



Review of the applicability of the Metropolitan Water District Act Section 124.5 ad valorem property tax limitation for fiscal years 2022/23 through 2025/26

Finance and Insurance Committee

Item 9-2

March 7, 2022

MWD Act Section 124.5

- Metropolitan Act Section 124.5, enacted in 1984, limits ad valorem property taxes to recover:
 - Metropolitan's general obligation bond debt service
 - A portion of its State Water Contract (SWC) obligations, limited to the debt service on state general obligation bonds (Burns-Porter bonds) for facilities benefitting Metropolitan
- The restrictions of Section 124.5 do not apply if the Board finds that collecting more is "essential to the fiscal integrity of the District"
- Since FY 2013/14, the Board has determined it was essential to Metropolitan's fiscal integrity to maintain the tax rate at .0035 percent

Essential to Fiscal Integrity

- Not defined in statute or elsewhere
- Applicability determination left to discretion of the Board
- No time period for the determination was established by the CA State Legislature
- Industry and Metropolitan metrics provide guidance

Legal Effect of 124.5 Determination

- Section 124.5 would not apply in the relevant time period
- No specific tax rate is set with this determination; no minimum or maximum tax rate established
- Tax rates are considered and set by the Board each August

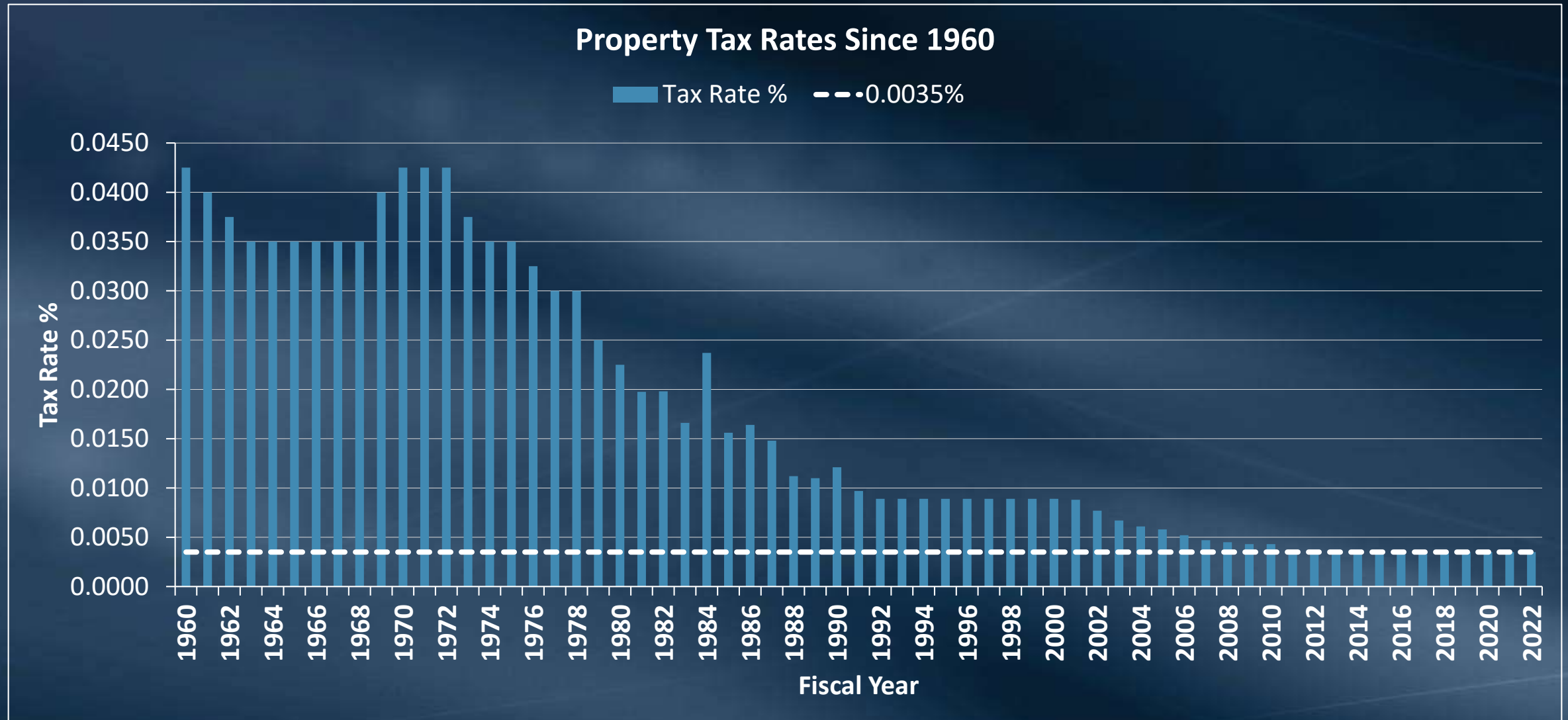
MWD Property Taxes

- Metropolitan has the statutory authority to levy property taxes to pay its expenses pursuant to the MWD Act Section 124.
- Since its creation, voters in Metropolitan's service area have approved the use of property taxes to pay for Metropolitan's major system investments and improvements:
 - CRA
 - Other improvements
 - State Water Project (SWP)

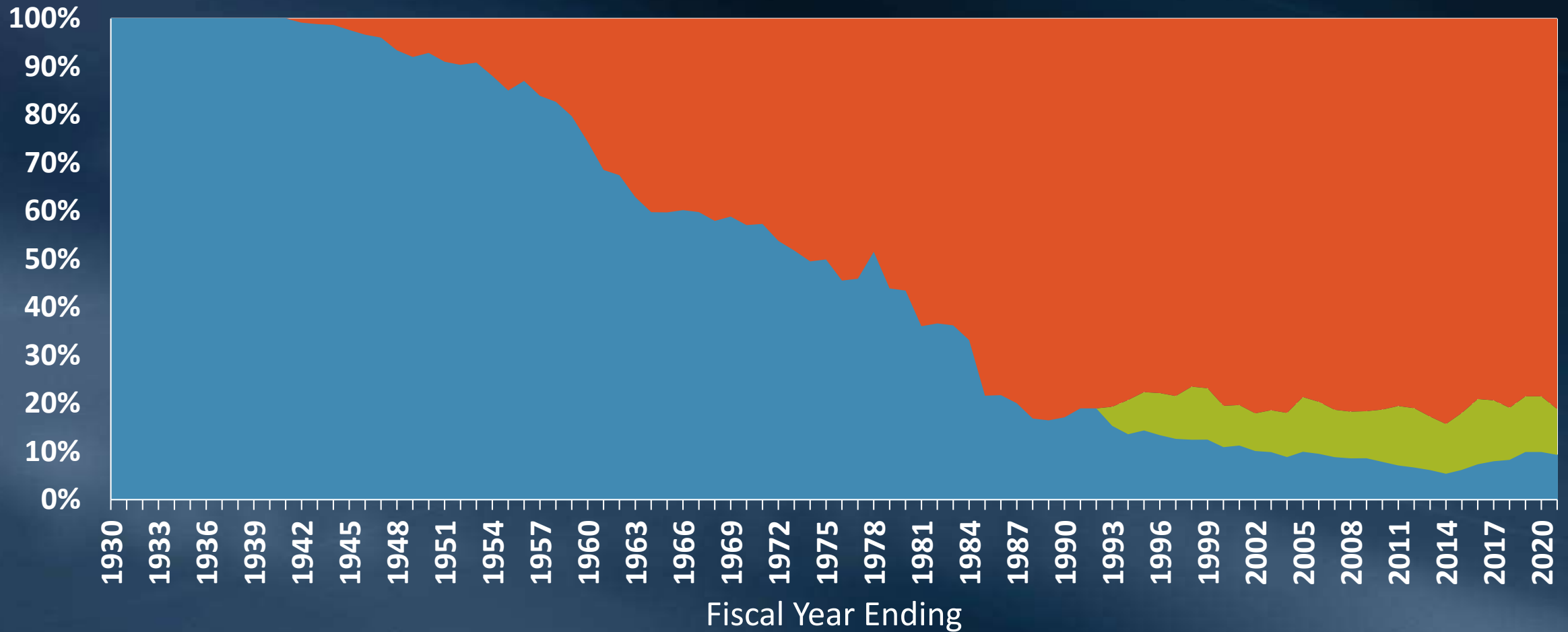
MWD Property Taxes, cont'd

- Metropolitan is one of 29 agencies that contract with the State (DWR) for participation in the SWP.
- Under the SWC, Metropolitan is obligated to pay allocable portions of the cost of construction of the SWP system and ongoing O&M costs regardless of the quantity of water delivered.
- Voters approved the use of property tax revenues for SWC expenditures, and therefore, the continued use of that revenue source would align with its intended use.

Historical Property Tax Rates



Historical Revenue Sources



■ Property Taxes

■ Fixed Charges

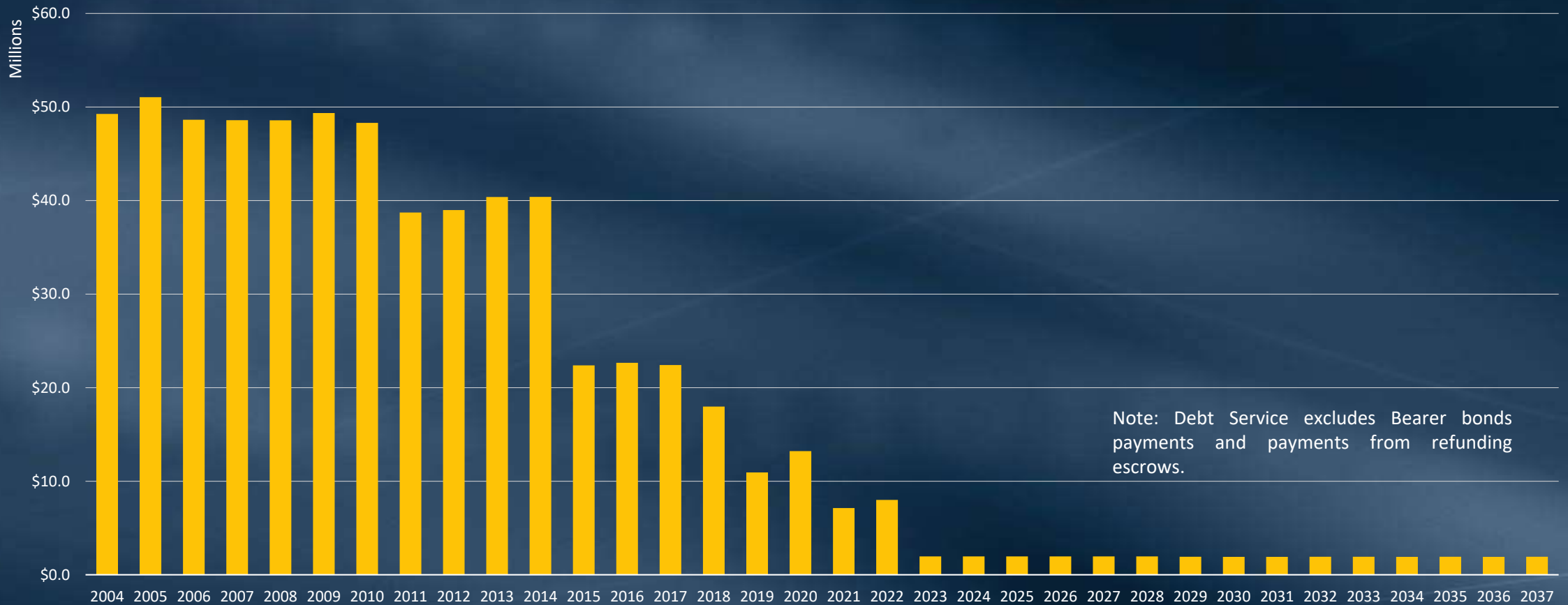
■ Volumetric Revenues*

* Includes water sales, exchanges and wheeling

Outstanding Debt Service

MWD GO Bonds

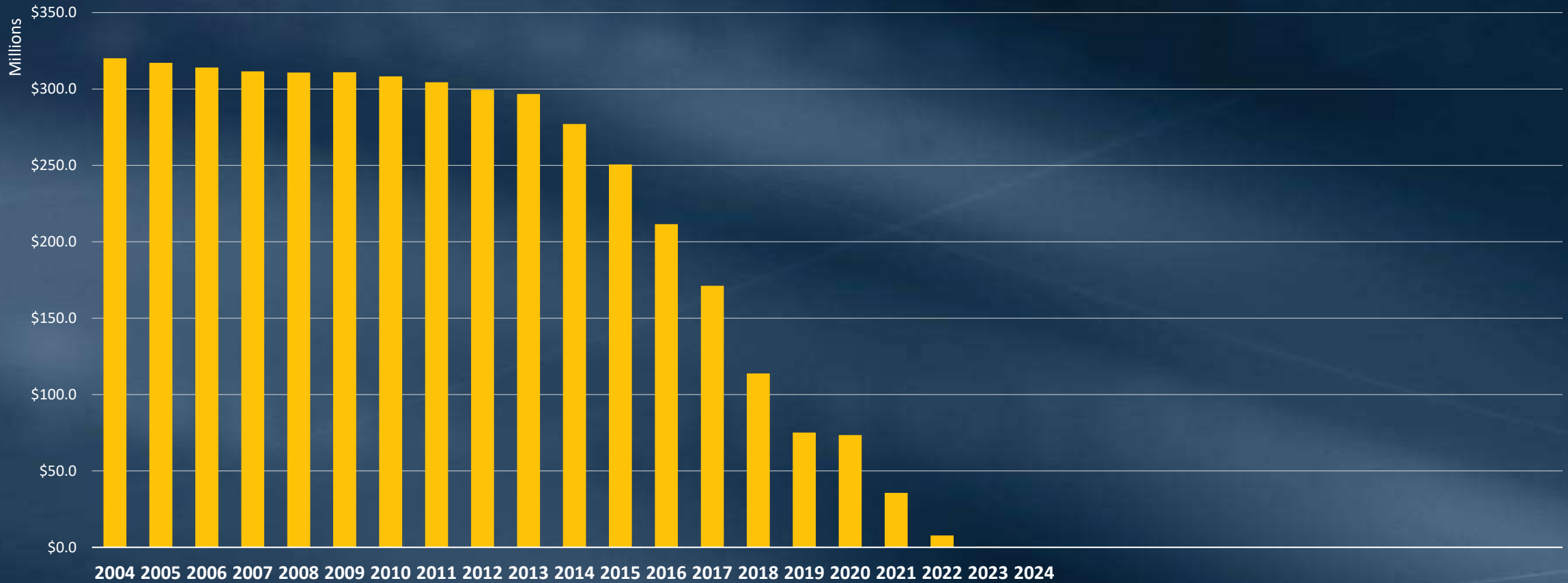
Fiscal Year Annual MWD GO Bonds Debt Service



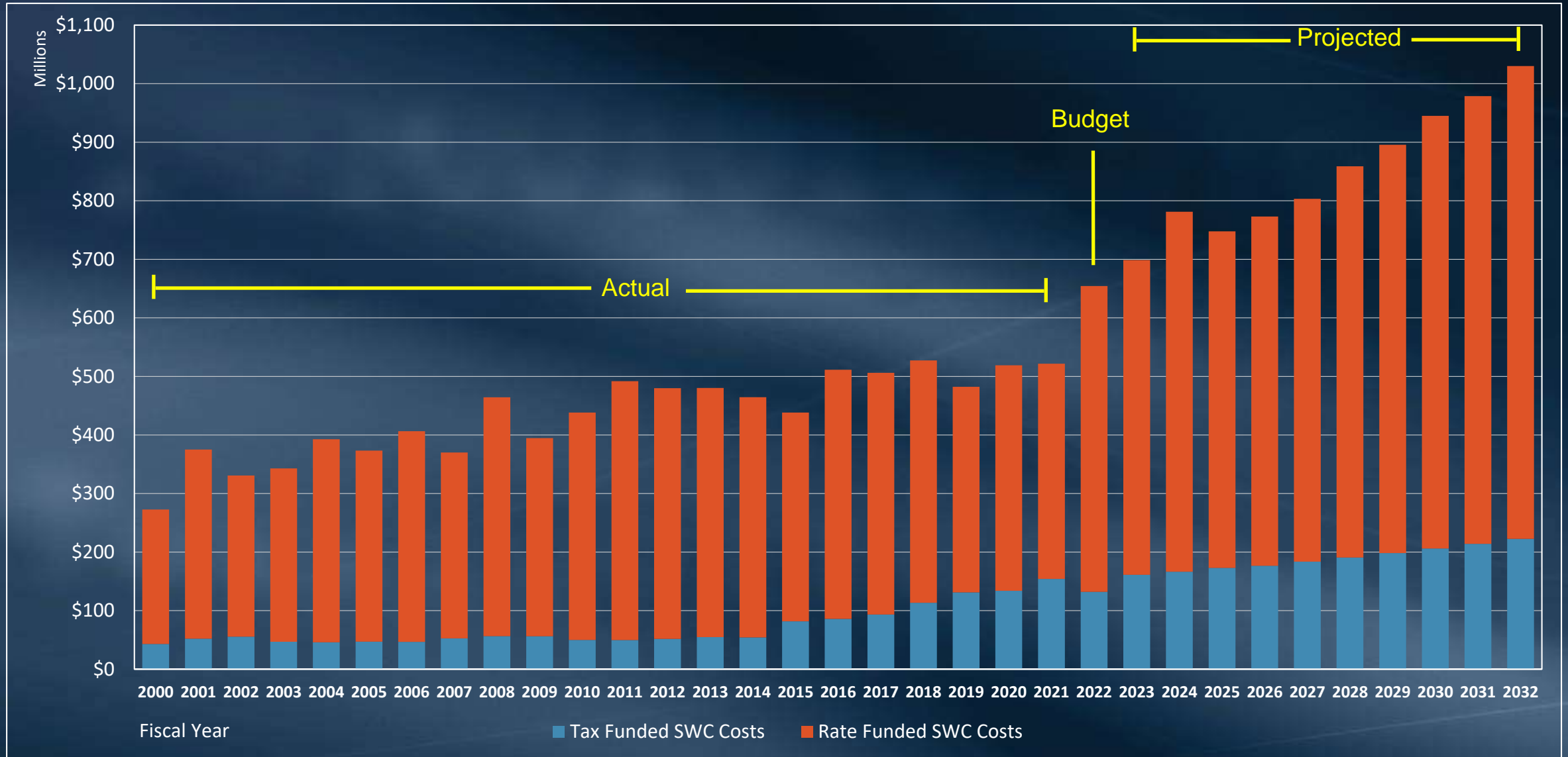
Outstanding Debt Service

DWR Burns-Porter Bonds

Calendar Year Annual BP Bonds Debt Service

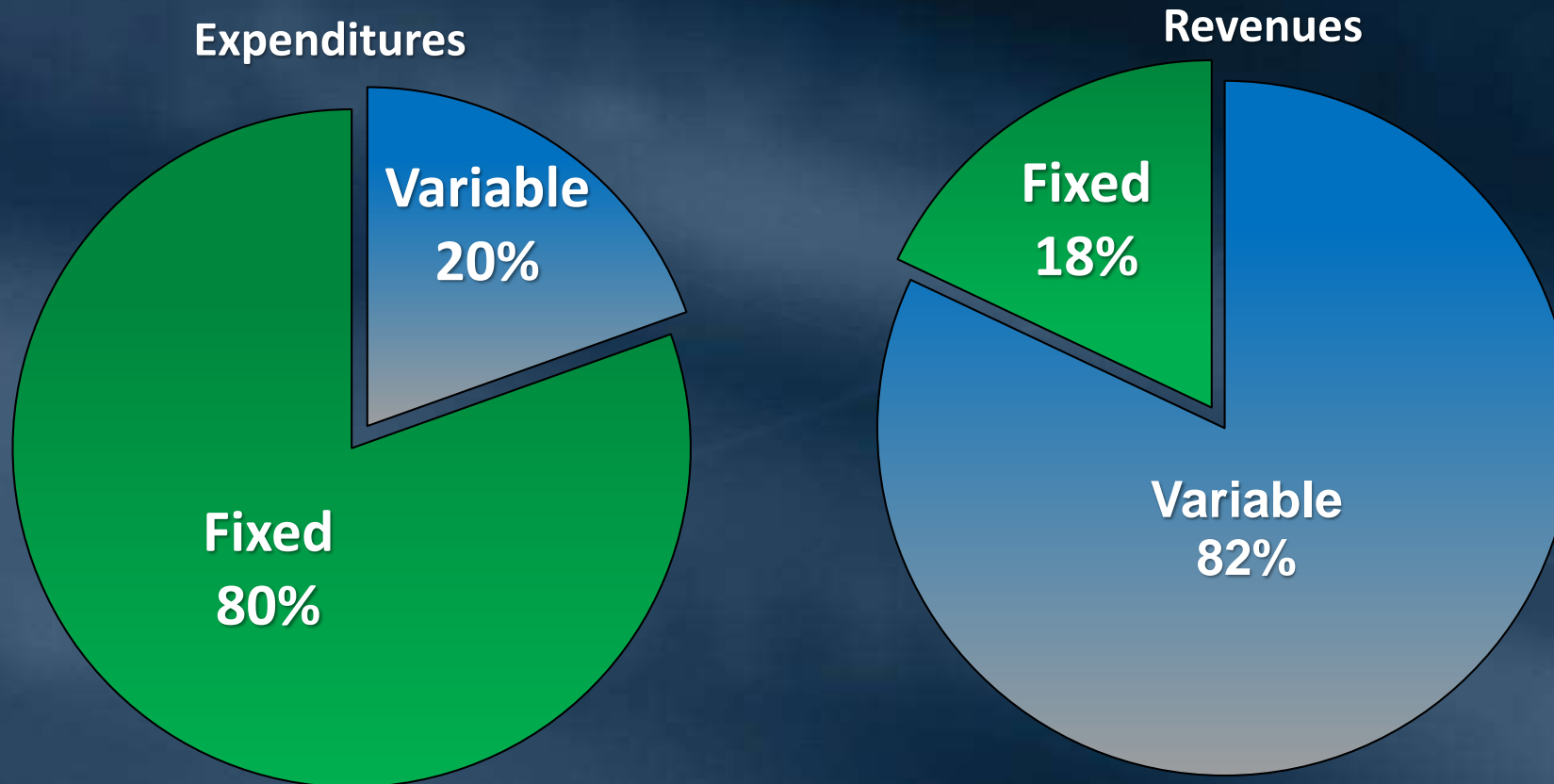


State Water Contract Costs



Fixed vs. Variable Components of Metropolitan Revenues and Expenditures

Proposed Budget FY 2022/23



Variable Expenditures include SWP Variable Power, CRA Power & Variable Treatment
Fixed Revenues include RTS Charge, Capacity Charge and Property Taxes

Credit Rating Assessment: Revenue Defensibility

- Credit ratings provide an overview of utilities' general financial health and ability to repay its debt obligations.
- Fitch Rating's U.S. Water and Sewer Rating Criteria
 - November 29, 2018 criteria included 30 percent or greater fixed revenue target
 - March 18, 2021 criteria introduce broader revenue defensibility metric
- Revenue defensibility is an “...assessment of a utility’s exposure to demand volatility and the flexibility within its rate-setting framework to recover costs of service and maintain operating profitability.”

Revenue Defensibility, cont'd

- “In its assessment of revenue defensibility, Fitch analyzes the historical patterns of revenue performance through economic and investment cycles, as well as growth trends over time, considering the utility’s revenue mix, customer characteristics, contractual framework, the economic underpinnings of its service area, and its capability to preserve revenue generation through rate increases or other measures.” (Page 4.)
- “Fitch may also determine the rate flexibility assessment to be higher...if characteristics are present that would tend to...lead to overall revenue stability...utilities who collect a significant amount of revenues from fixed charges, including revenues from property taxes or assessments, etc., may be assessed higher...given the nature of this income would...ensure greater revenue stability...” (Page 7.)
- “Fitch evaluates a utility’s vulnerability to sudden drops in demand and the impact on revenue defensibility...” (Page 7.)

Financial Policies and Fiscal Integrity

- The Board has adopted financial policies that provide guidance for determining its fiscal integrity.
 - Fixed-Charge Coverage Ratio of 1.20x
 - Minimum and Target Reserves
 - Revenue Bond Coverage Target of 2.00x
- A reduction in fixed charges increases dependence on variable revenue, which puts pressure on meeting the Board's financial policies during periods of higher volatility/low water transactions.

Property taxes help address Metropolitan's inherent volatility in its financial profile

- Metropolitan's inherent volatility is tied to cycles of hydrology and long-term impacts of Climate Change.
- Fixed revenues are a key factor in managing Metropolitan's financial volatility, which is tied to these underlying determinants.
- Property taxes represent approximately 50% of fixed revenues.
- As a more stable revenue stream, property taxes offset the need to adjust volumetric rates more frequently, or in a greater magnitude.
- If a determination regarding the applicability of Section 124.5 limitation is not made, an additional 9% rate increase would be required to recover costs

Metropolitan's fiscal integrity is supported by...

- Continuing an ad valorem property tax rate in excess of the 124.5 limit
- Maintaining a fixed revenue source in line with growing SWC costs
 - At its current rate of 0.0035 percent, property tax revenue would pay 22 percent of SWC obligations
 - If the Section 124.5 limit applies, property taxes would pay less than one-tenth of 1 percent of SWC obligations
- Providing a diversity of fixed revenue sources (Prop Tax, RTS/Standby Charge, Capacity Charge)
- Distributing the costs of Metropolitan's services more equitably (residences and businesses pay a modest share vs. Member Agencies) through property taxes

Support for a Four-Year Determination

- Making a four-year determination of the applicability of the MWD Act Section 124.5 is appropriate because...
 1. Provides flexibility to manage Metropolitan's finances during current drought conditions
 2. Ongoing financial and strategic planning efforts, which rely on this revenue component, won't be completed and implemented within the upcoming biennium budget period
 3. The inherent volatility found in Metropolitan's financial profile has a cyclicity beyond the biennium budget period
 4. Consistent with the scope of many financial planning timeframes

Next Steps

- The Board will hold a public hearing on March 8, 2022
 - Public comments on the applicability of Section 124.5 will be received at that time.
- At its regular Board Meeting on April 12, 2022, the Board will determine whether it is essential to fiscal integrity to continue to collect property taxes in excess of the Section 124.5 limit for FYs 2022/23 through 2025/26.
- If it makes such a finding, Section 124.5 will not apply in that timeframe.
- In August of each year, the Board may then set the property tax rate for the appropriate fiscal year. However, the Proposed Budget FYs 2022/23 and 2023/24 and CY 2023 and 2024 rates and charges assume the property tax rate is continued at 0.0035 percent.

