THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

INFORMATION

- Board of Directors
  Finance and Insurance Committee

9/12/2017 Board Meeting

9-2

Subject

Mid-cycle Biennial Budget Review

Executive Summary

In April 2016, the Board approved the Metropolitan Water District of Southern California's (Metropolitan) biennial budget for fiscal years (FY) 2016/17 and 2017/18 and associated rate and charges for calendar year (CY) 2017 and 2018. 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 2018.

At the midpoint of the biennial budget period, water sales are 160 thousand acre-feet (TAF), or 9 percent, under the FY 2016/17 budget of 1.7 million acre-feet (MAF), primarily due to the extraordinarily wet conditions of the past winter and a significant improvement in some member agencies' local supplies. Revenues are $142.9 million under budget due to the lower water sales. Expenditures are $168.5 million under the amount of the adopted budget and subsequently approved expenditures.

As of June 30, 2017, the balance in unrestricted reserves, which are held in the Water Rate Stabilization Fund and the Revenue Remainder Fund, is $372 million. The unrestricted reserve balance is $103 million below the beginning fiscal year-end balance, but is $125 million over the minimum. The $372 million balance is $229 million lower than the target.

Description

FY 2016/17 Review

As presented at the Finance & Insurance Committee Meeting of August 14, 2017, water sales were 160 TAF, or 9 percent, under the FY 2016/17 budget of 1.7 MAF, resulting in revenues that are about $142.9 million under budget. Expenditures were approximately $168.5 million under the amount of the adopted budget and subsequently approved expenditures. In July 2016, the Board increased the expenditures for Conservation and Supply Programs that it had approved in the April 2016 board adopted budget (Minute Item 50532). Metropolitan also increased its capital expenditures with the board-approved purchase of the Delta Wetlands Properties (Delta Islands) and other land acquisition expenses. This purchase was ultimately bond funded.

Water sales revenues were lower than budgeted due to decreased deliveries to some member agencies whose local supplies benefitted from the very wet winter. Expenditures were also below the amount of the adopted budget and subsequently approved expenditures. Operations and Maintenance expenditures, which were $405.9 million, came in slightly under budget due to prudent management of expenses and lower third-party claims. The State Water Contract (SWC) expenditures were lower due to a one-time credit and lower Capital and Minimum Operations Maintenance Power & Replacement (OMP&R) expenses, partially offset by higher power costs due to the 85 percent allocation in CY 2017. Conservation and Supply Programs came in lower than the amount of the adopted budget and subsequently approved expenditures. However, the reduction in expenditures was less than the reduction in water sales revenues. As a result, the year-end balance in unrestricted reserves declined by $103 million, but is $125 million over the minimum. The unrestricted reserve balance is $229 million below the target of $601 million, which is equivalent to 42 months of reserve protection for fixed costs recovered through volumetric water revenues when sales are 20 percent lower than budgeted. Financial policy coverage ratios at fiscal year-end are calculated to be 1.5 times for Revenue Bond Debt Service coverage (Senior and Subordinate liens), below the target level of 2.0 times, and 1.3 times for Fixed Charge coverage, above the target level of 1.2 times.

FY 2017/18 Outlook

Planning Assumptions

Key planning assumptions for FY 2017/18 were water sales of 1.7 MAF; use of operating revenues ($120 million) and bond funds ($80 million) to fund capital expenditures of $200 million; a 50 percent allocation for the State Water Project (SWP) and approximately 882 TAF from the Colorado River Aqueduct; continued funding for conservation, the Onsite Retrofit program, and the Local Resources Program (LRP) incentives from both operating revenues and the Water Management Fund; and funding of 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. Over the last eight fiscal years, Metropolitan has experienced five drought years bookended by very wet years. The current year is the wettest year ever recorded in the Feather River Watershed. The state is currently experiencing the aftermath of very wet conditions from the winter of 2016/17, resulting in forecasted sales for FY 2017/18 at 1.46 MAF, 240 TAF under budget, and forecasted revenues below budget of $139 million. While revenues are expected to be below budget, Metropolitan is taking steps to meet future dry conditions by storing a record amount of water in storage programs, managing Operations and Maintenance and capital expenditures, maintaining a diverse water supply portfolio, and funding conservation and local resource development.

Expenditures in FY 2017/18 are forecasted to be $108 million under budget. SWC expenditures are forecasted to be under budget due to a $17 million rate management credit and lower OMP&R costs for CY 2018 as SWC costs are forecasted to be below the projected amounts in prior Statements of Charges. These lower SWC costs are partially offset by higher variable energy costs to pump the CY 2017 SWP allocation of 85 percent. Colorado River Aqueduct power costs are under budget due to lower energy requirements since Colorado River supplies into the region have been minimized and diverted to storage.

Current weather conditions could change significantly by the winter. Variations in revenues and costs due to hydrology, local resource conditions, emergencies and outages, and economic conditions are managed by use of financial reserves, specifically the Water Rate Stabilization Fund and the Revenue Remainder Fund. During FY 2017/18, unrestricted reserves are projected to decrease by $76 million to $296 million, which is $38 million over the minimum unrestricted reserve balance.

The biennial budget adopted by the Board met the Board's financial policies by providing anticipated revenues that met the anticipated cost of service, met the Fixed Charge coverage target, and promoted long-term fiscal sustainability goals as reflected in the ten-year forecast. The biennial budget also projected the revenue bond coverage would meet target within five fiscal years. However, the lower revenue forecast based on the recent extraordinary wet year will result in lower financial policy coverage ratios at fiscal year-end. The Revenue Bond Debt Service coverage (Senior and Subordinate liens) is forecasted to be 1.4 times, below the target level of 2.0 times, and the Fixed Charge coverage is forecasted to be 1.2 times, at the target level of 1.2 times.

Exchange Agreement Set-Aside

The unrestricted reserves as of June 30, 2017 and the unrestricted reserves forecasted as of June 30, 2018 of $372 million and $296 million, respectively, do not include funds held in the Exchange Agreement Set-Aside Fund.

Due to San Diego County Water Authority's (SDCWA) litigation challenging Metropolitan's transportation rate components and pursuant to the exchange agreement between Metropolitan and SDCWA, Metropolitan is required to set aside funds based on the quantities of exchange water that Metropolitan provides to SDCWA and the portion of the payments disputed by SDCWA. This set-aside amount includes disputed payments and interest earned thereon, which is based on the interest rate earned by Metropolitan's investment portfolio. In April 2016, Metropolitan transferred these funds from unrestricted financial reserves to a new designated fund, the Exchange Agreement Set-Aside Fund. As of June 30, 2017, Metropolitan had set aside $303.5 million in the Exchange Agreement Set-Aside Fund. The amounts held do not include the statutory prejudgment interest, post-judgment interest, attorneys' fees, or costs awarded by the trial court, none of which the exchange agreement requires to be held. Amounts held pursuant to the exchange agreement will continue to accumulate based on the quantities of exchange water that Metropolitan provides to SDCWA and the payments disputed by SDCWA, until the litigation, including all appeals, is concluded.

Short-Term Revolving Credit Facilities

Metropolitan has executed two $200 million Short-Term Revolving Credit Facilities, under which Metropolitan may borrow from time-to-time. Funds drawn under the Short-Term Revolving Credit Facilities may be used for any lawful purpose. In April 2016, Metropolitan drew $125 million from each Short-Term Revolving Credit Facility, for a total of $250 million, and deposited these amounts in Metropolitan's unrestricted financial reserves. No additional draws were made by the end of June 2017. The current financial forecast for FY 2017/18 assumes an additional draw of $50 million by the end of June 2018.

Capital Expenditures

Capital expenditures for FY 2016/17 were $368 million, $74 million under the amount of the adopted budget and subsequently approved expenditures, due to work prioritization and project rescheduling. Also, of the $196 million approved for the purchase of the Delta Islands and other land acquisition expenses, only $174.1 million has been spent to date. Remaining costs will be spread over future years as surveying and other land acquisition costs are incurred. FY 2017/18 capital expenditures are forecasted at $200 million, the amount included in the FY 2017/18 revenue requirement. Metropolitan plans to fund FY 2017/18 projected capital spending according to the biennial budget from a combination of operating revenues and bond funds.

Items that May Impact the Next Biennial Budget, FY 2018/19 and FY 2019/20

Metropolitan will begin work in the fall on its next biennial budget, covering FY 2018/19 and FY 2019/20, and rates and charges effective January 1, 2019 and January 1, 2020. Issues for consideration for the next biennial budget are discussed below.

- Cost to Replenish Storage: Metropolitan forecasts adding to dry year storage through FY 2017/18. Should hydrologic conditions continue to be 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 2015 Integrated Resources Plan Update: Metropolitan's current rates support $32 million per year for the Conservation Credits Program (CCP) and approximately $44 million in LRP incentives. Whether funding beyond $44 million per year is necessary to accommodate the recently restructured LRP incentives will need to be evaluated in the next biennial budget and long-range forecast.
- California WaterFix: The estimated costs of the California WaterFix are currently factored into the ten-year forecast beginning in FY 2018/19. Later this fall, the Board will decide whether Metropolitan will support and participate in the construction of California WaterFix. The Board's determination will be considered in the development of the biennial budget and ten-year forecast.
- 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 Administrative Code Section 5107: Biennial Budget Process

Metropolitan Administrative Code Section 5108: Appropriations

Metropolitan Administrative Code Section 5200: Funds Established

Metropolitan Administrative Code Section 5202: Fund Parameters

Fiscal Impact

None

Gary Breaux *Chief Financial Officer/* *Assistant General Manager*	8/30/2017 *Date*
Jeffrey Kightlinger *General Manager*	8/31/2017 *Date*

Ref# cfo12650769