



San Diego County Water Authority

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

November 5, 2012

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 the Official Statement in connection with the issuance of the Water Revenue Refunding Bonds, 2012 Series G - OPPOSE

Dear Mr. Foley and Members of the Board:

We have reviewed 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 October 25, 2012 response from the Chief Financial Officer to our October 8, 2012 letter commenting on the changes he made to the last Revised Appendix A – many of which could have been, but were not, made available to the board members for review prior to the distribution of that Official Statement. We appreciate the opportunity to engage in a dialogue on these issues, if only through correspondence.

THE CHIEF FINANCIAL OFFICER’S OCTOBER 25 LETTER

We will respond to the points raised in Mr. Breaux’s October 25 letter in the order they were presented (headings ours).

Duty to disclose material information. We agree that Metropolitan’s offering statements are prepared to give investors material information about Metropolitan and its bond offerings. However, in addition to disclosure of material facts, it is also required that the information be presented in a manner that tells the “whole truth,” that is, in a manner that is not misleading. In addition to the specific factual issues we have identified in past correspondence, this is where we believe Metropolitan’s offering statements fall short. As one specific example (others have been identified in past letters on this subject), while Metropolitan discloses that none of its customers are required to purchase any water from Metropolitan, it does not tell the “whole truth” about its reduced sales, the nature and extent of local water supply development that is occurring throughout Southern California, or, that Metropolitan itself is so worried about its own reduced sales that it is engaging in a public relations campaign to try to impede local water supply development – at least here, in San Diego.

OTHER REPRESENTATIVE

County of San Diego

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

We do not agree that Appendix A “includes primarily historical information.” Or, that Metropolitan’s budget documents, resources planning documents and financial reports may be relied upon as a reasonable basis of future projections stated in the offering statements where those – materially outdated – documents are inconsistent with actual facts. By the measure described in Mr. Breaux’s letter, actual facts would be dismissed as “speculation” if those facts are inconsistent with Metropolitan’s planning documents. We have in past correspondence provided you and the other board members and staff many details why we believe Metropolitan’s fundamental planning documents are at best, materially outdated. All of these letters have been provided to you and the other board members and the complete inventory of letters may be accessed, as this letter may be, at www.MWDFacts.com.

Conservation “commitment” to the BDCP. Mr. Breaux appears to be saying that 1) Metropolitan has, indeed, made a “commitment” and 2) that it was made when the board adopted its Integrated Resources Plan (IRP), therefore, no further board action required. To argue that such a “commitment” was made because it is “consistent with the IRP and planning goals approved by the board” calls into question what the legal effect is of board adoption of the IRP.

If Metropolitan is contending that a “commitment” was made to conserve 700,000 acre feet of water beyond the 20x2020 retail mandated conservation savings in its IRP, then a different set of issues emerges, not the least of which is the need for CEQA compliance.¹ We ask again that you provide detailed information to the board of directors regarding this “commitment,” including what share of the 700,000 acre-feet of “*additional*” conservation is attributable to Metropolitan and how this will be factored into Metropolitan’s water resources plans and financial projections.

Changes to the official statement regarding the Quantification Settlement Agreement (QSA). Metropolitan changed language in the offering statement that had been presented in numerous prior bond offerings. The sole basis for those changes was to conform the language to its own new litigation theories. The Water Authority provided specific changes back to the prior language – which was consistent with the QSA agreements – but those changes were not accepted by Metropolitan.

Regarding the offering statement’s failure to adequately describe what would happen if the QSA agreements were interrupted, Metropolitan is fully able to describe what the impacts would be

¹ The Water Authority has advocated for an update to Metropolitan’s IRP, to take into account materially changed circumstances since the time the IRP was adopted by the board. Now, as a result of a recent court decision, Metropolitan must make its IRP more certain if it expects water suppliers to rely upon it in making water supply assessments associated with future development. See *Preserve Wild Santee v. City of Santee*, 2012 WL 5077156 (Cal.App. 4 Dist.) (Cal.App. 4 Dist., 2012) or 12 Cal. Daily Op. Serv. 11,906, 2012 Daily Journal D.A.R. 14,541. In its current form, the IRP is not a reasonable basis for projecting water resources or the need for water resources because it is not grounded in a reasoned estimate of future demand, and does not even purport to “account” for the future water supplies that will be developed in order to meet that demand. Instead, it promotes a “do everything” approach without taking into account what the cost would be or the likelihood of stranded investments.

under the *existing QSA agreements*. No one is claiming that there couldn't be negotiations or asking Metropolitan to speculate what the outcome of those negotiations might be.

Possibility that "all" future Southern California water supplies will be provided by Metropolitan. Based on your own explanation, the edit should be made to delete the phrase, "if any."

Discrepancy for standard of reporting local water supply development. Mr. Breaux's response to our letter does not address the issue we raised asking why the standard of disclosure of local water supply development for the City of Los Angeles is based upon its Urban Water Management Plan (UWMP), while for other agencies, including the Water Authority, the standard of disclosure Metropolitan is using is whether projects are "producing water or are under construction at the time a water sales projection is made." See our August 20, 2012 letter to Metropolitan RE: Board Memo 8-1 (OPPOSE), section **A-28 – Regional Water Resources**, at page 4 (the August 20 letter). We believe investors would want to know what plans *all* Metropolitan's member agencies have to buy less water from Metropolitan in the future, not just the City of Los Angeles. This is especially important information to be provided for the Water Authority, because it is Metropolitan's largest steady water purchaser.

Our letter did not dispute that the Los Angeles Aqueduct is a significant source of water supply within Metropolitan's service area. Nor did we dispute that certain disclosures are made about plans by the Water Authority to reduce its purchases of imported water from Metropolitan. What we asked is that Metropolitan "connect the dots" by making these disclosures in the appropriate sections of the offering statement regarding impacts on sales and revenues. See the August 20 letter, section **A-28 – Regional Water Resources**, at page 4.

LA-AVEK turnout. We agree that the "not-to-exceed" amount is a fact relevant to investors, however, the agreement itself does not contain such a limitation. That's precisely why we were concerned with Metropolitan's edits to the offering statement deleting the word "limits." We renew our request for an updated board report on this project and the amount of and limitations on anticipated reduced sales by Metropolitan when it is implemented.

Description of the IID-SDCWA water transfer. We have commented many times previously on how misleading it is to describe the provision of transportation and exchange services as the "sale of water" by Metropolitan in most contexts of its offering statement. While it is true that the fact of the water transfer is disclosed, the offering statement is misleading because it reports San Diego's purchase of water from IID as a water sale by Metropolitan. See the August 20 letter at page 1, **Reduced Sales**.

Metropolitan Sales Projections. There are a number of problems with Mr. Breaux's description of Metropolitan's process for estimating water sales that are then used in "**MANAGEMENT'S DISCUSSION OF HISTORICAL AND PROJECTED REVENUES AND EXPENDITURES.**" We have described the problems in past letters² which may be viewed at www.MWDFacts.com. A short summary is

² See, as an example, September 10, 2012 letter RE Update on "Rate Refinement" (Board Information Item 7-b); August 16, 2012 letter RE Rate Refinement Workshop and July 9, 2012

that Metropolitan's evaluation of six agencies³ showed its demand projections to be lower than the member agency projections in DRY years (an important fact not mentioned by Mr. Breaux in his letter). We do not disagree with that conclusion. However, in AVERAGE years, the member agency forecasts are LOWER than Metropolitan's forecast. For purposes of disclosures in Metropolitan's offering statements estimating future sales and revenues, a comparison of AVERAGE demands is much more informative to investors than a comparison of the occasional single or multiple dry year scenario. This is especially so since Metropolitan has also failed to "connect the dots" for investors to explain how its rate structure currently allows agencies to pay for water only in dry years when they need it, or that its failure to account for or properly allocate the cost of this dry-year capacity during average and wet years is one of the issues being challenged in the San Diego rate litigation.

Our past letters have raised two other critical facts not taken into account by Metropolitan or Mr. Breaux's letter: (1) Metropolitan's forecasted demands have decreased significantly in every iteration of its UWMP; and (2) Metropolitan has excluded from its UWMP plan significant local supplies that members are NOW developing. These projects include but are not limited to the Groundwater Reliability Improvement Program (GRIP) being developed by the Water Replenishment District of Southern California, the Carlsbad seawater desalination project being developed by the Water Authority, and the water transfers now being planned by the Los Angeles Department of Water and Power in order to fill the aqueduct connection authorized by Mr. Gastelum. If Metropolitan's "resources plan" included even a portion of these and other water supplies its customers are NOW developing, its future water sales would be greatly reduced.

Replenishment rates. The edits made to the offering statement do not address the fundamental problem that a significant portion of Metropolitan's projected water sales depend on the availability of discounted water – whether cast as a discounted replenishment water rate or as a new "incentive" based program. As we have pointed out in prior letters, it is inherently misleading for Metropolitan to report on the basis of "average" sales and "average" water prices that bear no relation to the actual economic factors investors need to make informed decisions about Metropolitan's future water sales and revenues.

PAYGo funding. Accurately describing the reason why Metropolitan's actual pay-as-you-go funding has consistently been less than *budgeted* does not require speculation – it is because Metropolitan's sales and revenues have consistently and substantially failed to meet budget.

Alleged cost-shifting. Metropolitan and the rest of its member agencies have contended for years

letter RE Update on Rate Refinement Discussion (F&I Item 7a). As indicated, each of these letters may be read in their entirety at www.MWDFacts.com.

³ Mr. Breaux refers to a "comprehensive analysis of all 26 member agencies," however, we are not aware of any such comprehensive report. If one exists, we request to be provided with a copy and will reassess the facts in regard to this issue. We are also unaware of any comparison of AVERAGE Urban Water Management Plan demands for all or even the six agencies and again request to be provided a copy if one exists.

that if Metropolitan's rates were revised as suggested by the Water Authority, it would unfairly "shift costs" to other member agencies. Please provide us with a copy of the financing team comments that have now questioned that premise and that were the basis of the edits made to the last offering statement.

Water purchase estimates for State Water Project. We disagree that the edits Metropolitan recently discovered should be made to the long-standing language of the offering statement are mere "wordsmithing."

EDITS TO THE OCTOBER 24, 2012 DRAFT OFFICIAL STATEMENT

The following specific comments address the most recent set of edits to the draft Official Statement, dated October 24, 2012. We incorporate by reference all of the prior comments made on the Official Statement, most of which have not been addressed by Metropolitan.⁴

A-3 – Integrated Water Resources Plan

The description added of the 2010 IRP update as an "adaptive management approach" is misleading. The IRP estimated water sales numbers are substantially higher than those used in Metropolitan's Urban Water Management Plan or disclosed in its offering statements. As noted in the August 20 letter at page 1, **Reduced Sales**, Metropolitan has finally reduced its water sales projections by 300,000 AF for FY 2013, 400,000 AF for FY 2014 and 350,000 AF for FY 2015 from those predicted in September 2010. However, these flawed numbers are still contained in Metropolitan's IRP and Metropolitan's IRP is still being used as the basis of its water resources planning and spending decisions. Calls to update the IRP or adjust spending decisions to *adapt* to these reduced demands have gone unheeded. Apparently, Metropolitan believes that its water sales can only "adapt" to increase, but never to decrease. This is a materially flawed planning assumption that is inconsistent with known facts.

Metropolitan should also include in the discussion of its IRP implications of the recent *Preserve Wild Santee* case noted in footnote 1 of this letter.

A-18 – Sale of Water by the Imperial Irrigation District to San Diego County Water Authority

Add to the last sentence of the first full paragraph at page A-19, "and Metropolitan has agreed to convey and exchange to the Water Authority in 2012 an additional 16,722 acre-feet of Conserved Water, regardless of the pending dispute between the parties as to whether the water was actually made available in 2011."

A-31 – Los Angeles Aqueduct

Disclosure should be made of the litigation that the City of Los Angeles has recently filed challenging its Eastern Sierra environmental mitigation obligations. The implications of this litigation should also be added at page A-12 discussing the open-ended "decision tree" process for determining

⁴ Past comments were provided in 2012 letters dated August 29, August 20, June 11, April 9 and February 13. All letters may be viewed at www.MWDFacts.com.

environmental mitigation requirements associated with the BDCP.

A-34 – Seawater Desalination

The offering statement has embedded Metropolitan's disclosure of the Water Authority's Carlsbad seawater desalination project in the discussion about its own subsidy program in a manner that is misleading and creates the impression that implementation of the Water Authority's project depends upon execution of the original multi-party incentive agreement in which Metropolitan was a party. Metropolitan is not a party to the Water Authority's draft water purchase agreement with Poseidon. We suggest deleting the following sentence that was added to the middle of the last paragraph on page A-34, "In late September 2012, SDCWA released a draft water purchase agreement with Poseidon for public review." The same sentence is included in the paragraph that has been added at the top of page A-35, where it is less misleading.

A-48 – Water Sales

While we appreciate the addition of footnote 3 to disclose that 225,000 acre-feet of Metropolitan's 1,676,855 acre-feet of water sales in 2012 were replenishment sales,⁵ the report of Metropolitan's water sales remains misleading as a result of its use of "averages" and its inclusion of its transportation and exchange of the Water Authority's Colorado River water as "water sales" by Metropolitan. Providing more detailed information about *actual sales* rather than "average" sales would help investors understand important and substantial trends in the volume of sales and price of Metropolitan water.

A-52 – Member Agency Purchase Orders

Metropolitan fails to disclose the conclusion reached by Metropolitan's own staff and reported to the board of directors, that the use of Purchase Orders fails to meet the board's articulated objective of providing for an annual assured revenue stream sufficient to pay Metropolitan's costs.⁶ Metropolitan's Purchase Orders are also subject to the requirements of state law and the state constitution including but not limited to Proposition 26.

A-53 – Classes of Water Service (Replenishment)

The description of the "Replenishment Service Program" as a sound water resource and financial program is inconsistent with Metropolitan's own assessment of the Program⁷ as featuring "questionable and unquantifiable performance criteria for a discounted water program," loss of full service sales due to the availability of discounted water and the unequal distribution of costs and benefits among the member agencies. Given that Metropolitan has disclosed that it remains in

⁵ Although it will not solve the bigger problem associated with Metropolitan's use of averaging, we suggest that you include the word "discounted" before "replenishment sales" in footnote 3.

⁶ See the Water Authority's September 10, 2012 letter to the board RE Update on "Rate Refinement" (Board Information Item 7-b), available at www.MWDFacts.com.

⁷ See Metropolitan's April 26, 2011 Board Memo 5-1 and a long series of letters on this subject included in the *Discounted Replenishment Water* section of www.MWDFacts.com.

discussion with its member agencies about how to continue discounted water sales under a new label (“incentive-based water storage program”),⁸ the last paragraph of this section, describing the fact that discounted water sales offset full service water sales, should not be deleted.

A-65 and A-70 – Variable Rate and Swap Obligations

Metropolitan has added a number of disclosures in its official statement regarding a possible loss in the value of its existing swap transactions that could be as high as \$169 million if interest rates remain unchanged or do not increase substantially during the remaining life of the swap agreements which range between 8-12 years. Further, it appears that the counterparty holding the swap can elect to terminate during optional dates which would result in an immediate loss to Metropolitan. This should also be disclosed in Metropolitan’s offering statement. Please advise if this is a correct interpretation of the disclosures added to the offering statement and whether these investments are consistent with the board’s investment policy.

A-79 – Historical Projected Revenues and Expenditures

See discussion at A-48 and footnote 5 of this letter, that the word, “discounted” should be added before the words, “replenishment sales” in footnote (b) at page A-80.

In addition, given (1) Metropolitan’s actual water rate increases as described; (2) Metropolitan’s reduced water sales as described at section A-3 of this letter; (3) the time line within which Metropolitan is legally required to disclose and begin to manage payment of its combined unfunded retiree health care obligation and unfunded pension obligation currently totaling \$757 million; and (4) the projected time line for BDCP implementation, there is no reasonable basis for the statement by MANAGEMENT that “rates and charges are projected to increase 3.0 percent per fiscal year” beginning in 2015 and thereafter. The *actual* rate increases over the past five years are a far better indicator of Metropolitan’s future rate increases than the projection by MANAGEMENT.

A-81 – Board direction to staff to evaluate cost-of-service methodology to ensure that all rates and charges recover the full cost of service effective January 1, 2011

It should be disclosed that the Water Authority’s MWD rate litigation alleges that Metropolitan has failed to properly allocate its costs proportionally among the member agencies that benefit. The staff has also failed to comply with this board direction by failing to include in its cost of service a credible plan to pay the cost of Metropolitan’s unfunded retiree health care obligation and unfunded pension obligation – currently totaling \$757 million. Given that investors rely upon the willingness of the Metropolitan board to raise water rates sufficiently to cover its expenses, it should be clearly disclosed in the Official Statement that these costs are not covered by the water rates and charges recommended by staff and approved by the board of directors.⁹

⁸ Indeed, development of a program for the sale of discounted water has been stated by the member agency managers to be one of Metropolitan’s top three “priorities.” See slide 2 of August 24, 2012 MWD Member Agency Managers Meeting PowerPoint Presentation.

⁹ Jerry Sanders, the Mayor of the City of San Diego, recently wrote to Metropolitan expressing his concern about this unfunded liability and the fact that Metropolitan does not have a plan to

Mr. Foley and Members of the Board

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A-81 – “Unrestricted” Reserve Balances

We do not understand how reserve balances that are held as collateral can be described as “unrestricted.” Please explain.

Except as otherwise noted, the comments in this letter, including those that are incorporated by reference, address only those issues that are actually highlighted in the draft revisions distributed by Metropolitan to the board of directors dated October 24, 2012.

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 Members and Member Agencies