



- **Board of Directors**
Finance and Insurance Committee

7/14/2015 Board Meeting

9-1

Subject

Mid-cycle Biennial Budget Review

Executive Summary

In April 2014, the Board approved the Metropolitan Water District of Southern California's (Metropolitan) biennial budget and associated rates and charges for fiscal years (FY) 2014/15 and 2015/16. The mid-cycle update provides an opportunity to review results of the first year of the two-year budget, reviews the outlook for the second year of the two-year budget, and highlights financial issues to be addressed in the next biennial budget and rate setting cycle, which will formally begin in February 2016.

At the midpoint of the biennial budget, Full Service and Exchange sales are projected to be about 155 thousand acre-feet (TAF), or 9 percent, over the FY 2014/15 budget of 1.75 million acre-feet (MAF), primarily due to the drought conditions and a reduction in some member agencies' local supplies. Expenses are projected to come in under budget after reflecting board-approved budget transfers from the Water Management Fund (WMF) for increased conservation and supply program spending. The result is a projected increase in net revenues of approximately \$120 million.

In May 2015, the Board designated \$160 million from the Water Rate Stabilization Fund (WRSF) for conservation programs, so the projected balance as of June 30, 2015 in the WRSF and the Revenue Remainder Fund is \$440 million, \$40 million below target as defined in Section 5202 of the Administrative Code.

Description

FY 2014/15 Review

Full Service and Exchange sales are projected to be about 155 TAF, or 9 percent, over the FY 2014/15 budget of 1.75 MAF, resulting in water sales revenues that are about \$103 million over budget. As of March 31, 2015, expenditures were projected to be approximately \$98 million under budget.

Full Service and Exchange sales revenues are higher due to increased deliveries to some member agencies whose local supplies have been impacted by the drought. Expenditures are forecasted to be below budget due to prudent management of expenses, lower power costs as a result of lower-than-budgeted deliveries of State Water Project (SWP) water, lower debt service costs due to a July 1, 2014 payment made as part of a May 2014 refunding, and lower spending on capital projects. As a result, net revenues are projected to be \$120 million higher than the budget. Financial policy coverage ratios at fiscal year-end are forecasted to be 2.61 times for Revenue Bond Debt Service coverage and 2.2 times for Fixed Charge coverage, above the target levels of 2.0 times and 1.2 times, respectively.

FY 2015/16 Outlook

Planning Assumptions

Key planning assumptions for FY 2015/16 were Full Service and Exchange sales of 1.75 MAF; use of operating revenues and the Replacement and Refurbishment (R&R) Fund to fund capital spending of \$268 million; a 50 percent allocation for the SWP and approximately 876 TAF from the Colorado River Aqueduct; and continued funding for conservation, the Local Resources Program (LRP) incentives, and supply programs in the region, the Central Valley and the Colorado River system.

Historically, water sales and expenditures can quickly change under different local hydrologic conditions. While the state is currently experiencing drought conditions, Metropolitan is prepared to meet these difficult conditions by budgeting prudently, maintaining a diverse water supply portfolio, and investing in long-term storage programs, conservation, local resource development, and drought response. Current weather conditions could change significantly by the fall. Variations in revenues and costs due to hydrology are managed by use of financial reserves established for this purpose, including the WRSF, the Revenue Remainder Fund, and the WMF.

The biennial budget adopted by the Board substantially met the Board's financial policies by providing anticipated revenues that met the anticipated cost of service, met the Revenue Bond Debt Service coverage and Fixed Charge coverage targets, and promoted long-term fiscal sustainability goals as reflected in the ten-year forecast.

Implementation of the Water Supply Allocation Plan (WSAP) and Budget Increase for Conservation

In April 2015, the Board implemented Metropolitan's WSAP at a Level 3 Regional Shortage Level for FY 2015/16. This action is expected to curtail Full Service and Exchange sales to approximately 1.8 MAF, which is basically on budget. In May 2015, the Board increased the budget for the Conservation Credits Program by \$350 million, bringing the total biennial budget to \$450 million in response to the current strong member agency and consumer demand for these programs. These increases have been funded from the WRSF, Water Management designated funds, and the Water Stewardship Fund. Much of the spending for these programs will occur in FY 2015/16.

Setting of the Ad Valorem Tax Rate

Consistent with the adopted budget, the FY 2015/16 budget includes \$92.2 million in ad valorem property tax revenue, which assumes the tax rate continues at the current level of .0035 percent of assessed valuation. Continuing the current ad valorem tax rate is essential to Metropolitan's long-term fiscal health and stability by providing a diverse, fixed revenue source, balancing the mechanisms for funding the immediate and anticipated obligations of the State Water Contract (SWC), helping to maintain Metropolitan's creditworthiness, and providing the Board with flexibility as it funds Metropolitan's SWC obligations and other obligations.

Operating Equipment

In April 2014, the Board appropriated \$8.2 million for operating equipment for FY 2015/16. At the time, a detailed list of operating equipment for FY 2014/15 was provided. **Attachment 1** is a list of the operating equipment designated for purchase in FY 2015/16 and is within the total amount of \$8.2 million that was included in the FY 2015/16 budget.

Capital Spending

Projected capital expenditures for FY 2014/15 are \$209 million, \$36 million under budget, due to the long permitting timeline for the Palos Verdes Reservoir projects and lower-than-planned progress payments on several construction contracts. FY 2015/16 capital expenditures are forecasted at \$215 million, \$53 million under budget, primarily due to favorable bids received on some projects and the deferral of some projects beyond FY 2015/16. While Metropolitan currently plans to fund all FY 2015/16 projected capital spending from revenues, the ongoing drought presents significant uncertainties regarding future revenues, expenditures and reserve balances. Rather than using operating revenues, Metropolitan could elect to debt finance all or a portion of capital spending in FY 2015/16 by issuing tax-exempt debt to reimburse the General Fund for capital expenditures. This could

provide Metropolitan with additional financial flexibility in light of the possibility that Metropolitan experiences lower-than-budgeted sales in FY 2015/16, or that the Board determines the need to provide additional funding for programs or activities. Accordingly, the Board could adopt a Resolution of Reimbursement that would authorize the use of tax-exempt debt to reimburse capital expenditures that occurred up to 60 days prior to the adoption of the Resolution of Reimbursement. Generally, reimbursements could be made up to three years after the date on which each capital expenditure was originally paid.

Items that May Impact the Next Biennial Budget, FY 2016/17 and FY 2017/18

Metropolitan will begin work in the fall on its next biennial budget, covering FY 2016/17 and FY 2017/18, and rates and charges effective January 1, 2017 and January 1, 2018. Issues for consideration for the next biennial budget are discussed below.

- Cost to Replenish Storage: Metropolitan forecasts drawing down dry year storage to approximately 800 TAF by the end of FY 2015/16. Should hydrologic conditions become more favorable, the Board may want to consider whether to budget for storage costs above and beyond the levels included in the long-range forecast.
- Potential Budget Impacts of the Integrated Resources Plan: Metropolitan's current rate structure supports \$20 million per year for the Conservation Credits Program (CCP) and LRP incentives up to \$250 per acre-foot. Funding beyond \$20 million per year for the CCP and funding necessary to accommodate the recently restructured LRP incentive will be evaluated in the next biennial budget and long-range forecast.
- Water Treatment Surcharge: Staff has completed a thorough review of costs recovered through the Treatment Surcharge and determined that some capital investments identified as treatment supported distribution, storage, and administrative and general activities. Additionally, some direct labor costs at the treatment plants were associated with distribution system activities. These adjustments were incorporated into the accounting for treatment costs for FY 2015/16 and will be used in determining the revenue requirement for treatment in the future. Also, the FY 2016/17 and FY 2017/18 rate setting will provide for the Board's consideration a fixed charge component to recover fixed treatment costs.
- Long-Range Financial Forecast: As part of the biennial budget and rate setting process, the ten-year forecast will be updated to incorporate changes to sales, revenues and expenditures, and any other changes to underlying assumptions.

Policy

Metropolitan Water District Act Sections 124.5, 134

Metropolitan Administrative Code Section 5200: Funds Established

Metropolitan Administrative Code Section 5202(a) and (e): Fund Parameters

Metropolitan Administrative Code Section 5108: Appropriations

Metropolitan Administrative Code Section 8122(g): General Manager's Contracting Authority in Specified Circumstances

Fiscal Impact

None



Gary Breaux
Chief Financial Officer

6/22/2015
Date



Jeffrey Kighlinger
General Manager

6/26/2015
Date

Attachment 1 – Operating Equipment FY 2015/16

Ref# cfo12637134

**Operating Equipment
FY 2015/16**

Item	Quantity	Total
Audio Visual	1	8,720.00
Automobiles	10	287,857.59
Construction/Shop/Maint Equip	39	1,067,273.61
CPU's, Laptops & Servers	40	596,230.00
Drafting Equipment	2	88,284.55
Heavy Equipment	16	2,656,023.55
Lab Equipment	8	946,899.35
Monitoring Equipment	11	170,939.25
Other Equipment	14	406,321.09
Pumps	9	147,254.06
Survey Equipment	2	163,500.00
Trucks	45	1,609,793.38
Utility Vehicles	2	41,183.25
Total		8,190,279.68