. Are peaking costs being adequately charged and collected under the current rate structure? With so many MWD costs being incurred to meet dry-year peaking demands (not just for treated water), what mechanisms can MWD put in place in order to send the right price signal to ensure that agencies generating peaking costs are in fact paying those costs? Our calculations show that the current capacity and RTS charges do not fully recover these peaking costs.
6. In light of reduced sales projections, does it make sense for MWD to continue to pay its member agencies to NOT buy MWD water?

Mr. Breaux
August 16, 2012
Page 2

7. Given that the 20% by 2020 requirement is a retail requirement, and that MWD sales are down by more than 30%, does it make sense for MWD to continue to make current investments in water conservation? Or, should it defer those investments until sales begin to improve? Why hasn't our adaptive IRP adapted to reduced sales?
8. If MWD is going to make additional investments in water conservation, shouldn't it reduce the amount of money it is spending on other water supplies by a like amount?
9. How will MWD ensure that its revenues are in fact sufficient to meet its operating expenses over the next five years? At my local agency at Padre Dam, we call this "living within the household budget". That is to say that expense is reduced to match the long term revenue stream, not the reverse.
10. What are the risks associated with projecting water sales based on "average" pricing? Will groundwater agencies buy as much water from MWD if it isn't discounted? Will other agencies pay more in order to subsidize discounted water sales especially as agencies develop new local supplies reducing their dependence on Met?
11. Given all of the changed circumstances, including the increasing cost of MWD water, is it reasonable to rely on historical data in projecting future water sales?

There are other issues and questions but this is a pretty good list of the issues I see that the Water Authority has raised over the past couple of years. We look forward to working with you and our fellow board members to ensure MWD's future and long term fiscal sustainability.

Sincerely,



Doug Wilson
Director

Attachments (without original enclosures):

1. July 9, 2012 re: Update on Rate Refinement Discussions
2. July 22, 2012 re: Board item 8-3 (LRP)
3. May 7, 2012 re: Board item 8-4 (conservation program)
4. March 21, 2012 re: Recommendation to cap MWD rate increases at 3%
5. March 12, 2012 re: LRPs
6. February 13, 2012 re: Board item 8-2 (draft remarketing statement)
7. February 3, 2012 re: Biennial budget
8. December 13, 2011 re: SB60
9. November 4, 2011 re: Board item 8-8 (discounted replenishment program)
10. October 25, 2011 re: KPMG audit report
11. October 7, 2011 re: WP&S items
12. August 22, 2011 re: Draft official statement
13. August 16, 2011 re: Member agency willingness to sign take-or-pay contracts
14. May 6, 2011 re: Board item 5-2 (sale of discounted water)
15. December 9, 2010 re: Draft official statement
16. September 22, 2010 re Draft official statement



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

July 9, 2012

Jack Foley
Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

RE: Update on Rate Refinement Discussions (Finance & Insurance Committee Item 7-a)

Dear Mr. Foley:

We have reviewed the PowerPoint presentation to the Finance & Insurance Committee, item 7-a, July 9, 2012 RE Update on Rate Refinement Discussions (the PowerPoint). After waiting more than five years – since the Long Range Finance Plan (LRFP) subgroup of member agency managers was formed in mid-2007 to discuss Metropolitan's Long Range Finance Plan and "Rate Refinement" – we believe the recommendations described in the PowerPoint fail to address the right priorities or solutions for Metropolitan.

Metropolitan's revenues have been insufficient to pay its expenses in five out of the last six years. Revenue stability and certainty should be a priority, and we agree with the belated conclusion now reached by Metropolitan staff and the member agency managers that the use of purchase orders has failed to meet this board objective over the past ten years. During this time, Metropolitan's fiscal stability has continued to deteriorate. "Use of the current rate structure" (however that is defined) will not address Metropolitan's need for revenue stability and cannot be relied upon to ensure that there will be a source of revenue for the multi-billion investments in the Delta and otherwise that Metropolitan is planning to make.

Rather than accepting the narrow "priorities" identified by staff and the member agency managers, we request that a board workshop be scheduled as part of next month's Finance & Insurance Committee meeting to consider the elements and priorities of a Long Range Finance Plan for Metropolitan – a plan that is now long overdue. Metropolitan should not continue to spend money on water supply projects without evidence describing the need for these projects, and its member agencies unwilling to pay for them over the long term. We ask that the subject of take-or-pay contracts be considered by the board of directors, along with any and all other proposed alternatives to reasonably ensure Metropolitan's recovery of sufficient revenues to pay its future costs and avoid stranded investments.

At a workshop, the board could consider all issues associated with a Long Range Finance
A public agency providing a safe and reliable water supply to the San Diego region

Mr. Foley
July 9, 2012
Page 2

Plan, including whether there is any support for ad valorem tax increases and any staff proposals to address the appropriate allocation of all standby service costs (not just treated water). We have distributed to the managers and attach to this letter a slide that depicts projected dry-year peaking by the Los Angeles Department of Water and Power, based on its Urban Water Management Plan. The staff's recent recommendation that all member agencies "share" this cost is not acceptable to the Water Authority because these costs are required to be charged to and paid by the member agencies that benefit from Metropolitan's expenditures to provide this service. The Water Authority expects to pay the costs associated with its own peaking – as all agencies should – but cannot and will not ask our ratepayers to "share" the costs of providing service to other agencies.

We ask that the board of directors take this issue up at the proposed workshop along with all other issues proposed for consideration by members of the board.

Sincerely,



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

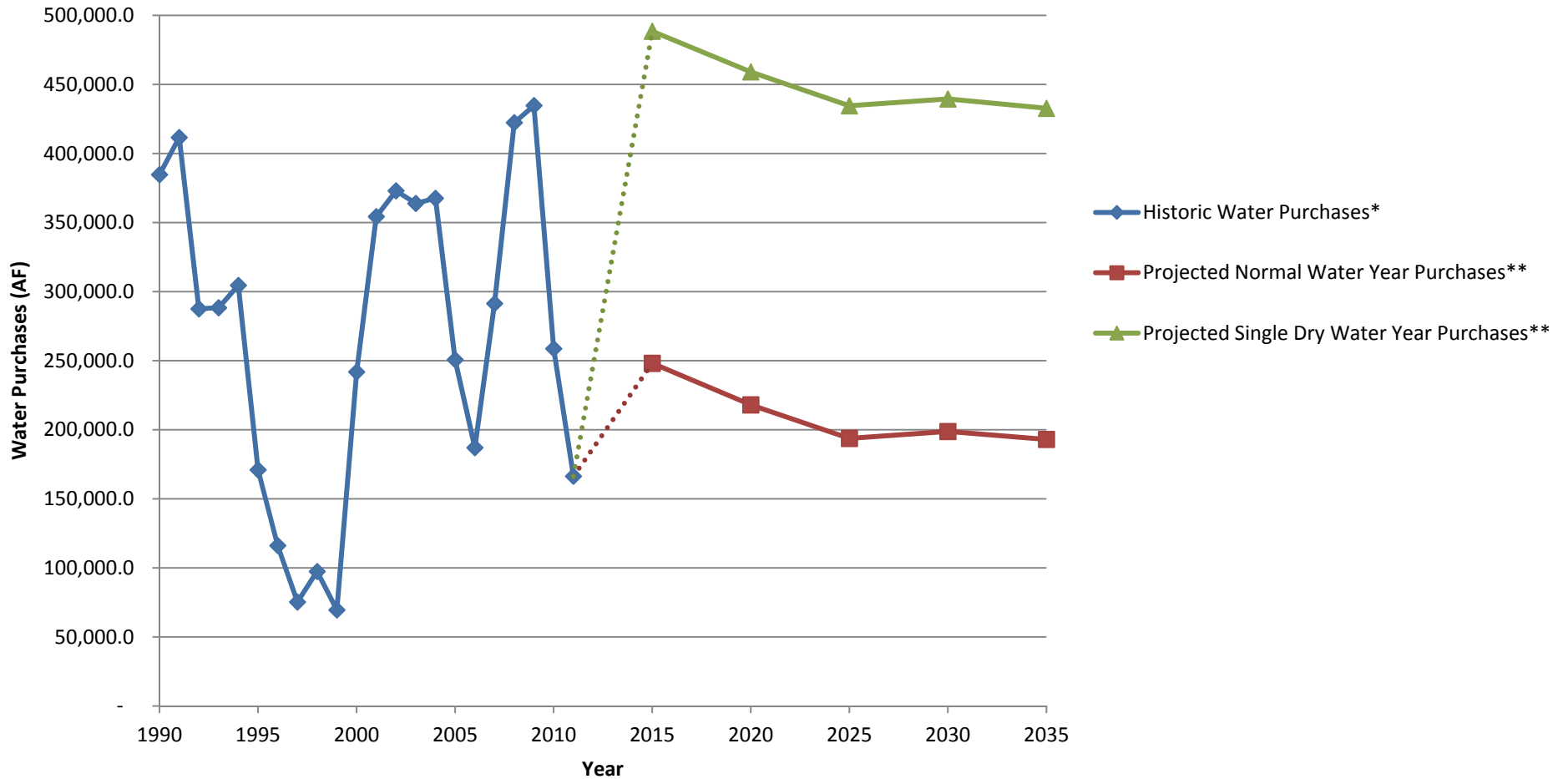


Doug Wilson
Director

cc: Metropolitan Board of Directors

Attachment: LADWP Historic & Projected Water Purchases from MWD

LADWP Historic & Projected Water Purchases from MWD



*Source: MWD Online Operations (1990-2007) and WINS Table A Report (2008-2011)

**Source: LADWP 2010 Urban Water Management Plan



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

June 11, 2012

John V. Foley, Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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 Item 8-3 -OPPOSE

Authorize entering into a Local Resources Program agreement with Municipal Water District of Orange County and the city of San Clemente for the San Clemente Recycled Water System Expansion Project. (WP&S)

Mr. Foley and Members of the Board,

The Water Authority OPPOSES Board Item 8-3 on the following grounds:

Under California law including Proposition 26, MWD is required to set water rates that do not exceed the reasonable costs of providing the particular service for which the rate is charged, and that are equitable, fair and non-discriminatory. MWD has failed to present in Board Memo 8-3, by reference to its outdated Integrated Resources Plan (IRP), even more outdated 2007 LRP “target” or otherwise, any showing that MWD’s payments for this local water supply project will benefit any ratepayers other than those of the city of San Clemente, which will own the water supply. There is no demonstration that any water supply or transportation costs are avoided by MWD as a result of these payments. The bald assertion in Board Memo 8-3 that, “*the project would strengthen regional water supply reliability*” is insufficient to meet the requirements of California law.ⁱ

Far from benefitting ratepayers of other member agencies, MWD’s continued payment of these subsidies under current circumstances *harms* all other MWD water ratepayers by further reducing demand for MWD water, thereby reducing MWD’s own revenues and driving up the cost of its water purchased by customers of other MWD member agencies. Moreover, MWD staff’s continued recommendations to approve subsidy agreements is inconsistent with its own actions months ago to suspend its “Local Resource Development Strategy Task Force” in order to reexamine the merits of the program and the water demand projections upon which it is based.

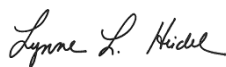
MWD’s expenditures have exceeded its revenues in three out of the past four yearsⁱⁱ because water sales are down by more than 30% since the 2010 IRP was adopted, let alone the 2007 LRP “target” for local resources development. Rather than respond to these changed circumstances (consistent with the IRP’s articulated “adaptive management”), MWD is consciously choosing to rely on outdated water supply and financial planning that assume bloated water demands that do not exist and are not reasonably projected to exist in the foreseeable future.

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

In addition to these grounds, the Water Authority objects to being charged a "Water Stewardship Rate" (WSR) to pay for this project because its ratepayers have been barred by the MWD board's August 2010 action from receiving any WSR benefits. Accordingly, the WSR is discriminatory, violates California law and may not be collected from the Water Authority's customers.

As part of the lawsuit it has filed challenging MWD's 2013 and 2014 water rates, the Water Authority is seeking to be relieved of any financial responsibility for this and other WSR projects approved by the MWD board of directors, so that the agencies that do not object may pay for these projects. As stated previously, the Water Authority has no objection if other MWD member agencies want to "pool" their money, however, that activity must be voluntary and not part of the water rates imposed by MWD on the ratepayers of all of its member agencies.

Sincerely,



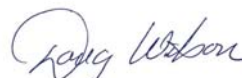
Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director



Doug Wilson
Director

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

ⁱ Attachment 3 to Board Memo 8-3 states in a footnote that, "IRP studies show reduced long-term costs to the region when local resources are developed due to downsizing or deferral of Metropolitan's capital improvements, reduction in operating costs for importation, treatment and distribution, and reduction in costs for developing alternative regional supplies. These benefits are realized by all Metropolitan member agencies through improved regional water supply reliability." However, there is no evidence to support this broad claim, which is insufficient in any case to meet the requirements of California law including but not limited to Proposition 26.

ⁱⁱ See February 14, 2012 Board Letter 8-2, page 60, note 5.



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

May 7, 2012

John V. Foley, Chairman
and Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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 8-4 – OPPOSE
Authorize changes to water conservation incentives (subsidies) as described

Dear Mr. Foley:

The Water Authority and its member agencies have a long and proud record of leadership in water conservation planning and implementation, based on strategic initiatives that will continue to reduce the region’s reliance on imported water supplies at an affordable cost. Given MWD’s role as a supplemental wholesale water provider – and taking into account the state mandate for 20% water conservation by 2020 at the retail level – the San Diego delegation does not support Agenda Item 8-4, to provide additional “incentives” to encourage water conservation. We have written to you and the board many times on this subject (reference to past correspondence is included below but not attached), so we provide only the following brief summary of the basis of our analysis.

Due to reduced demand for MWD water – and associated higher water rates – there is no need for MWD to pay subsidies to encourage water conservation at the wholesale level.

Water sales are already down at MWD by more than 30%. When sales are reduced, water rates go up as ratepayers are forced to pay more for using less water. As outlined in our March 21 letter to you and the rest of the board, it is time to stop punishing water use efficiency efforts by Southern California ratepayers who are already paying for water use efficiency programs at the retail level to meet the 20x2020 mandate.

The Water Stewardship Rate which is collected to pay for MWD conservation subsidies violates California law. The Water Stewardship Rate does not fairly apportion or reflect the actual, reasonable and proportionate costs of the services for which the rate is imposed. The Water Stewardship Rate violates the legal requirements of MWD’s principal act, Proposition 13 and the statutes implementing it, Government Code § 54999.7, the California common law of utility rate-making and Proposition 26. The Water Authority has provided MWD with detailed analyses by expert consultants establishing that the Water Stewardship Rate is legally defective.

OTHER REPRESENTATIVE

County of San Diego

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

Mr. Foley and Members of the Board

May 7, 2012

Page 2

The so-called “Rate Structure Integrity” clause adopted and imposed on the Water Authority by the MWD board of directors precludes any possible benefit to San Diego ratepayers from many MWD conservation programs. The board memorandum does not disclose that San Diego ratepayers are precluded from participating in MWD subsidy programs to the same extent as other MWD member agencies. We request that you include information in future board memoranda to fully disclose that information.

From a water resource planning, budget and policy point of view, we strongly encourage MWD to develop and implement a water conservation program that is better suited to its role as a wholesale water provider, that is based upon a calculable demonstration of need and avoided water supply cost (e.g., reduced take from the Delta, elimination of subsidies for member agency seawater desalination, etc.). Unfortunately, rather than viewing water use efficiency as a key part of its water resource plan and cost containment strategy – as recommended by the Water Authority for many years and by NRDC in its April 6, 2012 letter to you – MWD continues to limit itself to subsidy programs that are more appropriate at the retail level where the statewide conservation mandate has been imposed.

Sincerely,



Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

cc: Ed Osann, NRDC Senior Policy Analyst

Past correspondence to MWD RE water conservation programs and subsidies:

- August 16, 2010 letter on MWD staff analysis on opt-in/opt-out conservation program
- November 29, 2010 comments on MWD draft Long Term Conservation Plan (LTCP)
- July 20, 2011 comments on LTCP working draft Version 11
- August 15, 2011 letter opposing LTCP and revised policy principles
- November 13, 2011 letter RE turf replacement grant



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

March 21, 2012

John V. Foley, Chairman
and Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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: Recommendation to Cap MWD Rate Increases at 3% for 2013 and 2014

Dear Mr. Foley and Members of the Board,

We were disappointed that the majority of the MWD board of directors did not feel that it would be productive to meet together as a board to discuss approaches to lowering MWD’s proposed rate increases for 2013 and 2014, in advance of our board vote in April. As a result, we are submitting this letter to you and all members of the board for consideration prior to the April 10 board meeting.

RECOMMENDATION

We recommend that the board cap MWD “average” rate increases¹ at 3% for 2013 and 2014. We believe this can be accomplished – without any reduction of capital spending to maintain the Colorado River Aqueduct or any other MWD infrastructure – by reducing MWD’s Operations and Maintenance (O&M) expenditures by 10% and suspending conservation funding for the next two years. These changes would reduce the proposed two-year budget by \$116.5 million and allow the “average” rate increases to be capped at 3% or less in 2013 and 2014.²

Our recommendation would also direct staff to return to the board with specific budget reductions to accomplish the minimum 10% reduction in O&M (or, \$76.5 million in expenditures over the two years – without changing the scheduled OPEB funding).

OTHER REPRESENTATIVE

County of San Diego

¹ No one pays an “average” water rate at MWD – for example, MWD’s proposed Tier 1 Treated water rate increase for 2013 is 9.3%, and its Tier 1 Untreated water rate increase is 8.6%.

² Staff indicated previously that in order to reduce the rate increase from 7.5% for 2013 and 5% for 2014, to 5% for both years, it would need to cut expenditures by \$26.4 million over the two year period. Based on this formula, we assume that cutting expenditures by \$116.5 million (more than 4 times \$26.4 million) would allow the rate increases for both years to be held to 3% or less. If this assumption is incorrect, then we ask that MWD staff provide the board with the amount of the budget reduction necessary to hold rates to 3% or less over the next two years.

BACKGROUND

In its budget and recommended “average” proposed water rate increases of 7.5% and 5% for 2013 and 2014, respectively, MWD staff proposed to *increase* the O&M budget by \$15 million in 2013 and \$22.5 million in 2014, including higher travel expenses, staffing levels and consulting services. This budget proposal *increases* MWD’s O&M budget by \$52.5 million over the two years, and includes staffing increases of at least 42 or as many as 80 new employees.³

In response to board member requests to lower the first year “average” rate increase to 5%, staff recommended a mix of reduced expenditures (\$14 million and \$13 million, respectively for 2013 and 2014), reducing Central Valley storage funding and \$5 million per year reduction of conservation funding or other cuts of similar magnitude.

Staff’s recommended budget is inconsistent with MWD water sales and revenue trends, discussed below. It is also out of step with cities and other public water suppliers throughout Southern California that have been forced to make the difficult decisions to reduce expenditures as a result of declining revenues. Rate increases to support expanded budgets, including more staff and increased spending, ignore the economic realities our water ratepayers are facing. Budget reductions should target reduced spending rather than water supply programs such as the Central Valley storage funding.

DISCUSSION AND OTHER CONSIDERATIONS

Protection of Colorado River Aqueduct and Other Infrastructure – We agree it is important to maintain MWD infrastructure investments, including the Colorado River Aqueduct. *That’s why our proposal would leave intact all capital spending as proposed by staff.* But as we all know, repair and replacement of aging infrastructure is not the “No. 1 driver” of MWD’s proposed water rate increases.

Stop Punishing Water Conservation by Southern California Ratepayers – Water ratepayers across the Southland have responded to our call to reduce water usage over the past few years. Now, water ratepayers do not understand – and they are angry – that they are being asked to pay more for using less water.⁴ In fact, reduced demand for MWD water is the *principal reason* MWD’s rates have risen 75% since 2006, and the principal reason why MWD’s expenditures have

³ MWD’s January budget document states that it includes a total authorized personnel complement of 1,907 (including 24 temp equivalents) for 2012/13 and 2013/14, with an assumed vacancy rate of 2.7% and 2.9%, respectively. This translates to 1,832 and 1,828 FTE for each of the two years, respectively. But staff reported to the board in February that it had 1,756 employees on its payroll – which would mean that MWD intends to hire 80 additional staff. A subsequent report by staff at the February board meeting said that applying the vacancy rate would result in 1,798 full time equivalents (exclusive of temps), which would mean that MWD intends to hire 42 additional staff.

⁴ See, for example, San Diego County Grand Jury Report, *San Diego County Water Rates: High Today, Higher Tomorrow* at <http://www.sdcounty.ca.gov/grandjury/reports/2010-2011/WaterRatesFinalReport.pdf> This concern is being raised in retail water rate-setting proceedings across Southern California.

exceeded revenues in three of the last four fiscal years.⁵ However difficult it is to explain to water ratepayers, we all know that fixed costs are not reduced with reduced sales – and, that it is essential that fixed costs be paid. But MWD’s proposed rate increases go far beyond covering fixed costs – the budget actually *increases* spending on projects that are *not necessary* at this time of reduced demand for MWD water.⁶

This is why we recommend that conservation funding for the next two years be suspended.⁷ While we understand the popularity of these programs, these expenditures are simply not necessary to “incentivize” water conservation at a time when water sales are already down more than 30% at MWD and most retail water suppliers. Retail ratepayers are already being asked to fund the difference between fixed costs and the amount of revenue available from reduced sales. It isn’t fair – or even logical – to also ask our ratepayers to pay for even more water conservation right now – they need and deserve to take the “break” that suspension of these payments would provide in the form of lower water rates.⁸

Renewed Call for Moratorium on Use of MWD Ratepayer Dollars to Pay for Member Agency Water Projects – MWD has also been relying on its outdated Integrated Resources Plan⁹ and unrealistic water sales projections to support its continued payment of MWD water ratepayer dollars to subsidize member agency water supply projects. These projects are not owned or operated by MWD, and MWD has no right to the water supply. MWD has failed to demonstrate that these payments benefit the customers of any member agency other than the agency receiving the payments.¹⁰ The bald statement that these projects “will strengthen regional

⁵ February 14, 2012 MWD Board Letter 8-2, page 60, note 5 and attached Remarketing Statement.

⁶ Staff continues to rely on an outdated Integrated Resources Plan (IRP) and unrealistic sales projections to support its expenditures.

⁷ We note that although MWD continues to budget conservation at \$20 million annually, its actual expenditures are significantly less. This is all the more reason to eliminate this spending from the proposed budget.

⁸ MWD should continue its conservation program except for the payment of financial subsidies. The Water Authority supports increased water conservation as part of a sensible, long-term plan that takes water rate impacts into account. Ratepayers are already highly motivated to conserve water due to higher water prices. MWD should not pay for state-mandated conservation requirements at the retail level. See Director Steiner’s August 15, 2011 letter to Mr. Foley re: Board Memo 8-7 – Adopt the Long Term Conservation Plan and revised policy principles on water conservation – OPPOSE. Finally, the Water Authority would support increased conservation investments by MWD – now and in the future – that are based upon a calculable demonstration of need and avoided water supply cost (e.g., reduced take from the Delta).

⁹ See Director Steiner’s October 11, 2010 letter to Chairman Brick re: Adoption of the 2010 Integrated Resources Plan – OPPOSE and attachments. MWD’s IRP is not a useful or realistic planning tool and cannot be relied upon to assess the need for water supply investments by MWD (and thus the benefits to MWD’s customers). Although the IRP stated that it would rely upon “adaptive management” to adjust to changed circumstances, *MWD has failed to adapt* to the fact that its water sales are down by more than 30%. MWD has also consistently failed to inform the public about the rising cost of water or include in its own planning the likely impact of higher water costs on demand for MWD water.

¹⁰ If the Water Authority is successful in its challenge of the Water Stewardship Rate to pay for these water supply projects, the costs will be redistributed to all other MWD member agencies and fall

water supply reliability,” absent a substantial factual basis and analysis connecting the facts to the conclusion, is insufficient to support MWD spending under Proposition 26 or other legal requirements.

Stop Underwriting Peaking Costs of Los Angeles and Other Agencies – The Water Authority has calculated that the annual benefit to the City of Los Angeles Department of Water and Power under the current MWD rate structure – resulting from MWD’s failure to identify and allocate the costs of annual peaking – is \$35 million to \$40 million *per year*. *The Water Authority is not the only agency underwriting these costs – ratepayers from Orange County, Ventura County, Riverside County and San Bernardino County are also paying for LA’s annual peaking.* This is because the current rate structure fails to account for the costs associated with annual peaking, including the cost of water, distribution and storage capacity necessary to serve these sporadic annual demands.¹¹

Many agencies, including the Water Authority, have *some* annual and seasonal peaking that is not accounted for in MWD’s cost of service. These costs should be identified and charged to the agencies that are benefitting from the investments necessary to meet their water supply needs. We raised this issue in our February 3, 2012 letter to Business and Finance Committee Chairman Grunfeld, copied to MWD’s General Manager and Chief Financial Officer (copy attached). Nearly one month later, on March 6, 2012 – after the budget workshops had already been concluded – we received a response from the CFO that did not address the substance of this issue, but stated that, the issue “is worded as a statement or position and should be addressed through the Board or Committee process” (copy attached). On March 8, we responded to the CFO’s letter, again presenting this issue in the form of a question. We asked,

Does the MWD cost of service currently capture and charge to the agencies that benefit, the full costs of system “standby” capacity and supply that enables year-to-year (annual) peaking off MWD?

We still have not received a response from the CFO, from MWD management or from the Chairman of the Board or Chairman of the Business and Finance Committee. *Properly assigning these costs would result in additional water rate reductions for many ratepayers throughout MWD’s service area.* We ask that you support our request at the April board meeting that this issue be addressed through the board or committee process, as suggested by the CFO – and, that adoption of *rates* be deferred until the board receives a full explanation why these costs are not accounted for or properly assigned in MWD’s cost of service. By copy of this letter, we are also

disproportionately on the agencies – and their customers – that have not been rewarded with rich subsidy contracts.

¹¹ Staff’s February 17, 2012 presentation to the Member Agency Managers on the Proposed Biennial Budget, Revenue Requirements, and Water Rates and Charges Fiscal Years 2012/13 and 2013/14, slide 7, is incorrect. While it correctly states that additional physical capacity must be designed into the system and additional capital costs are incurred, and that these costs include portions of distribution and regulatory storage, it is incorrect in its statement that MWD’s capacity charge “recovers the costs of the system used to meet peak demands.” This is not accurate even as to seasonal peaking, let alone annual peaking, *which is not accounted for in MWD’s cost of service allocations.*

Mr. Foley and Members of the Board

March 21, 2012

Page 5

asking the General Counsel to advise us, in writing, whether she agrees with the CFO that the MWD board has the option, as a “policy” matter, to *not charge the cost of the services, facilities and supplies attributable to annual peaking to the agencies that benefit.*

SUMMARY

We urge the board to adopt a budget that caps the “average” rate increases at 3% for 2013 and 2014. Further, we recommend that the adoption of water rates and charges be deferred until MWD management has provided a cost of service analysis that properly accounts for and assigns all MWD costs – including the cost of annual peaking – to the agencies that benefit.

Sincerely,



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director



Doug Wilson
Director

Attachments:

1. Water Authority’s letter to MWD re biennial budget dated February 3, 2012
2. MWD response to Water Authority’s comment letter dated March 6, 2012
3. Water Authority’s response to MWD letter dated March 8, 2012

cc: Jeff Kightlinger, MWD General Manager
Gary Breaux, MWD Chief Financial Officer
Marcia Scully, MWD General Counsel
San Diego County Water Authority Board of Directors



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

March 12, 2012

John V. Foley, Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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: Oppose Local Resources Program Agreements – Board items:
7-4 – LADWP Chevy Chase Park and Los Feliz Golf Course
8-6 – LADWP Harbor Industrial Project
8-7 – LADWP Hansen Dam Golf Course
8-8 – LADWP Griffith Park
8-9 – Eastern MWD Landscape Irrigation
8-10 – West Basin MWD Seawater Barrier and Landscape Irrigation

Mr. Foley and Members of the Board,

We have reviewed the staff reports recommending board approval of six funding agreements under the Local Resource Programs (Board items 7-4, 8-6, 8-7, 8-8, 8-9, and 8-10). We oppose the use of MWD regional water ratepayer dollars to pay for these local supply projects of these member agencies, on the following grounds.

- 1) Preparation of the underlying data and cost of service and rate structure proposal purporting to justify these payments is the product of a broken governmental process, all as described in detail in the submittals the Water Authority has presented at the public hearing on MWD’s proposed water rates and charges for 2013 and 2014. As presented at the public hearing earlier this morning, the agencies that are the principal beneficiaries of these programs are draining millions of dollars from the pockets of water ratepayers in other cities and regions in favor of their own.
- 2) There is no credible basis established by the board memoranda or otherwise to support these payments. The mere statement that, *“the project(s) would strengthen regional water supply reliability”* is wholly insufficient to support the use of regional ratepayer dollars to pay for these agencies’ local water supply programs. Nor are these payments supported by any demonstration in the board memoranda or otherwise that these payments benefit anyone but the individual agencies to which payments are being made. There is no demonstration that any water supply or transportation costs are avoided by MWD as a result of these payments.

3) To the contrary, these payments harm all MWD water ratepayers by further reducing demand for MWD water and the revenues MWD depends upon for its very existence, and thus driving up the cost of MWD water supply for all other water ratepayers. MWD’s expenditures have

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

exceeded its revenues in three out of the past four years.¹ MWD's lower sales are driving up the cost of water. Customers are angry because they are being asked to pay more at the same time they are using less. Rather than respond to these circumstances, MWD is further exacerbating the situation by paying some of its member agencies to buy even less water. MWD's continued reliance on an outdated Integrated Resources Plan that includes bloated water demands that clearly do not exist – and are not reasonably projected to exist any time in the near future, if ever – is an insufficient basis to justify these payments.

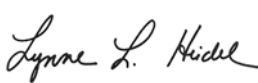
4) As of August 2010, the MWD board took action stating that the Water Authority is no longer eligible to receive funds collected through its Water Stewardship Rate. As a result, and because no other direct or indirect benefit to the Water Authority and its customers is demonstrated, the rates and charges violate California law and may not be collected from the Water Authority's customers.

5) Staff's recommendation to the board to approve these projects is inconsistent with its own action in the *public member agency process* to suspend further discussions with the Local Resource Development Strategy Task Force, in order to reexamine the merits of this program and the water demand projections upon which it is based. Until that examination is completed, consideration of all local resource projects should be suspended.

6) The board memoranda proposing funding for these projects are insufficient to inform the board of directors of the costs associated with these projects. For example, Board Letter 8-9 (Eastern Municipal Water District) states that MWD's share of the cost will be \$2.3 million, but that it could go up to \$31.3 million – almost 14 times higher. Similarly, Board Letter 8-10 (West Basin) states that the financial impact to MWD is \$7 million, but that it could go up to \$50 million – more than 7 times higher. The board has no way of knowing based on the Board Letters what the benefits and risks are, or what MWD's financial exposure in connection with these projects will be.

The Water Authority would have no objection if the other MWD member agencies and the cities and customers they serve wish to subsidize the local water supply projects of the City of Los Angeles and other large agencies benefitting from this program. However, if they wish to do so, a separate fund that they pay into should be created for that purpose.

Sincerely,



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director



Doug Wilson
Director

cc: Jeff Kightlinger, MWD General Manager

¹ See February 14, 2012 Board Letter 8-2, page 60, note 5.



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

February 13, 2012

Board of Directors
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

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

OTHER REPRESENTATIVE

County of San Diego

Re: Board Memo 8-2: Authorize the execution and distribution of Remarketing Statement in connection with the remarketing of the Water Revenue Refunding Bonds (Index Mode), 2011 Series A-1 and A-3, in the amount of \$128,875,000

Dear Chairman Foley and Board Members,

We have reviewed Board Memo 8-2 including Attachments. For reasons we have described in detail in prior correspondence concerning the sale of bonds by Metropolitan – as well as in recent correspondence regarding the proposed budget (Attachment 1) – we are not comfortable that the Remarketing Statement as drafted by Metropolitan allows us to meet our legal responsibilities in voting to approve the draft Remarketing Statement. We must therefore respectfully vote against the staff recommendation.

We understand the need for the remarketing. And, we acknowledge the edits Metropolitan made in response to our comments on the last draft Appendix A (Attachment 2). However, we do not believe the edits went far enough to ensure that information essential to making an informed investment decision is being presented in a manner that is not misleading. The draft Remarketing Statement does not correct these deficiencies. In summary, the principle (but not exclusive) areas of concern remain the following:

- Failure to sufficiently describe the changed circumstances that have resulted in reduced demand for Metropolitan water.
- Failure to adequately describe the impact on water sales of conservation requirements and higher water rates.
- Risk associated with Metropolitan’s inability to secure long term purchase contracts or legal equivalent from its member agencies.
- Risk to Metropolitan of its heavy reliance on water sales revenues to pay its fixed costs.
- Failure to adequately describe the risks and costs associated with uncertainly and volatility of water purchases by City of Los Angeles.
- Risk associated with projecting water sales based on “average” pricing.
- Failure to reasonably estimate future water rate increases, generally, and as associated with Metropolitan’s Integrated Resources Plan as adopted by the Board.

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

- Impact of Proposition 26 on setting water rates and charges.
- Failure to describe impacts resulting from the fact that Metropolitan expenditures have exceeded revenues in three out of the last four years.
- Undue reliance on historical data to predict future outcomes in the current, changed water supply and fiscal environment.

While we are aware and have taken into account that the draft Remarketing Statement includes a number of “disclaimers” in these and other areas, we are concerned that certain of these disclaimers could be challenged because they relate to matters that could or should have reasonably been known by Metropolitan and its Board of Directors.

We do not come to this decision lightly. If Metropolitan and the Board wish to work with us to address our concerns, we will provide detailed comments on the draft Remarketing Statement. We note that we have raised these concerns repeatedly in the context of many different board actions, without receiving a substantive response.

Sincerely,



Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

cc: Jeffrey Kightlinger, General Manager
Gary Breaux, Chief Financial Officer
San Diego County Water Authority Board of Directors

Attachments:

1. February 3, 2012 letter re: MWD Budget and Rates
2. August 22, 2011 letter re: Appendix A



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

February 3, 2012

Aaron Grunfeld
Business and Finance Committee Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

**OTHER
REPRESENTATIVE**

County of San Diego

Re: Proposed Biennial Budget and Associated Rates and Charges for 2012/13 and 2013/14

Dear Mr. Grunfeld:

First, we want to thank you for your commitment to hold budget workshops so the board may review, ask questions and understand the proposed budget.

We have reviewed staff's proposed biennial budget and associated rates and charges for 2012/13 and 2013/14, as well as the slides presented at the January workshop. Based on this preliminary review, we are providing you with the comments, requests and questions which are attached. In order to facilitate the board's deliberation of these issues, we request that staff respond to our comments and questions in writing prior to the next budget workshop.

We look forward to continuing this important dialogue at the next budget workshop.

Sincerely,

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

Attachment

cc: Jack Foley, MWD Board Chairman
Jeff Kightlinger, MWD General Manager
Gary Breaux, MWD Chief Financial Officer

MWD Budget Workshop #1 – January 24, 2012

San Diego County Water Authority (SDCWA)'s MWD Delegates' questions and comments on proposed biennial budget and associated water rates and charges for FY 2012/13 and 2013/14

All references are to Budget Memo 8-1 for the January 10, 2012 Board meeting or to the power point presentation at the January 24, 2012 budget and rate workshop.

1. The Board must take steps to “right-size” MWD in order to ensure that revenues – based on more reasonable demand projections – are sufficient to pay MWD’s costs.

- MWD’s water deliveries declined almost 500,000 acre feet over the last four years from 2.26 million acre feet (MAF) in 2008 to 1.68 MAF in 2012. Moreover, the 2012 delivery figures included 164,000 acre feet of San Diego County Water Authority’s (Water Authority) QSA transfer water and 225,000 of “one-time” discounted water sales that would not have occurred at full price. MWD’s 2010 Regional Urban Water Management Plan (RUWMP) shows its average year sales in 2030 will be 22% lower than projected in MWD’s prior RUWMP just five years ago. MWD’s sales projections are flat or trending downward and yet, the Board has taken no meaningful actions, in terms of programs or staffing, to reduce the expense side of the budget to reflect this dramatic reduction in MWD sales.
- What is basis of budget demand projections assuming full service sales of 1.5 MAF next year and in future years? The Board memo states that the sales estimate is “conservative,” yet, this assumption is 200,000 acre feet more than this and last year’s full service sales of 1.3 MAF.
- MWD has not covered its operating costs in six out of the last eight years (2004-2011). The first order of business must be to reduce spending, consistent with budget cuts already implemented by most of the cities and retail agencies in Southern California.
- Given that retail demand is down 20% or more across the MWD service area, we recommend a moratorium on all subsidy programs designed to further reduce MWD sales (and revenues). The moratorium should remain in place until MWD updates its IRP projections and conducts a comprehensive study to evaluate the need for MWD to pay for such programs. This recommendation should not be interpreted to suggest that the Water Authority does not fully support the development of local supply projects including increased water use efficiency, but rather, that funding should be at the local level.
- The budget notes that replenishment water will be sold at full service rates, however, it does not appear to account for the cost of “incentives” or “rebates” that are also part of the staff recommendation for a revised replenishment program. Please identify the amount and cost of service category to which these incentives or rebates are assigned. What rate is proposed to generate the revenue to pay the cost of these incentives or rebates?

2. MWD should reasonably spread cost burdens among current and future rate payers; it should not raid revenues intended for capital projects to pay operating expenses, and should not overburden future rate payers by deferring OPEB funding.

- The budget includes a reduction of PAYGo revenue collections in 2012/13 that is inconsistent with the Board’s adopted policy. If the Board approves this recommendation, MWD will have failed to follow its own PAYGo funding policy in eight out of the last ten years (2005-2014). Funding capital projects at such low PAYGo levels unfairly shifts obligations from current

MWD Budget Workshop #1 – January 24, 2012

San Diego County Water Authority (SDCWA)'s MWD Delegates' questions and comments on proposed biennial budget and associated water rates and charges for FY 2012/13 and 2013/14

ratepayers to future ratepayers. Moreover, several years of midyear reallocation of PAYGo funds intended for capital to meet operating expenses has distorted cost of service. The Board should not continue to apply revenues that are collected for capital projects to pay operating costs.

- The proposed budget continues to shift a disproportionate share of unfunded OPEB liability to future ratepayers. The funding schedule presented at the January workshop to begin ramping up payments to match MWD's Annual Required Contribution (ARC) does not go far enough. MWD should cut costs now in order to increase funding to match its ARC.
- A greater share of MWD's Capital Improvement Program (CIP) now consists of R&R projects. Indeed, the January workshop presentation showed R&R expenditures represent about two-thirds of CIP costs over the two years reviewed. Aside from the misuse of PAYGo to pay operating expenses, we would also suggest that the Board consider changing its PAYGo funding strategy so it is *proportionate* to the total CIP over time. This would ensure that current ratepayers are not being asked to pay a disproportionate share of R&R.

3. MWD must properly account for the cost of storing water.

Based on data assembled from the proposed budget, the supply and delivery balance is as followed:

Supply/Demand	2012/13	2013/14
State Water Project (Exchange)* Net to MWD	1,260 TAF (120 TAF) 1,140 TAF	1,140 TAF (108 TAF) 1,032 TAF
Colorado River**	727 TAF	890 TAF
Total supply to MWD service area	1,867, TAF	1,922 TAF
Total MWD demand**	1,700 TAF	1,700 TAF
Excess supply	167 TAF	222 TAF

*The budget document does not describe the exchange; if this is not MWD's exchange obligation with Coachella and Desert Water, please provide details.

**The budget document includes Water Authority's QSA water at 172.7 TAF and 177.7 TAF for 2012/13 and 2013/14, respectively, as both supply and demand. MWD does not report the local water supplies and associated demand of its other member agencies, and has no basis for treating Water Authority's QSA water differently. In accordance with the terms of the Exchange Agreement, the revenues generated from payments made under the Exchange Agreement should be treated as transportation or wheeling revenues.

- Staff reported at the workshop that it plans to store 300,000 acre feet of water this year, which is more water than is estimated to be available for storage in the supply and delivery balance. What is the source of the water staff is planning to store, and, how are the costs of that water captured in the cost of service? How much funding is included in the budget to pay for storage costs? Finally, is the energy cost of moving the water into storage being captured in the System Power Rate or through Supply Programs?

San Diego County Water Authority (SDCWA)'s MWD Delegates' questions and comments on proposed biennial budget and associated water rates and charges for FY 2012/13 and 2013/14

4. The cost of service does not recover the costs of system “standby” capacity and supply that enables year-to-year peaking off MWD.

- Many agencies peak off the MWD system from year-to-year, depending on hydrology and the availability of local water supplies. MWD has developed and continues to develop water supplies and incur storage and facility costs in order to meet these demands, but is not fully allocating the costs associated with these investments from the agencies that benefit from them. MWD must change its rate structure in order to account for and allocate these costs so that they are borne by the agencies that benefit by being able to peak and then roll off the MWD system.

5. The Delta Supply Surcharge should be continued because the purpose for which it was established by the Board has not changed.

- Please provide the basis of the staff recommendation to delete the Delta Surcharge. Given the rationale stated in Board Memo Revised 8-3 dated April 14, 2009, the Delta Surcharge should remain in place. In fact, the budget states at page three that increased funding is being included to aggressively pursue exactly the type of projects the Delta Surcharge was intended to cover.
- Was the Delta Supply Surcharge combined with the Tier 1 supply rate? If not, how were these costs reassigned?

6. Staff needs to provide more information why individual rate components are increasing or decreasing; and, take steps to better smooth rate increases at the retail level.

- The proposed individual rates and charges include changes that vary significantly from the “average” 7.5% increase staff reports. Since no agency pays “average” rates, information needs to be provided on why individual rates and charges are increasing or decreasing. Please provide the data supporting the System Access Rate increases. Also, please provide the data supporting the supply rate decrease.
- Staff should also explain why some elements show decreases one year and increases the next year – or vice versa, and, present alternatives to avoid swings in the rates and charges.

7. Staff must track all rate component costs and expenditures, not just the Water Stewardship Fund.

- MWD tracks over- and under- expenditures for revenues collected under Water Stewardship rate, but not others. What is the basis for this disparate treatment? For example, although MWD has a Treatment Surcharge Rate Stabilization Fund, when fund revenues are insufficient to pay those costs, MWD uses General Fund revenues to cover the difference. The net effect is that raw water customers are subsidizing treated water customers. We request that MWD provide a cost of service analysis for all rate components and identify or develop internal tracking mechanisms to prevent cross-subsidies.

MWD Budget Workshop #1 – January 24, 2012

San Diego County Water Authority (SDCWA)'s MWD Delegates' questions and comments on proposed biennial budget and associated water rates and charges for FY 2012/13 and 2013/14

8. All operations and staffing should be “right-sized” to reflect reduced demands.

- What were staffing levels and budget in 2008? What are they today?
- What criteria has staff used to “optimize” staffing levels?
- Are the staffing levels recommended in the budget higher than current actual levels? If so, why?
- Please provide a list of the O&M association dues that total \$5 million annually.

9. A contingency plan should be included in the proposed budget.

- The biennial budget should include a contingency plan that would automatically be triggered mid-year to reduce *current costs* in the event projected revenues are lower than budgeted.
- Similarly, the budget should provide a plan that describes in detail how MWD will apply excess funding in the event projected revenues exceed expenditures. This is especially important in light of the recent draw-down of reserves, raids on the PAYGo fund and cross-subsidies that have been created by the failure to track individual rate components – or to budget so that projected revenues are reasonably expected to be sufficient to pay MWD's expenses.

10. Even if it is unwilling to update or modify its cost of service analysis generally – which it should – MWD must at a minimum provide a new cost of service analysis to ensure compliance with Proposition 26.

- Even If the Board does not require staff to update or modify its cost of service analysis, or, support a moratorium on local projects spending to mitigate the impacts of reduced demands and MWD revenues, staff must identify the benefits it claims are associated with these payments and demonstrate that those benefits are received by those paying the charges and that the amount of the charge is reasonably related to the benefits. The benefits that have been stated but which have not been supported by any data or analysis include (1) capacity will be made available that is otherwise not available for the transportation of MWD water; (2) investments MWD would otherwise need to make in other facilities and/or water supply will be avoided as a result of these payments; and (3) MWD needs and will benefit from the local water supply it is paying for. Please provide the analysis required by Proposition 26.



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

December 13, 2011

John V. Foley
Chairman of the Board
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, CA 90054-0153

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: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD's Urban Water Management Plan
REQUEST TO INCLUDE INFORMATION IN REPORT TO LEGISLATURE

Dear Chairman Foley and Members of the Board of Directors:

We request that this letter and all of its attachments be made a part of today's board record and included in MWD's Annual Report to the Legislature regarding the adequacy of MWD's Urban Water Management Plan to achieve increased emphasis on cost-effective conservation, recycled water and groundwater recharge as described in the MWD Act.

As background to yesterday's public hearing on this subject, the Water Authority prepared and submitted to MWD a short PowerPoint presentation that was not allowed by Mr. Kightlinger to be shown to the board of directors. MWD staff also refused to distribute hard copies of the presentation to the board in accordance with the usual practice as stated on the speaker's request form; because of these refusals, San Diego Director Lewinger distributed the copies. We were not aware at the time of the hearing that the Water Authority's PowerPoint had already been loaded on the MWD computer, or we would have objected at that time. Water Authority staff was also informed yesterday that no presentations may be made to the MWD board unless they are first reviewed and approved by MWD management. We do not believe that MWD may place any such prior restraint on the content of material proposed to be presented at any public meeting of the MWD board of directors. As Chair, you undoubtedly know that the Brown Act expressly states that "a local agency shall not prohibit public criticism of the policies, procedures, programs, or services of the agency, or the acts or omissions of the legislative body." (Government Code § 54954.3 (c).)

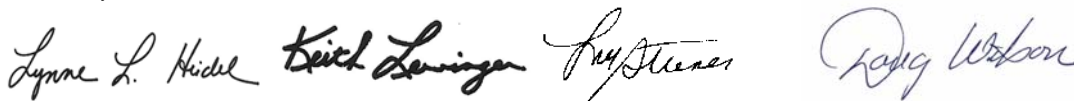
Copies of the Water Authority's PowerPoint presentation, written testimony by Assistant General Manager Dennis Cushman and a report by Gordon Hess and Associates titled, *Comparison of MWD Demand Projections, Member Agency UWMPs and Local Water Supply Development Plans* (Hess Report), are attached. As you know, for the reasons described in Mr. Cushman's testimony and attachments, we believe that MWD focused on the wrong question at yesterday's public hearing and in its draft Report to the Legislature by limiting it to a report on MWD subsidy programs.

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

We also request that MWD inform the Legislature about its "Rate Structure Integrity" (RSI) "policy" and clause, which may be used by MWD to terminate all MWD funding agreements for conservation, recycled water and groundwater recharge in the event that agency challenges MWD's water rates in court or before the Legislature. Further, MWD should include in its SB 60 report that the MWD board has, in fact, terminated, with limited exception, all of the Water Authority's funding agreements that contain the RSI provision, and refused to enter into future funding agreements supporting conservation, recycled water and groundwater recharge in San Diego County. (A copy of MWD's June 23, 2011 to the Water Authority is attached.) MWD has essentially blackballed the Water Authority from participation in these programs, in spite of the fact that it continues to collect more than \$16 million annually from San Diego County water ratepayers to pay for these programs. MWD should also inform the Legislature that the Water Authority is challenging MWD's actions and the constitutionality and legal propriety of the RSI clause in the lawsuit now pending in Superior Court in San Francisco.

For the reasons described in Mr. Cushman's testimony and in the Hess Report, we do not believe that MWD has done the analyses necessary – either in its 2010 Integrated Resources Plan (IRP) or 2010 Regional Urban Water Management Plan (RUWMP) to support and enhance water conservation, recycled water and groundwater recharge in Southern California. Indeed, the greatest impediment may be the very perpetuation of the notion that these projects will only be developed if MWD subsidizes them. Conservation is at an all-time high throughout the Southland as a result of the higher water rates being charged by MWD and its member agencies. More local water supply projects are being developed because they have become cost-competitive due to the higher water rates being charged by MWD. It is clearly time for a fresh and realistic look at MWD's demand and rate projections and to tie future resource planning directly to the willingness and firm financial commitment of its member agencies to pay.

Sincerely,



Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Doug Wilson
Director

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

Attachments:

1. Water Authority's PowerPoint Presentation to MWD WP&R dated December 12, 2011
2. Water Authority Assistant General Manager Dennis Cushman's testimony
3. Comparison of MWD Demand Projections, MWD Member Agency UWMP's and Local Water Supply Development Plans, prepared by GH&A, Inc. December 2011
4. MWD June 23, 2011 letter to Water Authority



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

November 4, 2011

John V. Foley
Chairman of the Board
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

Re: Board Memo 8-8 –
Approve Policy Principles for a Replenishment (Discounted Water) Program

Dear Chairman Foley,

Board Memo 8-8 asks the board to approve policy principles to guide the development of a new program for the sale of discounted water. We do not believe that the policy principles as proposed by staff provide a sufficient and clear basis to guide the development of a new program. Indeed, we do not believe that the staff has established the need for a new program to sell discounted water, whether it is described as “replenishment,” “regional water management,” or otherwise.

We have raised a number of questions over the past several months, since the General Manager first proposed the sale of discounted water last April. Our concerns have focused on the unprecedented budgetary and fiscal challenges confronting Metropolitan, including the fact that its expenditures have exceeded revenues in six out of the last nine years. Over the last four years, Metropolitan has resorted to raiding funds intended for pay-as-you-go capital expenditures in order to meet normal operational expenses. The discounted water program is a concern because when Metropolitan sells water at a discount, it displaces full-rate water sales, which in turn leads to lower revenues overall and insufficient recovery of fixed costs..

While the staff continues to bring back recommendations based on the wishes of the member agencies, it has failed again to address the needs of Metropolitan. We understand why the member agencies would like Metropolitan to sell them water at a discount, what we do not understand is how the Metropolitan staff proposes to ensure benefit to all member agencies when discounted water is sold to some, or, how Metropolitan will be in a position to reverse its declining financial condition through the sale of discounted water.

The analysis provided in Board Memo 8-8 fails to address the very concerns raised by staff in its April 26, 2011 Board Memo (5-1) that first recommended reinstating the sale of discounted water. Those concerns included – and remain:

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

- Questionable and unquantifiable performance criteria for a discounted water program;
- Loss of full service sales due to availability of discounted water;
- Unequal distribution of costs and benefits among member agencies; and
- Cash flow and budget issues associated with availability of discounted water.

The staff has also failed to respond to questions about Metropolitan's existing storage programs or the assumptions it is making about the use of that storage in the future. As a result, there is no basis for determining either the need for, or benefit of another new program.

We are attaching our past communications to the board on this subject. We request that staff respond, in writing, to the questions asked in our letters. Doing so would provide the board with a sound foundation to discuss the real policy principles involved in the proposed sale of discounted water. We would appreciate a written response to our letters in any event because they raise issues and concerns of great interest to our member agencies and water ratepayers.

Sincerely,



Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

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

Attachments:

1. April 25, 2011 letter to Jack Foley re: Board Memo 5-1 – Sale of Discounted Water and Attachment 1: Issues Associated with the Sale of Discounted Water by MWD
2. May 6, 2011 letter to Jeff Kightlinger re: Board Memo 5-1 – Sale of Discounted Water
3. September 12, 2011 Comments and Questions on Board Memo 9-2 – Update on Replenishment Service Program, Director Keith Lewinger
4. October 7, 2011 letter to Jack Foley re: Water Planning and Stewardship Committee Items 6a, 6b, and 6d



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

October 25, 2011

Jack Foley, Chairman
Metropolitan Water District of Southern California
PO Box 54153
Los Angeles, CA 90054-0153

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
- Oliverheim Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Romona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallécitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuma Municipal Water District

Re: KPMG Audit Report of MWD's Basic Statements for Years ended June 30, 2011 and 2010

Dear Chairman Foley:

The Auditor's report states that it is prepared in accordance with Government Auditing Standards. Though these standards do not require the presentation of budgetary information for Enterprise funds, it would be extremely helpful for this information to be presented as supplemental information in the Comprehensive Annual Financial Report (CAFR) following the notes to the financial statements, so it could provide a context for evaluating evidence and understanding of findings, conclusions and recommendations in the report.

Referring to page 13, the information on future debt service is misleading as it does not include projected future debt issuance. It should be noted that it does not include projected future debt issuance.

In the CAFR transmittal letter it would be prudent to disclose the potential impacts of Proposition 26 on revenue policies, in particular, that the collection of revenues under the current policy for conservation and Local Resource Programs may not meet Proposition 26 or other legal requirements.

Referring to page 58, Bay Delta discussion mentions it is expected that the BDCP will be approved, and a permit decision will be made in 2012, but the report should disclose the potential cost impacts to MWD of the BDCP plan.

Referring to page 60, SDCWA litigation disclosure mentions that the Exchange Agreement requires MWD pays the disputed portion paid by SDCWA if the Water Authority prevails, but it should also disclose that in accordance with the Exchange Agreement MWD is required to escrow the disputed funds each year until the litigation is completed.

Referring to page 69, the discussion should disclose that there is an escrow account for the SDCWA litigation, identify where it is held and that as well as any implications for reserve fund Board policy minimums.

OTHER REPRESENTATIVE

County of San Diego

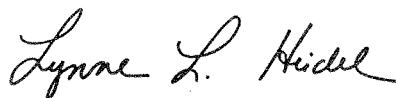
A public agency providing a safe and reliable water supply to the San Diego region

We request that management respond in writing to the issues identified in this letter.

Sincerely,



Jim Bowersox
Director



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

cc: MWD Board of Directors



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

October 7, 2011

John V. Foley, Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

Re: Water Planning and Stewardship Committee items 6a, 6b, and 6d

Dear Chairman Foley,

We have reviewed the staff reports to be discussed under Committee items 6a, 6b and 6d at the October 11, 2011 Water Planning and Stewardship Committee. The reports provide a long list of activities described as implementation of the 2010 Integrated Resources Plan (IRP) including BDCP and other imported water projects, recycled water projects, conservation, seawater desalination and, the sale of discounted water. What is absent from the reports is any analysis showing:

- The demand for all of the water that will be produced by these projects;
- The rate increases associated with implementation of all of these projects;
- The regional benefit (to all member agencies paying the rates) of payments by Metropolitan for some member agency local water supply projects;
- The regional benefit (to all member agencies paying the rates) of the sale of discounted water by Metropolitan at a time when its water sales are more than 25 percent lower than projected and water rates are far higher than projected in Metropolitan’s adopted Long Range Finance Plan; or
- How all of these projects are expected to be paid for.

Almost twenty years ago, the Metropolitan Blue Ribbon Committee Task Force urged Metropolitan to fully integrate its resource planning and rate structure efforts because, “reliability, cost and demand are all interdependent and should be treated that way in the IRP and rate structure reform processes” (page 9). Unfortunately, Metropolitan has steadfastly refused to do so – as reflected in this month’s board reports of ongoing project implementation without any discussion whatsoever about cost or demand. Metropolitan’s stubborn refusal to reduce its spending and operations is inconsistent with the economic reality today facing every city and water retailer in Southern California.

The IRP states that it is based on “adaptive management.” It is time now for Metropolitan to “adapt” to actual, changed circumstances including dramatically reduced sales, dramatically

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

Mr. Foley
October 7, 2011
Page 2

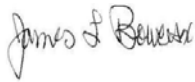
reduced projected demand for Metropolitan water, and, rapidly escalating water rates that will further dampen demand for Metropolitan water.

Since 2003, Metropolitan's expenditures have exceeded its revenues for six out of nine years, and for the same number of years, it has diverted funds intended for pay-as-you-go capital projects to pay for operational expenses. Metropolitan's financial reserves are being depleted, and now stand at their lowest level in 20 years. Metropolitan must stop analyzing project implementation in a vacuum and on a piecemeal basis.

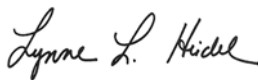
The rate increases associated with declining sales and new projects are inevitable. The impacts of these rate increases are already being felt throughout Southern California. We strongly urge Metropolitan to cease entering into any new project funding agreements and cease the sale of discounted water until Metropolitan staff and board update IRP demand projections to reflect current realities.

Metropolitan needs a rate structure and long-term financial plan that are fully integrated with realistic demand projections. Metropolitan must conduct a cost/benefit and cost of service analysis to justify both the investment of regional ratepayer dollars in member agency water supply projects and the sale of water at a discount. Not only is this required by law, but it is sound fiscal planning that is essential at a time when Metropolitan's revenues are clearly insufficient to pay for its current costs and programs.

Sincerely,



Jim Bowersox
Director



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

Cc: MWD Board of Directors
Jeff Kightlinger



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 22, 2011

Board of Directors
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

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 Diabolo
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

OTHER REPRESENTATIVE

County of San Diego

Dear Chairman Foley and Members of the Board:

We have reviewed Appendix A of MWD's Draft Official Statement, distributed to the members of the board on August 15 relating to the upcoming refunding of certain fixed revenue bonds (Draft or Appendix A). While we support MWD's desire to take advantage of the market to reduce its debt obligation, we remain concerned that MWD's financial condition is not accurately described in Appendix A. As you know, the Water Authority's MWD representatives have sent three prior letters regarding Appendix A dated September 22 and December 9, 2010 and May 16, 2011, copies of which are attached as Attachments 1-3, respectively, and incorporated herein by reference. Although MWD made specified changes as described in response letters dated September 23 and December 13, 2010 and email dated May 24, 2011, respectively, we do not believe that MWD has adequately addressed the stated concerns or that the August 15, 2011 Appendix A fairly presents MWD's financial position currently or prospectively. We request that the Draft be modified to address these concerns in order to provide adequate disclosure to potential investors.

The Water Authority has previously raised many of the questions and concerns noted in this letter in prior written communications with MWD. These past communications include but are not limited to letters regarding the budget, dated April 11, 2011; adoption of the Long Term Conservation Plan, dated August 15, 2011; and, Member Agency Willingness to Sign Take-or-Pay Contracts and Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting, dated August 16, 2011. A copy of each of these letters is attached again for consideration by you and the other members of the board, MWD's management team, General Counsel, outside bond counsel, underwriter's counsel and other members of the financing team (Attachments 4-6, respectively). Unfortunately, MWD has not responded to our letters directly or indirectly by addressing the issues on the merits in changed MWD board policy or management actions.

In addition to the concerns that are described in this past correspondence, which we request you address in your response to this letter, we have the following specific comments on the Draft.

Appendix A, as a whole, fails to adequately describe the financial impacts associated with reduced water sales. Although the Draft discloses that its member agencies are not required to purchase any water from MWD (page 27), the Draft fails to describe the associated risk to MWD, or, its inability to secure long term purchase contracts or other firm financing commitments that are not subject to change by the board of directors to meet its current and future fixed obligations.

Although the Draft includes a section titled, "Regional Water Resources" (beginning at page 27), the

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

discussion does not make clear what MWD's role is – or is not – in developing local water supplies. Many of the projects noted as "Regional Water Resources" will actually be developed at the local level without any involvement by MWD and, thus, further reduce MWD water sales in the future. The Draft should disclose that local water supplies have become much more cost-competitive as a result of the increasing cost of MWD's imported water and that as a result, many MWD member agencies are now pursuing the development of local water supply alternatives.

In addition to the development of local water supplies described above, the escalating cost of MWD water will likely result in reduced sales in the future. The Blue Ribbon Committee Task Force noted this more than 15-years ago. However, MWD continues to present analyses that do not consider the cost of water as a feature that will dampen future water sales. See, for example, Management's Discussion of Historical and Projected Revenues and Expenditures at page 71 (future sales forecasts will reflect "a return to more normal weather conditions, a recovering economy and population growth, *notwithstanding impacts of conservation and projected increases in water rates*" (emphasis added)). The Draft appears to mistakenly rely on past history as an indicator of future MWD sales (page 27) rather than assessing the dramatically changed circumstances confronting MWD.

Although the state legislature has mandated 20% conservation by 2020, MWD's IRP, recently adopted Long Term Conservation Plan and Appendix A do not describe any impact on MWD water sales. In fact, the Draft states that MWD water sales will return to historic levels at 2 million acre feet beginning in fiscal year 2013-14 "notwithstanding impacts of conservation" (page 71). The Draft should explain how sales are expected to continue at these levels at the same time the retail agencies in the MWD service area are achieving 20% conservation.

Although the Draft discloses the Water Authority's purchase of conserved water from IID and the water it has developed from lining the All-American and Coachella Canals, the Draft describes MWD's transportation of this water under the Exchange Agreement as an MWD water sale. This characterization is misleading and disguises the true fact that MWD water sales have been *reduced* by the amount of water the Water Authority has independently secured from these sources.

The discussion of the Water Supply Allocation Plan (WSAP) (page 26) is also misleading in that it does not state that Preferential Rights is the statutory method for allocating MWD water during a time of shortage. Preferential Rights is discussed briefly much later in the Draft (page 50) but the two topics are not tied together. The discussion of Preferential Rights should also make clear that any "use" of Preferential Rights is at the discretion of the member agencies that hold the rights, not MWD.

The Draft should connect the discussion of Regional Water Resources (beginning at page 27) with the discussion of both MWD revenues (page 41) and Management's Discussion of Historical and Projected Revenues (page 70) (Management Opinion). While MWD continues to project returning sales of 2 million acre feet, its discussion of seawater desalination programs alone shows potential reduced sales of almost 400,000 acre feet, exclusive of the many other local water supplies that are now being developed throughout the MWD service territory.

All of the information relating to the sale of discounted water is in the section on resources (page 30). The Draft should be revised to tie this discussion to Revenues (beginning at page 41) and should also be addressed in Management's Opinion. By its own report, MWD chose to sell water at a discount in part because its member agencies would not pay full service rates for replenishment

water. See MWD Board Memo dated May 10, 2011, a copy of which is attached, explaining that MWD water sales would only increase if water is sold at a discount due to the “budgetary or other financial constraints that the member agencies have” (Board Memo at page 3) and that offering water at full service rates would not “significantly increase the demand for replenishment water.” And yet, as noted above, the Draft excludes consideration of the impact of the cost of water on future MWD water sales. The Draft should describe how MWD’s sale of discounted water reduces full service water sales – reduces water sales revenues – and causes the cost of MWD’s full service water to escalate even higher as the true costs are spread among an even lower sales base.

In its May 10, 2011 Board memo recommending the sale of discounted water as replenishment sales, MWD staff asserted that the sales would increase current year (FY 2012) net revenues by \$57.8 million (see “Options 3 and 4 Replenishment Service Program,” top of page 5). In their ratings reports in May 2011, the rating agencies relied on the promise of additional revenues from replenishment sales to help improve MWD’s fiscal position. However, four months into this eight-month discounted water sales period, MWD is not realizing “positive Net Revenue” as the board memo forecast. On the same day MWD staff released this Draft Appendix A for review by the board, our board heard reports in the Finance and Insurance Committee and the Engineering and Operations Committee that, taken together, foretell that the discounted water sales program will result in a net revenue shortfall of approximately \$30 million in the current year, assuming 225,000 acre-feet of discounted water is sold by the end of December. In the Business and Finance Committee, the Board was informed that current year water sales are projected to fall short of budget projections by 13,000 acre-feet (assuming a budget based upon 1.8 MAF of sales; the Draft Appendix A says MWD’s FY 2012 forecast was for 1.85 MAF of sales). In the Engineering and Operations Committee, the Board was informed that MWD has already sold 118,000 acre-feet of discounted water, and has demands from the member agencies for 323,600 acre-feet of discounted water. Thus, it appears that projected sales of 1.787 MAF includes assumed sales of 225,000 acre-feet of discounted water. As we warned last May, discounted water sales are cannibalizing full-rate water sales, and will lead to a revenue shortfall this fiscal year of \$30 million on the differential alone. This represents a nearly \$90 million shift from the MWD staff prediction in May of “positive Net Revenue” of \$57.8 million as a result of discounted water sales. MWD is likely to end FY 2012 with yet another revenue shortfall, making it the fourth year out of the past five years in which revenues were not sufficient to cover expenditures.

The Draft should include a discussion and cost estimate for the BDCP and potential impact on water rates. These projected costs of MWD’s imported water supplies are the measure by which current decisions are being made to invest in alternative local water supply development and are having an impact now on MWD water sales.

The Draft discloses the ongoing draw down of reserve balances in its discussion of the Capital Investment Plan (page 37), but does not tie these trends into Management’s Opinion. The Draft should also disclose the amount of the reserves that are currently held in escrow as a result of the San Diego County Water Authority litigation as well as amounts projected to meet future escrow requirements and the impact this will have on reserve balances.

The Draft should disclose that MWD has had the same external financial auditor for more than 19 years. Further, that a question has been raised regarding MWD’s treatment of its State Water Project contract for accounting purposes (see discussion at page 63).

The Summary of Receipts by Source (page 42) and Summary of Water Sold and Water Sales Receipts (page 43) should disclose receipts for the transportation of water by MWD. Although footnote 3 (page 44) states that “water sales” includes wheeling, the sale of water and the transportation of water are two completely different service functions.

The Draft’s Summary of Water Sold and Water Sales Receipts (page 43) also fails to disclose important information by reporting “Average Receipts Per Acre Foot.” Since no water is sold by MWD at “average” rates, MWD should disclose the amount of water it sells at full price and under discounted water programs.

The Draft should include a more detailed explanation of current and potential litigation. MWD is on notice of the additional claims the Water Authority intends to file including Rate Structure Integrity, Preferential Rights and Breach of Fiduciary Duty. The Water Authority has also informed MWD that it does not believe that current conservation and Local Resources Programs meet Proposition 26 or other legal requirements. The Water Authority has informed MWD that it does not believe that there is a legal basis for the sale of discounted water to some but not all MWD member agencies. Although the litigation is disclosed in the Draft (discussion of the rate structure at page 45), the litigation should also be noted in the discussion of MWD’s Principal Customers (page 49).

Agricultural water sales are discussed in the section entitled, “Classes of Water Service,” but should be tied to both Revenues and Management’s Opinion on future water sales. The Draft should note that agricultural water sales have historically accounted for as much as 150,000 acre feet or more of MWD’s total annual sales, but were less than 35,000 acre feet in 2010. Most of the water sales under the Interim Agricultural Water Program were to customers of the San Diego County Water Authority and are not expected to continue at full service rates when the IAWP terminates on January 1, 2013.

The Draft taken as a whole does not disclose the financial impacts to MWD of significantly reduced future water sales by MWD. The projected sales decline is significant. MWD’s 2000 Urban Water Management Plan (UWMP) projected that MWD would sell approximately 2.3 million acre-feet of water in 2020 (average year demand). By the time of its 2005 UWMP, MWD revised the 2020 projection downward to approximately 2 million acre-feet. MWD’s 2010 UWMP – adopted nine months ago – again lowered the 2020 projection, this time to 1.66 million acre-feet. In all, MWD’s current projected (average year) sales for 2020 are nearly 30 percent lower than it projected just 10 years earlier. The factors contributing to reduced MWD water sales are not accurately described in Appendix A.

The Draft notes in a footnote that disbursements exceeded revenues in the fiscal years ended June 30, 2008, 2010 and 2011. This is a material factor that should be discussed more fully in the Draft and included in Management’s Opinion, particularly in light of the likelihood that expenditures will once again exceed revenues in FY 2012.

For the reasons described above and in the Water Authority’s letter on the budget (Attachment 4), we do not believe that the projection of MWD’s water sales and water rates described in Management’s Opinion (page 68) are reasonable. We believe sales will be substantially less than described and that water rates will be substantially higher than described.

Chairman Foley and Members of the Board

August 22, 2011

Page 5

Please contact me if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Keith Lewinger". The signature is written in a cursive, flowing style.

Keith Lewinger, on behalf of San Diego County Water Authority
Representatives on the MWD Board of Directors

cc: Jeffrey Kightlinger, General Manager
Thomas DeBaker, Interim Chief Financial Officer
San Diego County Water Authority Board of Directors

Attachments:

1. September 22, 2010 letter re: Appendix A
2. December 9, 2010 letter re: Appendix A
3. May 16, 2011 letter re: Appendix A
4. April 11, 2011 letter re: MWD Budget
5. August 15, 2011 letter re: Adoption of Long Term Conservation Plan
6. August 16, 2011 letter re: Member Agency Willingness to Sign Take-or-Pay Contracts and Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting
7. MWD Board Memo dated May 10, 2011 re: Sale of Discounted Water



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 16, 2011

Mr. Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
P. O. Box 54153
Los Angeles, California 90054-0153

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
- OTHER REPRESENTATIVE**
- County of San Diego

Re: Member Agency Willingness to Sign Take-or-Pay Contracts
Request to Correct the Record of July 12, 2011 MWD Board of Directors Meeting

Dear Mr. Kightlinger:

During discussion of your business plan at the MWD Board of Directors meeting on July 12, 2011, Water Authority Director Lewinger asked if you would incorporate into your business plan several suggestions, including one specifically suggesting MWD secure take-or-pay contracts with its member agencies. In response, you stated that "...with respect to securing Board approval of firm take-or pay contracts, we discussed this for two years in 2000-2002 and staff comments of the Water Authority at the time were against take-or-pay contracts." Your statement is incorrect. In fact, the Water Authority has a long track record advocating that MWD obtain long-term take-or-pay contracts with its member agencies in order to stabilize its revenues and improve its fiscal sustainability. Indeed – please correct us if we are wrong – the Water Authority is the **only** MWD member agency that has indicated a willingness to make a firm funding commitment to pay for MWD spending programs.

Fifteen years ago, in 1996, the Water Authority made a proposal for a **take-or-pay contract** as outlined in its "Summary of Proposal to Resolve Colorado River and Rate Refinement Issues, dated April 22, 1996" (Attachment 1).

Later, as a part of the rate restructuring process for years 2000-2002, the Water Authority Board of Directors adopted, and then formally submitted a proposal to MWD’s Board of Directors entitled "Framework of Key Contract Terms, dated February 17, 2000" (Attachment 2). The basic premise of the framework was that member agencies should specify by contract the water and services MWD would provide and a formula by which the agency agrees to pay for the water and services. Details of a **take-or-pay contract** between the Water Authority and MWD are included in Attachment F of the proposed framework. The framework sought to address many of the fiscal challenges that existed then, but which have grown far worse over the past decade. We asked the question at that time, on page 6, item 8: **"Given the magnitude of its expenditures, is there any legally enforceable method other than take-or-pay contracts that can provide MWD with the certainty it needs to assure its fiscal integrity and stability?"**

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

As these documents – and many other comments by the Water Authority’s staff and MWD delegates over the years – reflect, the Water Authority has long advocated that take-or-pay contracts with MWD’s member agencies are necessary to address deficiencies in its revenue structure. Specifically, MWD continues to incur more and more fixed costs and debt obligations – amounting to more than 70 percent of its total costs – at the same time it has no financial commitments from its member agencies to pay for these costs. Instead, MWD continues to rely upon revenues from water sales, which today provide approximately 80 percent of MWD’s revenues and yet are highly variable. The gulf between MWD’s fixed expenses, at 70 percent, and fixed revenues, at 16 percent, is a key reason why MWD is in the worst financial crisis in its history.

More than 15 years ago, the MWD Water District Blue Ribbon Task Force (Blue Ribbon Task Force) found that the “greatest challenge” confronting MWD was the disconnect between its water supply planning process and its member agencies’ actual willingness to pay (or not pay) for MWD programs (see generally, Task Force Report, *The IRP/Rate Structure Process and MWD Decision Making* at pages 5-9 and *The Integrated Resources Planning (IRP) process* at pages 10-15).¹ The Blue Ribbon Task Force found that:

- “An effective rate structure should generate sufficiently stable revenues to cover fixed costs” (page 15); and noted that,
- “Some of the member agencies most strongly supporting big-ticket projects...also had the most aggressive plans to reduce their future MWD water purchases and develop independent supplies.” (Page 23.)

In order to address MWD’s long term fiscal sustainability, the Blue Ribbon Task Force recommended that MWD’s rate structures should ensure coverage of fixed costs without substantial modifications based on water use or other variable factors (page 20).

More than 15 years have now passed since the Water Authority and Blue Ribbon Task Force independently recommended that MWD adopt fixed payment commitments to address the growing instability of MWD’s financial structure. At that time, the Blue Ribbon Task Force warned that, “[c]omprehensive rate structure revisions should not be further delayed, and pressing MWD revenue needs should be addressed as soon as possible.” (Page 21.) Unfortunately, as you noted during your August 10, 2010 IRP presentation in San Diego (full quotation is included at Attachment 3), the rest of MWD’s member agencies “...prefer it the way it is” and remain unwilling to sign take-or-pay contracts or other firm funding commitments to pay for MWD spending programs.

¹ A second Blue Ribbon Committee was established by the MWD Board of Directors in January 2010. It has issued a Report, dated April 12, 2011, which has not yet been addressed by the MWD Board of Directors. Although the principal purpose of the 2011 Blue Ribbon Committee was to consider trends and uncertainties over the next 50 years that could affect MWD, it noted the importance of ensuring that the MWD rate structure provide a stable level of revenues to cover fixed costs – and, that if MWD’s member agencies find they can procure water more cheaply and reliably from other sources, they will reduce their purchases from MWD. See generally, Report of the Blue Ribbon Committee dated April 12, 2011, *Finances and Pricing*, at pages 73-76.

Mr. Kightlinger
August 16, 2011
Page 3

At the same time the MWD board has refused to ask or require MWD's member agencies to commit to pay for MWD spending programs, it continues to adopt business and water resource plans that include massive spending for future State Water Project Bay Delta Conservation Plan costs, Integrated Resources Plan capital spending and long-term subsidy expenditures. While the Blue Ribbon Task Force appreciated the risk that was apparent more than 15 years ago ("MWD can no longer afford to build major facilities and hope that member agencies will buy enough water to pay for them over several years" (page 23)), MWD appears now to be reaching the breaking point due to reduced demands and implementation of member agencies' ongoing plans to buy less water from MWD. MWD's downward fiscal spiral is being hastened by the approval of more and more subsidies to its member agencies that will lead to even lower MWD sales – and revenues. Furthermore, the resumption of discount water sales by MWD in May of this year, which are displacing full service sales, will lead to even lower water sales revenues and continued operating budget shortfalls as MWD's spending is not curtailed to match its lower water sales.

While MWD's "Purchase Orders" are clearly no substitute for enforceable contracts, the expiration of the current Purchase Orders in December 2012 provides the board with another opportunity to address the deficiencies in the current financial structure and rate model. The Water Authority recommends that a **board process** be established as soon as possible to grapple with these issues. The Water Authority remains willing to execute a take-or-pay contract with MWD, and, to make the other tough decisions that are necessary in order to stabilize MWD's revenues and fiscal sustainability.

MWD's rising rates and debt burden, coupled with the lack of political will on the part of the MWD board to require its member agencies to commit to pay for MWD spending programs, is exactly the kind of political risk that was identified in the recent downgrade of our country's credit rating by Standard & Poors. In May of this year, the rating agencies noted that while MWD is heavily dependent upon variable sales of water for its revenues, its member agencies are not obligated to purchase any water from MWD, a finding that appeared to be a factor in Fitch Ratings' downgrade. We would like to work together with MWD staff and the rest of the board to avoid further downgrades of MWD's credit ratings.

Finally, the Water Authority requests that you correct the record regarding the statements made by you at the July 12, 2011 Board meeting discussion on the business plan. This can be accomplished by appending this letter, with attachments, to the July Board meeting minutes, as well as incorporating this letter by reference and attaching it to the minutes of the August 2011 board meeting – and we request that you do so.

Sincerely,



Fern Steiner, on behalf of the Water Authority's MWD Board Directors

cc: Water Authority Board of Directors
MWD Board of Directors
MWD Member Agency Managers

Mr. Kightlinger
August 16, 2011
Page 4

Attachments:

1. Summary of Proposal to Resolve Colorado River and Rate Refinement Issues, dated April 22, 1996
2. Framework of Key Contract Terms, dated February 17, 2000
3. Jeff Kightlinger quote from August 10, 2010 IRP presentation in San Diego



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

May 6, 2011

Jeff Kightlinger, General Manager
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

County of San Diego

Board Memo 5-1 – Sale of Discounted Water

Dear Jeff,

Thank you for responding to our April 25, 2011 letter regarding MWD’s proposed sale of discounted water to selected member agencies. We appreciate that water supply conditions in 2011 have improved significantly; however, the question before the board is what to do with the water that is now available to MWD.

You state in your letter that MWD will maximize the use of its storage assets in 2011 to store available supplies. Director Steiner has requested and you have agreed to provide detailed information how MWD will do that. *Past MWD board reports show that MWD has ample storage and put capacity available to store all of the available water in MWD storage facilities.* Indeed, by our calculation, even if all of the available water is stored by MWD – as we believe it should be – MWD’s storage will remain less than half full.

You also state that MWD will likely end the year with its regional storage reserves at the “highest levels in history”; however, this observation fails to take into account the *fundamental shift in MWD’s water supply reliability planning which – unlike past history – now relies heavily upon the withdrawal of water from storage in dry years.* That is why the Water Authority has supported MWD’s multi-billion dollar investment in storage facilities and agreements, which provide more than 5 million acre feet of storage capacity. Given this water supply strategy and investment, it is difficult to understand why MWD now has no intention of maximizing its investment in storage in a year like this, when water is available. MWD is barely out of a multi-year allocation, yet instead of filling its storage reserves, it wants to sell it at a discount.

The problems with the replenishment program have been previously documented and we will not repeat them here. MWD has been well aware of these concerns for many years but has failed to address the problems in any revised board policy or otherwise. Suffice it to say that the program does not provide benefits to MWD commensurate with the cost to MWD of the program. If MWD is intent on selling discounted water, then it should be made available to all MWD member agencies equally, not just to select agencies on the purported basis of a clearly flawed water supply management program.

On the financial side, the board memo and your letter are clear that under the discounted sales

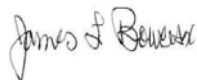
A public agency providing a safe and reliable water supply to the San Diego region

proposal, MWD will not recover its fixed costs. This month's staff report shows MWD's FY 2011 sales have further dropped to 1.6 million acre feet (MAF), from the budgeted 1.93 MAF. Although short term cash flow may be improved by the proposed sale of discounted water, it has a deleterious effect on MWD's financial position overall. We believe you know that MWD's fiscal crisis is real – we would welcome the opportunity to work with you on finding real solutions.

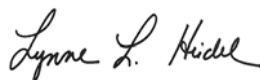
Regarding your comments on the member agencies' willingness to pay for current and future fixed costs, our comments were taken directly from the MWD board memo citing the member agencies' "budgetary and fiscal constraints" as the reason they are not buying MWD water now at the full price that was assumed in the current fiscal year budget. Clearly, the sale of water at full price would be the preferred option because the region would achieve the same storage and water supply benefits and MWD would come closer to hitting its own budget, which is more than \$150 million short that also threatens to leave reserves precariously low.

Finally, we believe you know that the Water Authority's litigation has nothing to do with challenging State Water Project costs – the only question is how those costs should be allocated between supply and transportation. The Water Authority expects to remain one of MWD's largest customers and to pay its fair share of MWD's costs under its State Water Project supply contract. Indeed, to our knowledge, the Water Authority is the only MWD member agency that has actually offered to enter into a long-term contract with MWD for the purchase of State Water Project water and other supplies and services. With firm contracts, MWD could count on being able to cover its fixed costs, now and in the future. We would be happy to make a presentation to the board on the history of that offer as well as make a proposal for the future. We agree that MWD is in a fiscal crisis and the gimmicks being employed this year – including a "fire sale" of discounted water – will not solve or even address the real problem.

Sincerely,



Jim Bowersox
Director



Lynne Heidel
Director



Keith Lewinger
Director



Fern Steiner
Director

cc: Jack Foley, MWD Board Chairman



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

December 9, 2010

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

OTHER REPRESENTATIVE

County of San Diego

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

Dear Mr. Thomas:

We reviewed Appendix A of MWD's Draft Official Statement, distributed to members of the Board of Directors on November 24, 2010 for an upcoming bond sale. We have a number of concerns. A principal concern is that the Draft Statement does not disclose MWD's present and future reduction in water sales due to a variety of key facts.

2010 Integrated Resources Plan

The recently adopted 2010 IRP articulated a new untested business strategy for MWD that is different than the historical role it has played in importing supplemental water supplies to Southern California. The implementation of this strategy would result in an overdevelopment of supplies by at least 200,000 acre-feet in 2020 and as much as 500,000 acre-feet per year through the overdevelopment of local supplies – either by MWD directly, or developed in concert with MWD subsidies. This new strategy has significant cost implications that have not been adequately described in the IRP or disclosed in the Draft Official Statement and could result in reduced sales rather than increased sales by MWD in the future. We described our concerns in our October 11, 2010 letter to MWD (copy attached and incorporated herein by reference). The 2010 IRP showed an MWD demand ranging from 1.67 million acre-feet to 1.75 million acre-feet in 2015, depending on how aggressively MWD would pursue local resources development. MWD demand is projected to be even lower in 2035 at between 1.35 million acre-feet and 1.65 million acre-feet. These are significant projected reductions in MWD sales. The Draft Statement fails to adequately disclose this fact.

Moreover, a month after MWD's board adopted the 2010 IRP, MWD staff released new water sales projections as part of its Long Range Finance Plan that show even lower potential sales by 2020, in a range from of a low of 1 million acre-feet, a high of 2

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

million acre-feet and a “projected expected” sales of 1.6 million acre-feet. The financial impact on MWD of 400,000 to 500,000 acre-feet of lower sales represented by the “projected expected” forecast is significant, and MWD must reconcile this major discrepancy in its Appendix A.

In addition to these concerns, MWD must analyze and disclose applicable limitations on its ability to fund local projects anticipated by the IRP under its existing rate structure, and, subject to the new Constitutional limitations under Proposition 26 as recently passed by California voters.

Projected Water Sales

The projected sales for the near term are overstated given current and reasonably anticipated water sales. After a series of steep rate hikes (increasing Tier 1 Treated Rate by 55 percent between 2008 and 2012), water management actions including aggressive conservation messaging, cessation of discounted replenishment water sales, phasing out of the agricultural program rate, and the implementation of M&I water allocation, MWD has significantly lowered its water demand. For the 10-year period of 2000-2009, MWD’s annual water sales averaged 2.17 million acre-feet. This calendar year, MWD’s sales are projected to equal a multi-decade low of about 1.5 million acre-feet – nearly 700,000 acre-feet below past decade’s average (and 1 million acre-feet below its peak sales year) and importantly, 250,000 acre-feet below MWD’s budgeted amount. Staff reported just last month that MWD’s current year revenue is expected to be \$120 million less than budgeted due to declining sales. This will put ever-increasing pressure to raise rates even higher, if not in CY 2012, then in following years.

We do not believe it is reasonable to assume MWD water sales will return to the 2 million acre-feet level in the time frame noted in the Official Statement, or, that it has the water supplies available to sustain sales in this range continuously. Moreover, as noted above, the implementation of the IRP could actually result in further reduction in MWD’s own water sales.

Use of Bond Proceeds and Need for Funds

Given today’s extraordinary upward rate pressure, and downward water sales trends, it is unclear why MWD is considering selling bonds at this time. We were informed by staff just last month due to lower water sales, MWD would be drawing down about \$100 million from its Rate Stabilization Fund to help cover the impacts of low sales, resulting in reserves that are lower than the Board’s established minimum level. We should be reviewing all expenditures, including scrubbing the Capital Investment Program, to reduce rate pressure. Selling the bonds now would result in MWD needing to expend the money within the specified time – that does not make sense. MWD needs to first figure

Mr. Brian Thomas
December 9, 2010
Page 3

out what its new CIP expenditures should be in the current fiscal situation, and sustained lower water sales before committing itself to spending additional funds.

In conclusion, we believe MWD's exposure to sustained lower water sales is significant due to factors such as challenges to MWD's supplies, implementation of SBX7-7, the adoption of the 2010 IRP, and high water rates' impact on consumer demand; these factors must be disclosed in detail. As such, we request that the Draft Statement be modified to ensure MWD provides adequate disclosure to potential investors.

Thank you.

Sincerely,

A handwritten signature in black ink that reads "Keith Lewinger". The signature is written in a cursive, flowing style.

Keith Lewinger
Director

Attachment

Cc: MWD Board of Directors
Jeff Kightlinger, General Manager
MWD Member Agency Managers



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

September 22, 2010

Brian Thomas
Assistant General Manager/Chief Financial Officer
Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

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

OTHER REPRESENTATIVE

County of San Diego

Dear Brian:

On the afternoon of September 16, you distributed to members of the Board of Directors Appendix A of MWD’s Draft Official Statement for an upcoming refunding bond sale and asked for comments to be submitted by noon today; given the tight deadline, we limit our comments in this letter and the attachments to only the most significant issues and concerns with Appendix A. These comments are presented to you by the four of us as directors representing the San Diego County Water Authority. We request that you respond to the questions presented in this letter and make the necessary modifications to Appendix A of the Official Statement before it is finalized and issued. We believe additional time is warranted to schedule a full board review of the issues noted in this letter and in our IRP Comment Letter discussed below.

2010 Integrated Resources Plan

On page A-3, fourth paragraph, MWD makes only passing reference – and does not disclose key facts – about its 2010 Integrated Resources Plan Update. The document states that the IRP “...is expected to be completed in late 2010.” In fact, the IRP is expected to be presented by MWD staff to the Board of Directors for adoption at its October 12, 2010 meeting – only 13 days after the initiation of bond sales covered by this Official Statement. Appendix A fails to disclose material facts about the 2010 IRP that should be disclosed to potential investors, including but not limited to MWD’s plan to develop so-called “buffer” water supplies in the amount of up to 500,000 acre-feet per year, at a cost of billions of dollars over the next 25 years. On September 10, 2010, the Water Authority submitted to MWD extensive comments on the IRP. A copy of that letter is attached and the questions and comments incorporated herein (IRP Comment Letter). We request that MWD provide a substantive discussion in Appendix A regarding potential legal and financial implications from the shift from MWD’s historic role as a supplemental imported water supplier to local water supply developer; that identifies the breadth of the IRP implementation strategies under consideration, and the extent of costs and future water rates that would be necessary to implement the IRP recommendation. Appendix A should also include a discussion – here and elsewhere – on the effects higher water rates are expected to have on MWD sales. Experience over the past several years clearly shows a nexus between sharply higher water

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

rates and conservation (demand reduction) by customers (ratepayers). MWD should disclose the impacts of its IRP strategies that would lead to water rates exceeding \$2,000 an acre-foot by 2035 if not sooner and the impacts increasing water rates would have on water demands on MWD. Further, as discussed at length in the IRP Comment Letter, how will MWD ensure that there will be customers to pay for its regional local water supply projects when so many agencies are in the process of developing local water supply projects of their own for which their retail customers will pay through retail water rates. This concern should also be discussed in connection with the renewal of purchase orders at page A-1.

We are also concerned that the discussion is misleading about the purpose and importance of the IRP in the development and implementation of the "Preferred Resource Mix." Responding to questions about the necessity of CEQA review prior to adoption of the draft IRP update, MWD staff has stated that such review is not required because the IRP is not a document that controls future decision-making in a manner that could result in the possibility of a significant effect on the environment. However, MWD staff has also stated that it intends to take immediate action to implement projects and programs identified in the draft IRP should it be adopted by the Board. When viewed in its entirety, the discussion of the IRP and the Preferred Resource Mix suggest the IRP is viewed by MWD as a controlling document that would be the first step in the implementation of a major new supply program and would be subject to CEQA. If this is not the case, MWD must make that clear and should also provide assurance that CEQA compliance will be accomplished before any actions are taken to implement any of the programs or projects contemplated as part of the draft IRP's Supply Buffer.

Seawater Desalination Project Subsidies

On page A-4 and again on page A-31, under *Seawater Desalination*, MWD mischaracterizes the Carlsbad seawater desalination project and the status of the incentive payment agreement with MWD relating to this project. MWD also fails to disclose the fact that MWD has initiated termination proceedings on incentive payment agreements with the Water Authority and its member agencies, and, that it is MWD that has refused to sign the Carlsbad Seawater Desalination Project agreement approved by its own board on November 10, 2009.

In the Seawater Desalination Sections of Appendix A on Pages A-4 and A-31, Metropolitan addresses the status of member agency agreements for incentive funding for seawater desalination projects, including the Water Authority's incentive funding agreement. Metropolitan states that "SDCWA has not executed the proposed agreement." This statement would mislead the reader to conclude that but for SDCWA's execution, the agreement would be in effect today. That is not true. The Water Authority's incentive funding agreement, approved by the Metropolitan Board on November 10, 2009 and by the Water Authority Board on December 17, 2009, includes rate structure integrity language that allows Metropolitan to terminate the agreement should the Water Authority file litigation to challenge Metropolitan's rate structure. Following the Water Authority's initiation of litigation in June 2010 (briefly discussed on page A-47) challenging Metropolitan's rates and charges, Metropolitan's Board initiated termination of existing Water Authority funding agreements that include rate structure integrity language. On August 25, 2010, in a letter to the Water Authority from Metropolitan's General Manager (attached), the Water Authority was notified that "Metropolitan's Board of Directors also directed staff to defer execution" of the Water Authority's seawater desalination incentive funding agreement "...as termination proceedings would begin

immediately upon execution.” These facts regarding the Carlsbad Seawater Desalination Project agreement should be stated on pages A-4 and A-31.

Near-Term Delta Actions

On page A-25, under *Near-Term Delta Actions*, MWD discusses the potential supply benefit of the proposed Two-Gate System and other “near-term” actions to improve water supply and ecosystem of the Delta. However, MWD does not provide a timeline estimate of when it expects the Two-Gate project to be in place and producing improved supply reliability of approximately 150,000 acre-feet per year in certain years. We request an estimated operational date for the Two-Gate project be added to this discussion.

Five-Year Supply Plan

On page A-26, under *Local Resources*, MWD projects that 122,000 of additional, new supply could be online by 2014 from recycled water treatment plants, groundwater recovery plants, desalination plants and new hookups to existing recycled water plants. This figure seems optimistic based on the experience. If MWD indeed projects this level of implementation, it is not our belief that the costs associated with such level of local resources development have been included in the budget or water rates adopted for 2011 or 2012. We request that the estimated costs and associated water rate increases be added to this discussion. In addition, given the long lead time generally associated with the development of such projects, we believe MWD should describe the process by which it will be able to implement local projects of this magnitude within the timeline described in the O.S.

Significant Exposure to Reduced Sales

On page A-29, Appendix A describes a construction project that will provide an interconnection between the Antelope Valley-East Kern Water Agency and the Los Angeles Aqueduct. Under an agreement with MWD, the City of Los Angeles will be able to acquire and move into the LA Aqueduct supplies obtained independently of MWD. This section notes that the annual quantity of supplies moving into the LA Aqueduct through the interconnection is “...not to exceed the supplies lost to the City as a result of its Eastern Sierra environmental obligations, including water for the Lower Owens River Project and Owens Lake Dust Mitigation Project...” That amount, Appendix A notes, was 98,000 acre-feet from April 2009 to March 2010. However, MWD does not disclose that the City of Los Angeles currently purchases water used to offset the use of its own Eastern Sierra supplies for environmental purposes from MWD, and that the interconnection with AVEK will allow LA to reduce its purchase from MWD on an acre-foot-for-acre-foot basis. Reduction of sales by approximately 100,000 acre-feet per year will have a material effect on MWD revenues and on MWD’s water rates. And yet, on page A-30, MWD asserts that the City of LA’s “future reliance on Metropolitan supplies may increase with implementation of these (Eastern Sierra environmental) projects.” The motivation for LA to pursue the interconnection with AVEK in the first place is its apparent belief that it can acquire independent supplies at a lower cost than MWD’s supply cost. Therefore, in contrast to the statement on page A-30, it is more likely LADWP will acquire any additional environmental offset water needed from sources other than MWD.

Future Water Sales and Receipts

On Page A-69, and again at A-71 to A-72, MWD projects steady growth in water sales over the next five years from 1.77 million acre-feet in the current fiscal year (2011), to 2.11 million acre-feet in FY 2015, “...reflecting a return to average weather conditions.” This projection appears to attribute the current low water demands on MWD (and reduced sales) to a single factor: weather. A return to

Mr. Brian Thomas
September 22, 2010
Page 4


normal weather, the report implies, will result in returning sales to pre-shortage levels. No discussion or consideration is provided to what effect other factors –most notably higher water rates – have had, and continue to have in suppressing water demand and sales. The O.S. also fails to discuss or take into account the recently passed 20x2020 legislation requiring 20% conservation at the retail level. Appendix A should provide an analysis of the impacts higher water rates and conservation requirements are having on demand and sales, and factor those impacts into projections of future water sales (e.g. the next five fiscal years and beyond).

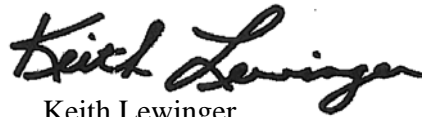
Page A-72 notes that because of lower-than-budgeted water sales in the current year (160,000 acre-foot lower than budgeted), MWD will make a draw of \$34 million from its Water Rate Stabilization Fund. However, on September 17, 2010, at the MWD Member Agency Managers meeting, MWD management reported that the net draw from the Water Rate Stabilization Fund this year is projected to be \$100 million. MWD should reconcile these two figures and ensure the number reflected Appendix A is the correct one.

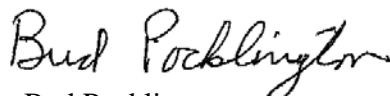
We believe the comments contained in this letter and the attachments must be addressed through substantive modifications to Appendix A and request those changes be made to ensure MWD provide accurate and adequate disclosure to potential investors.


Thank you.

Sincerely,


Lynne Heidel
Director


Keith Lewinger
Director


Bud Pocklington
Director


Fern Steiner
Director

Attachments

Cc: MWD Board of Directors
Jeff Kightlinger, General Manager



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

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.