



San Diego County Water Authority

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June 7, 2013

John (Jack) V. Foley and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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

OTHER REPRESENTATIVE

- County of San Diego

RE: Board Memo 8-5: Authorize the execution and distribution of the Official Statement in connection with the issuance of the Special Variable Rate Water Revenue Refunding Bonds, 2013 Series E (Flexible Index Mode) – OPPOSE

Dear Chair Foley and Members of the Board:

We have reviewed June 11, 2013 Board Memo 8-5, including the redline copy of Appendix A, and determined we must again vote against the staff recommendation to authorize execution and distribution of the Official Statement in connection with the sale of bonds. In making this determination, we have also considered the information provided by Mr. Breaux in his May 22, 2013 response to our last letter to you on this subject dated May 13, 2013.

Before we address the specific comments we have on the current draft Appendix A, we will address some of the comments and information provided by Mr. Breaux.

Investment Policy. Mr. Breaux states that, “[n]othing in the swap portfolio affects the investment policy,” and that, “the Statement of Investment Policy does not apply to interest rate swaps, which are governed by the Master Swap Policy.” Thank you for this technical clarification. However, to get the issue back in context, our initial question was prompted by MWD’s disclosure in a PowerPoint presentation, that MWD ratepayers would be funding as much as \$20 million in termination penalties associated with the proposed financing plan for which the bonds were being sold. In our February 11, 2013 letter we asked,

We request a detailed report to the board on the swap policy and on the MWD Board’s broader investment policy for the protection of water ratepayer funds. We believe that it is important for the Finance and Insurance Committee and Board of Directors to receive a more robust and detailed report of these activities, as well as to look at the Board’s investment policies and consider whether they should be updated or changed to be more conservative.

Whether it’s the board’s investment policy or swap policy, the central question is one of risk – specifically, how much risk the board is willing to take with ratepayer dollars.

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

While the information provided to the board noted the potential rewards of interest rate swaps, we found it virtually devoid of any explanation of the risks associated with interest rate swaps. Failure to fully explain the risks associated with such a complex, structured financial product leaves MWD open to criticism when the actual facts evolve in such a way, as they have in this case, that MWD could have saved more by staying in variable debt. This is one of the reasons that many agencies and cities are unwilling to authorize interest rate swap agreements.

We look forward to your July presentation and hope that it will focus on the subject of risk, including whether the swap policy is consistent with the objectives of the board's overall investment and financial policy.

Interest-bearing account. Mr. Breaux states that, "the amounts that are in dispute are being set aside in a separate account..." Please provide the account information.

We respectfully disagree with the rest of the responses and conclusions stated in Mr. Breaux's letter.

Comments on Draft Appendix A

Frequency of editorial changes to the Official Statement. In general, we are concerned with the frequency of editorial changes being made to the Official Statement that do not reflect updates to describe material events that have occurred since the last distribution of the Official Statement.

A-30: Level of water sales estimated by MWD. The redline deletes the following sentence:

The level of water sales estimated in Metropolitan's adopted biennial budget and revenue requirements for fiscal years 2012-13 and 2013-14 reflect local supplies from the Los Angeles Aqueduct system and other systems at higher than normal levels based on hydrologic conditions that occurred in 2010 and 2011.

Why is this statement being deleted, given that there cannot possibly have been a change in the level of water sales estimated in the biennial budget?

A-32 Conjunctive Use. As in the case of past edits to the Official Statement relating to the Replenishment Service Program, the edits to the first full paragraph change the prior statement describing objectives to statements of fact about the purported benefits of discounted water sales. We have stated many prior objections and provided extensive comments on the inaccurate and unsupported characterizations of purported benefits from MWD's sale of discounted water.

A-32 Seawater Desalination. We have commented previously that MWD's description of

Regional Water Resources and Local Water Supplies is generally misleading, because it is written in a manner that suggests MWD is, or must somehow be involved in local projects, through the payment of subsidies or otherwise. As requested in past correspondence, we believe that the Official Statement should be corrected to include discussion about the local water supply development plans that all of the member agencies have, not just the City of Los Angeles. See, for example, our letter dated November 5, 2012 at page 3, *Discrepancy for standard of reporting local water supply development*.

Given that the MWD Seawater Desalination Program incentive agreement referenced in the statement was not signed, we suggest that the last paragraph on page A-32 be edited to read as follows:

In November 2012, SDCWA approved a water purchase agreement with Poseidon Resources LLC (Poseidon) for a seawater desalination project in Carlsbad (the "Carlsbad Project") for a minimum of 48,000 acre-feet and a maximum of 56,000 acre-feet per year. The Carlsbad Project is under construction and is anticipated to be completed in 2016.

The rest of the paragraph is not relevant; what the investor needs to know is that MWD sales will be reduced by the Carlsbad Project.

A-45: MWD Revenues – ad valorem property taxes. We recommend you delete the last sentence because it does not accurately reflect the legislative history of the statutory limitation on MWD's authority to levy ad valorem property taxes.

A-58: Investment of moneys in funds and accounts. What changes have occurred since the last Official Statement in May requiring MWD to add the disclosure that, "the market value of Metropolitan's investment portfolio is subject to market fluctuation and volatility and general economic conditions"?

A-79: Financial projections that take into account actual results of operations and assumed water sales. The following text, which describes the basis of the projected revenues and expenditures is deleted:

The projected financial information relating to fiscal year 2012-13 in the following table is based on a financial projection as of December 31, 2012 which takes into consideration actual results of operations through December 31, 2012, projections for the period of January through June 2013 and assumes sales of 1.74 million acre-feet. Based on actual results of operations through March 31, 2013 and projections for the period of April through June 2013, Metropolitan now projects for fiscal year 2012-13 that water sales will increase to 1.81 million acre-feet, Parity Bonds Debt Service Coverage will be 2.24, Debt Service Coverage on all Obligations will be 2.23, and Fixed Charge Coverage will be 1.70.

Footnote (a) now states:

Projected revenues and expenditures are based on assumptions and estimates used in the adopted 2012-13 and 2013-14 biennial budget and reflect the projected issuance of additional bonds. Projected revenues and expenditures for fiscal year 2012-13 include actual financial results for July 2012-March 2013 with revised projections for the balance of the fiscal year.

What necessitated this change in the description of the basis of MWD's statement of historical and projected revenues and expenditures? Or, please confirm if no change in the process has been made or is intended to be described.

A-82: *Cost of service.* MWD should disclose that it does not believe that statutory and constitutional requirements limiting how much a utility may charge for its services apply to MWD. This could be done by adding the following sentence at the end of the second full paragraph:

Metropolitan contends that this is the sole legal requirement affecting the setting of its rates and charges and that cost-of-service industry standards and legal limitations, including but not limited to Proposition 26, do not apply to Metropolitan. See "METROPOLITAN REVENUES—Litigation Challenging Rate Structure" in this Appendix A.

We incorporate by reference all of our prior comments which have not been corrected in this or past versions of the Official Statement.¹

Sincerely,



Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Authority Board of Directors and Member Agencies

¹ Water Authority letters dated 9/22/2010, 12/9/2010, 5/16/2011, 8/22/2011, 2/13/2012, 4/9/2012, 6/11/2012, 8/20/2012, 8/29/2012, 10/8/2012, 11/5/2012, 2/11/2013 and 5/13/2013.