

# Long Range Finance Plan Rate Refinement Discussions

Meeting #3  
September 29, 2011

## Agenda

- Introductions
- Topics for Today
  - Follow up from September 9, 2011
  - Continue discussion on fixed revenue issues
- Next meeting, October 14

## Follow up from September 9

## September 9 Follow Up

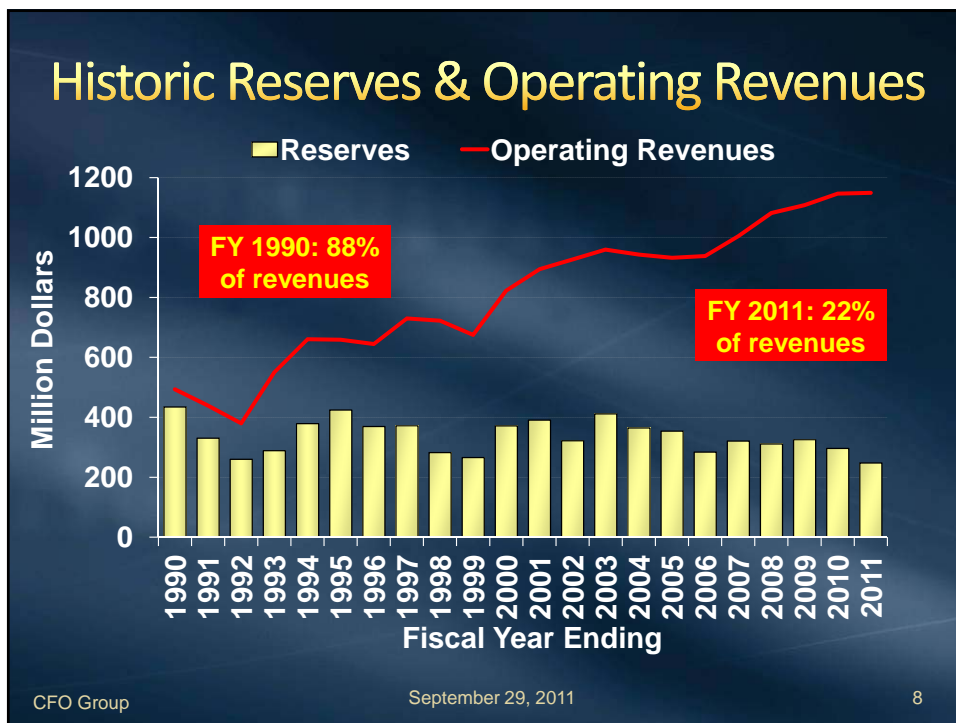
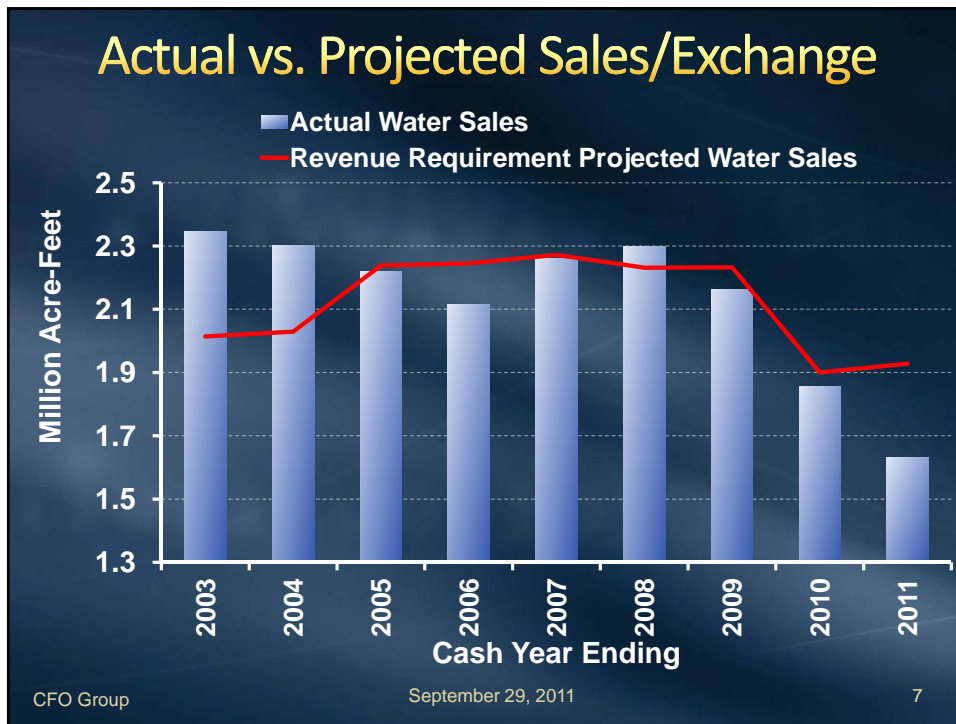
- Compton Purchase Order
- Feedback on aligning Tier 1/Tier 2 and Supply Allocation Plan
  - Is there consensus to change?
- Data requested
  - Actual versus projected sales, AF
  - Actual sales revenues versus reserve levels
  - Rate actions
  - Purchase Order background information

## Aligning WSAP and Tier 1/Tier 2: Current Practice

- Supply Allocation Plan on a fiscal year basis
  - Provides a better understanding of water year
- Rates and Charges, including Tier 1/Tier 2 on a calendar year basis
  - Changes take effect at a uniform time
  - Changes take effect during low usage periods
- What is the challenge to water management issues, and is it worth making changes to a portion of the rate structure?

## Aligning WSAP and Tier 1/Tier 2

- Option #1: WSAP implementation moves up to January 1 from July 1
  - Unsure of water year outlook
- Option #2: Tier 2 calculation performed on a fiscal year basis, not calendar year
  - One portion of rate structure on a different time sequence
  - Agencies in Tier 2 in middle of calendar year; accelerates when rate impacts occur
- Option #3: Effective Date for rate changes moves up from January 1 to July 1 of the prior year
  - Consistent with Board actions in prior years
  - Aligns with Budget and fiscal year and results in lower rate increases, as implementation is sooner in the fiscal year
  - Changes effective at the height of summer



## Financial Data Table

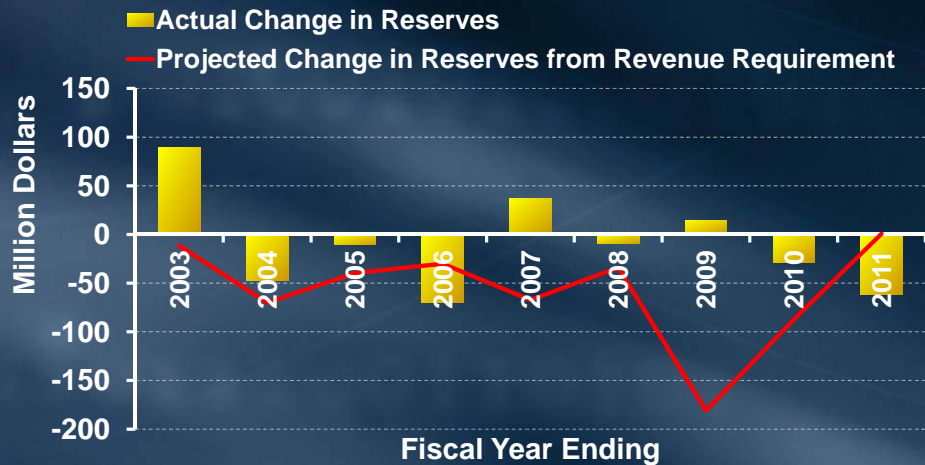
Fiscal Year Ending	2003	2004	2005	2006	2007	2008	2009	2010	2011
Rate Increase	0.0%	2.0%	4.4%	1.6%	3.4%	5.8%	14.3%	19.7%	7.5%
<b>Change in Reserves, \$M</b>									
Rev. Req. Projection	(12)	(70)	(40)	(30)	(67)	(34)	(181)	(88)	1
Actual	90	(47)	(10)	(70)	37	(10)	14	(29)	(61)
Variance	101	23	29	(40)	104	24	195	59	(62)
<b>Water Sales &amp; Exchange, MAF</b>									
Rev. Req. Projection	2.01	2.03	2.24	2.25	2.27	2.23	2.23	1.90	1.93
Actual	2.35	2.30	2.22	2.12	2.26	2.30	2.16	1.86	1.63
Variance	0.33	0.27	(0.02)	(0.13)	(0.01)	0.07	(0.07)	(0.04)	(0.30)

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## Change in Reserves



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## Financial Data Table

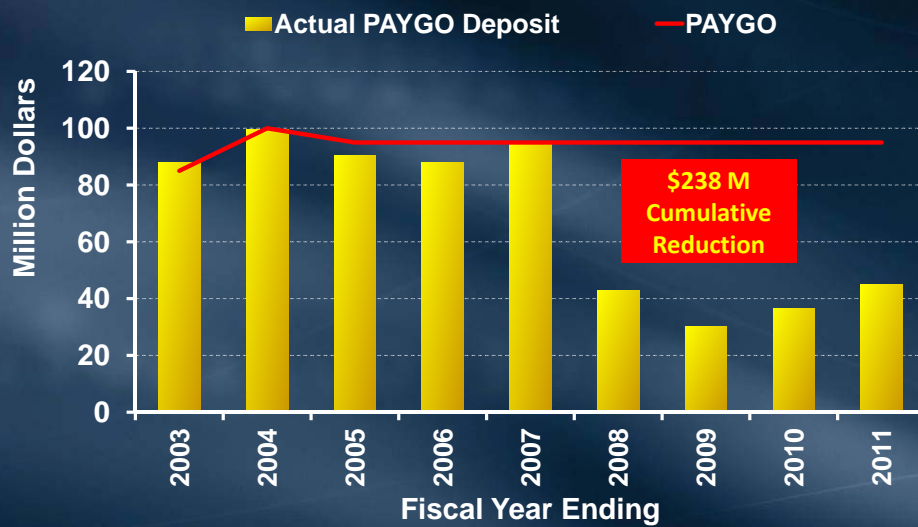
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<b>PAYGO Deposit, \$M</b>									
Rev. Req. Projection	85	100	95	95	95	85	95	37	95
Actual	88	100	90	88	95	43	30	37	45
Variance	3	(0)	(5)	(7)	-	(42)	(65)	-	(50)
<b>Water Sales &amp; Exchange, MAF</b>									
Rev. Req. Projection	2.01	2.03	2.24	2.25	2.27	2.23	2.23	1.90	1.93
Actual	2.35	2.30	2.22	2.12	2.26	2.30	2.16	1.86	1.63
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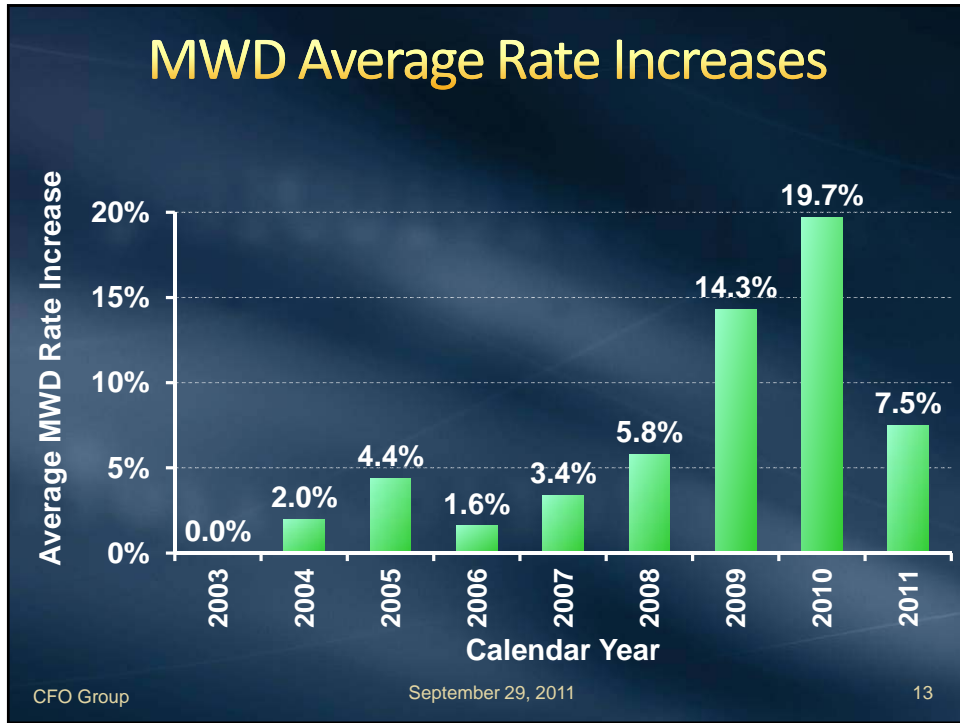
## PAYGO Deposit Has Been Reduced



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### Additional Background Information

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## 2012 Rate Increase vs. Water Sales

### Major Assumptions:

- 2012 Rate recovers full COS in 2011/12
- 40% SWP allocation
- Adjusted Supply Program purchases to match demand

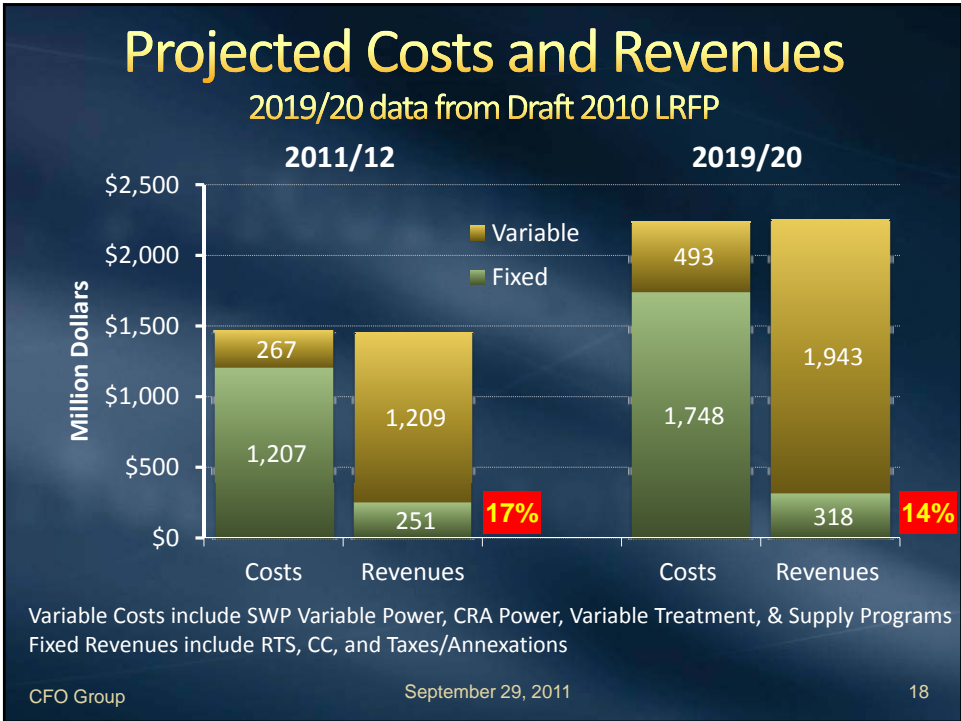
## 2012 Rate Increase vs. Water Sales Analysis from Spring 2010

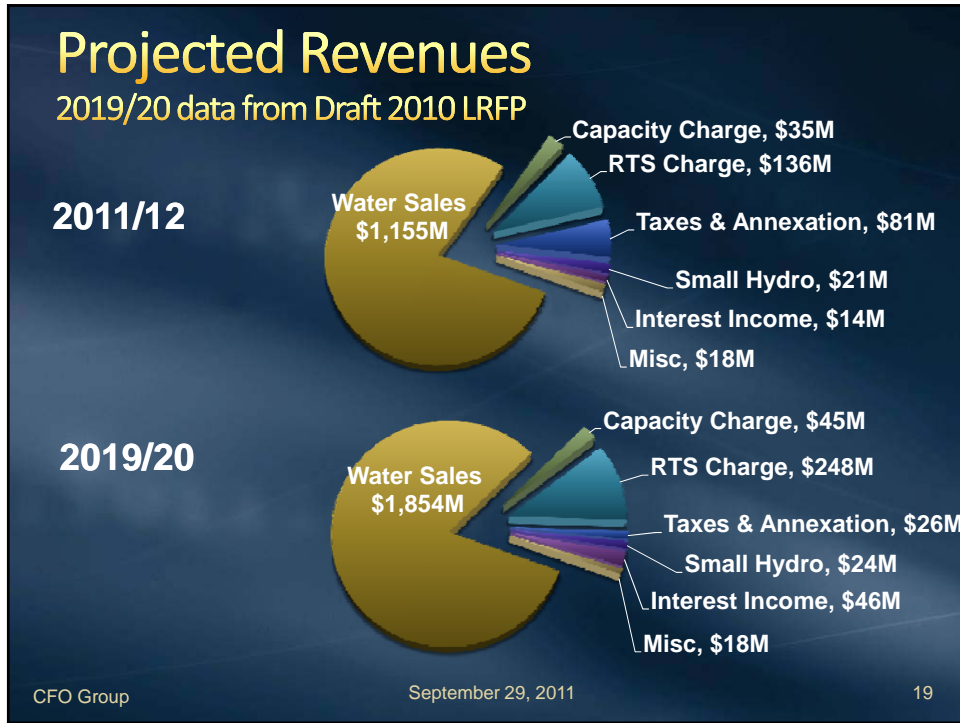




# 2011/12 Projected Costs and Revenues

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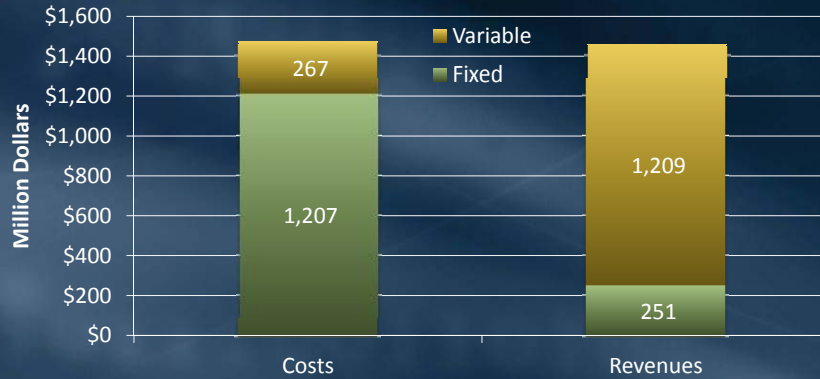




### Potential 2011/12 Reserve Impact Under Historic Low Sales Scenario

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## 2011/12 Projected Costs and Revenues @ 1.80 MAF Sales



Variable Costs include SWP Variable Power, CRA Power, Variable Treatment, & Supply Programs

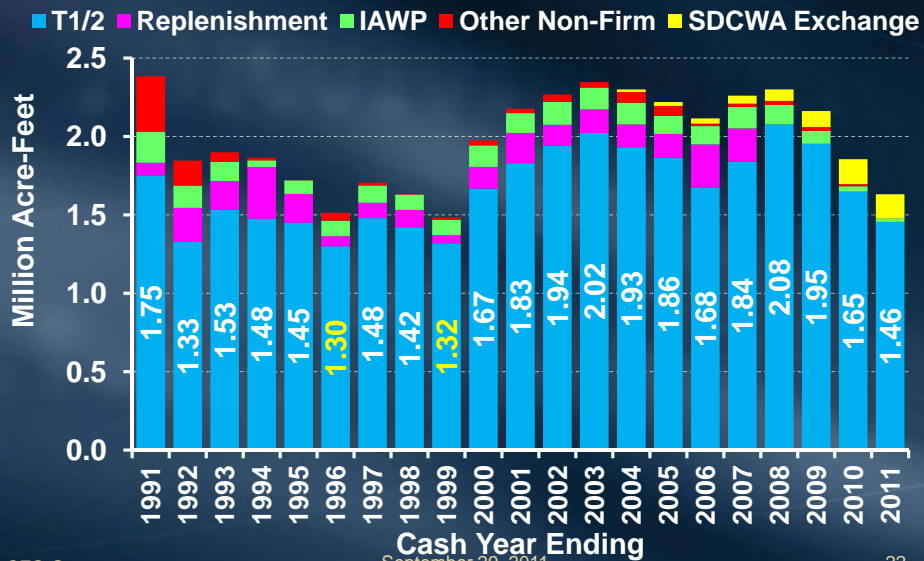
Fixed Revenues include RTS, CC, and Taxes/Annexations

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## Water Sales, Wheeling and Exchange



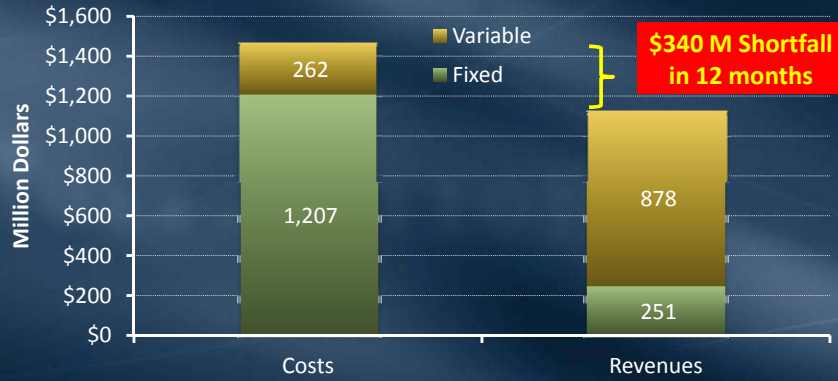
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## 2011/12 Projected Costs and Revenues @ 1.30 MAF Sales

- Adjusted 1.8 MAF budget projection
- Supply programs could not be further reduced
- \$5M reduction in variable treatment costs



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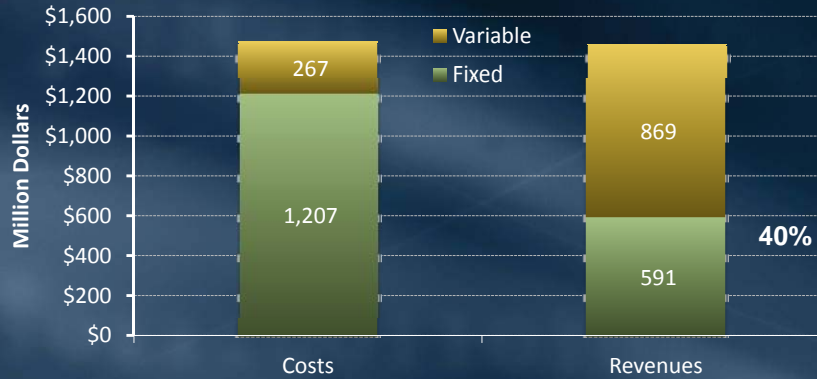
What if MWD had an additional \$340M of Fixed Revenues?

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## 2011/12 @ 1.80 MAF Sales with additional \$340M of Fixed Charges



Variable Costs include SWP Variable Power, CRA Power, Variable Treatment, & Supply Programs

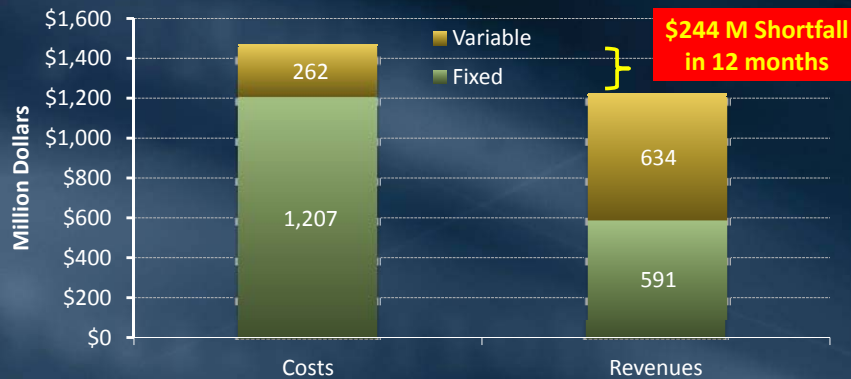
Fixed Revenues include RTS, CC, and Taxes/Annexations + \$340M of new charges

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## 2011/12 @ 1.30 MAF Sales with additional \$340M of Fixed Charges



Variable Costs include SWP Variable Power, CRA Power, Variable Treatment, & Supply Programs

Fixed Revenues include RTS, CC, and Taxes/Annexations + \$340M of new charges

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## Benefits of Increased Fixed Charges

- Reduces revenue volatility
  - Reduces need to maintain high reserves
- Reduces rate spikes resulting from low sales
  - More predictable rate increases
- Improves MWD's financials
  - Improves coverage in low sales years
  - Helps maintain credit ratings

## Benefits of Increased Fixed Charges

- Recent downgrade by Fitch to AA+
  - "The downgrade reflects a weakened financial profile and demand volatility."
  - "Expenditure flexibility is limited given Metropolitan's relatively fixed costs associated with its water supply and debt costs."
  - "Metropolitan's rate structure is heavily weighted towards volumetric pricing, so fluctuations in demand have a direct impact on its revenues."

## Examples – Fixed Revenue Enhancements

- Within Metropolitan's Service Area
- Industry-wide

## Within Metropolitan Service Area

- City of Newport Beach (Retailer)
  - '09 - 90% commodity/10% monthly service charge
  - '12 - 72% commodity/28% monthly service charge
- City of Pasadena (Retailer)
  - Increase in Fixed Distribution and Customer Charge
- SDCWA (Wholesaler)
  - Fixed revenues to fixed costs ratio going from 67% to 80%
- Current efforts
  - Cities of Pomona and Orange, Mesa Consolidated

## Industry Trends-Considerations

- Take-or-pay provisions for contract-wholesale customers
- Variability in revenue – potential sales “swings”
- Increased reserve levels
  - Rate stabilization funds
- Greater pay-go for capital
- Fixed cost and fixed revenues
  - Cost of service considerations
  - Affordability concerns with higher fixed charges
- Fixed charges for fixed costs
  - El Paso: Water Supply Replacement Charge
  - Phoenix: Environmental Charge
  - Charlotte: 20% of debt service in Fixed Availability Fee

## Purchase Order Background

- Outcome of Board’s 1999 Strategic Planning Process
  - Board was concerned about stabilizing revenues and providing a firm financial base to move into the future
- The Statement of Common Interests in the Strategic Plan Policy Principles included Financial Integrity
  - “The MWD Board will take all necessary steps to assure the financial integrity of the agency in all aspects of its operations.”
  - Principles for guiding the selection of a preferred rate structure included “rate structure should provide certainty and predictability”



## Purchase Order Background (cont'd)

- Take or Pay contracts, Purchase Orders, or other construct?
  - Established to indicate additional financial commitment to Metropolitan
  - A negotiated solution to balance Metropolitan's desire for an additional level of financial commitment against member agencies' desire to not take on undue financial risk

## List of Issues - Categorized

- Issues related to fixed revenue:
  - Fixed revenue generation
  - Tier 1 limit / trading Tier 1 limits
  - Fixed commitment to pay for the system (contracts)
  - √ ● Purchase Order status, Compton
  - Review of financial policies
- Issues related to specific programs:
  - Replenishment (Workgroup report in September)
  - √ ● Aligning the WSAP and T1/T2 rates
- Issues related to cost causation
  - Growth charge for infrastructure
  - Treated water cost recovery
  - Look back period for Capacity Charge

## Next Steps

- Meeting October 14, 2011
  - At Member Agency Managers' meeting
  - Investigate alternatives for fixed revenue generation