



San Diego County Water Authority

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

May 12, 2014

Jeffrey Kightlinger 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 8-2: Authorize execution and distribution of the Official Statement in connection with the issuance of the Special Variable Rate Water Revenue Refunding Bonds, 2014 Series D, and authorize payment of costs of issuance from bond proceeds - **OPPOSE**

Mr. Kightlinger and Members of the Board:

The Water Authority's MWD Delegates have reviewed the May 13, 2014 Board Memo 8-2, including the redline copy of Appendix A and have determined we must again vote against the staff recommendation to authorize the execution and distribution of the Official Statement in connection with the sale of bonds. We request that staff and bond counsel respond to each of the issues and questions presented in this letter and past letters, which are incorporated by reference. Additional copies are available upon request.

General Comments

The INTRODUCTION (page A-1) has added a sentence that states that, "...statements [in Appendix A] are based on facts and assumptions set forth in Metropolitan's current planning documents, including, without limitation, its most recent biennial budget." We believe that this statement fails to adequately disclose that MWD's "long term" planning process is now effectively *limited* to the two-year planning horizon of the biennial budget. We believe that full disclosure of the relevant facts and circumstances would include, not only reporting that the Long Range Finance Plan has not been updated for more than ten years (since 2004), but that material changes have occurred during that time period. Further, that the member agencies have been *unable to agree on a long term finance plan to pay for MWD projects and programs*. We also believe that MWD should disclose its recent shift from forecasting *actual* projected revenues and expenses (to use MWD's new terminology, changed in this Appendix A), to the use of "average" sales assumptions," which staff has set at a number where sales are expected to be exceeded in seven out of ten years. Such an artificial

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

approach to "budgeting" -- is not "conservative," as it has been described by staff, it is a flagrant attempt to obviate the requirement to meet cost-of-service requirements in the setting of MWD's rates and charges. MWD simply wants to use massive over-collections -- as it has over the past two years -- any way it wants without having to explain to ratepayers in advance how much money it needs to provide the services it provides, i.e., have a real budgeting process.

Please explain the substantive change intended, if any, in the terminology edits of "expenditures" to "expenses" and "receipts" to "revenues" throughout this Appendix A.

Comments on Draft Appendix A

A-4: Drought Response Actions. MWD lacks a comprehensive board policy guiding the use and replenishment of storage reserves to meet dry-year demands. While MWD may have sufficient water in storage to meet full demands this year, the use of more than 1 million acre-feet -- or, almost one half -- of MWD's reserves in one year as currently planned poses a great risk to MWD's water supply reliability next year and in future years, should the drought continue. Appendix A should disclose that risk and MWD's plan to mitigate the risk and related impacts to MWD's revenues and finances. MWD should also disclose where it expects to secure supplemental water transfers and purchases to meet regional demands under current conditions.

A-4: Financial Reserve Policy. MWD's financial reserve policy for many years was to cap reserves to ensure MWD did not retain more cash than it needs from its ratepayers -- as evidenced by the use of the word, "maximum level" of reserves in all previous Appendix A Official Statements. Recently, staff self-declared that the policy was not a "cap" at all, but a "target," all without a single board meeting or directive to change the policy.

The discussion of *MWD's financial reserve policy* at page A-4 also creates the appearance that MWD has "planned" to manage under and over collections through its "financial reserve policy." Nothing could be further from the truth. MWD's revenue and expense projections have historically been off by hundreds of millions of dollars -- over or under. This is not the result of "drought," "climate change" any other unforeseen circumstance or financial management through MWD's "reserve" policy; it is simply the result of poor planning and estimation by MWD, and the improper use of reserves for expenditures other than maintaining stable and predictable water rates and charges. As noted above, MWD has recently changed its "budget" and rate-setting process to use sales and revenue estimates that staff *knows* will be exceeded in seven out of ten years. MWD has chosen to set budget and rates arbitrarily, rather than best-estimated sales and expense projections that are essential to sound business management and rate-setting. This shift and the risks of such an approach should be disclosed in Appendix A.

In order to avoid the consistent, materially incorrect shortcomings in its sales estimates used in rate setting, MWD should instead take into account its member agencies actual projected demand for MWD water, which factors in their reductions or increases in reliance on local water supplies. MWD's failure to do so presents a substantial risk of stranded costs and commensurate impact driving up water rates.

A-6 Recycled Water. The description of recycled water as "not potable" is dated and should be modified. Orange County Water District already is using recycled water to recharge its groundwater basin. With today's technology, recycled water can be treated to potable water quality.

A-21 Sale of Water by the Imperial Irrigation District to San Diego County Water Authority. The Water Authority has objected on many past occasions to the language describing the sale of water by IID to SDCWA and transportation of that water by MWD as the payment by the Water Authority of "a lower rate" for the MWD water. This language is designed solely to support MWD's litigation arguments, and does not accurately describe the facts or terms of the Exchange Agreement. The description is misleading in that it intends to suggest to the public that MWD's water sales are higher than they really are.

A-29 MWD water storage capacity and water in storage. The Table that describes MWD's various storage accounts should also disclose MWD's contractual obligations to deliver water out of storage. For example, on page A-26, the Appendix A described the arrangement MWD has with Southern Nevada Water Authority whereby MWD agrees to store unused Nevada's Colorado River apportionment for SNWA's later use. The Appendix A states that through 2013, MWD has stored 160,000 acre-feet of SNWA water, which it eventually will need to pay back. That information, and any other MWD obligations and limitations on available storage supplies, including take capacity, should be disclosed clearly on the table displayed on page A-29.

A-43 Capital Investment Plan. Please explain why "resource development" was deleted as an objective of the Capital Investment Plan (CIP). Also, how MWD has valued "flexibility" for purposes of rate-setting and allocation of CIP costs. These edits again appear to be litigation-driven rather than based on any facts or programmatic changes to or relative benefits of the CIP.

A-44 Pay-as-you-go funding. The Appendix A should disclose that the over-collected revenues were not the result of "improved financial operations," as stated, but rather, were the result of poorly estimated revenues and the intentional use of sales that exceed artificial estimates as described above. The Appendix A misleads the reader into believing that MWD's over-collected revenues are the result of improved financial operations, when nothing could be further from the truth. Further, the Appendix A states that, "[a]s in prior years, pay-as-you-go funding may be reduced or increased by the Board during the fiscal

year," without mentioning that the board has had an established pay-as-you-go funding policy that it has failed to meet. Moreover, there has never been any board policy discussion on the merits of changing the \$95 million cap to \$160 million. MWD's lack of disclosure on financial projections and policies is arbitrary and inherently involves great risk, which should be disclosed in the Appendix A.

A-46 Distribution system - prestressed concrete cylinder pipe. Please provide a copy of the estimate to reline all 100 miles of PCCP at \$2.6 billion.

A-46 Administrative Code. Please add a statement that the General Counsel has opined that the Administrative Code may be waived by the Board of Directors *ex post facto*, without prior notice and without even knowing that they are doing so. We are aware of no other public agency that has such an unusual procedural process, which we believe materially reduces the transparency and accountability of the MWD board of directors and limits the public's - and bond investor's - ability to be advised in advance and be heard on MWD board actions.

A-50 Property taxes. Please indicate that there is substantial disagreement regarding MWD's interpretation of what is "essential to the fiscal integrity of the district" and that there has been no cost-of-service study or report supporting the claim that the suspension of the tax limitation results in a "fair distribution of costs throughout MWD's service area," except for MWD's own bald assertion that is the case.

A-52 Water wheeling and exchanges as MWD "sales." MWD continues the highly misleading practice of reporting revenues from wheeling service as MWD water sales. Wheeling service should be reported separately from the sale of MWD water supplies. It is also highly misleading to investors to use "average" dollars per gallons per acre-foot of water sold because it impedes the ability of investors in MWD bonds to understand what alternative sources of supply are competitive with MWD water supplies and therefore may be expected to reduce MWD's future water sales.

A-53-55 Litigation Challenging Rate Structure. Although MWD characterized the Water Authority's rate cases as a challenge to MWD's "rate structure," the cases challenge the specific allocation of costs in the specific years at issue in each case. The description of the Court's ruling is incomplete in that it fails to mention that the Superior Court found that MWD's allocation of costs are **not reasonable** and violate the common law, California statutes and the California Constitution, including Proposition 26. The trial court has determined that MWD's rates violate all of these legal standards and requirements.

A-59, 60 Financial reserve policy. Please provide a copy of the probability studies of the wet periods that affect MWD's water sales. Please provide a 10-year summary of how successful the Water Rate Stabilization Fund has been in maintaining stable and predictable water rates

and charges. MWD's financial reserve policies must be revised to comply with Proposition 26. MWD is essentially operating a giant slush fund without any cost-of-service basis for its rates and charges prior to or after collection of those rates and charges.

A-62 Ten largest water customers. It is misleading to characterize wheeling/exchange water as MWD "water sales" because there is no basis in law or fact for doing so.

A-62-63 California ballot initiatives. The Appendix A fails to disclose that the Superior Court has already ruled that Proposition 26 applies to MWD for all rate years subsequent to the time the ballot measure was passed in November 2010, i.e., MWD is subject to Proposition 26 going forward. MWD has not established rates and charges that comply with Proposition 26 and will have the burden in court in future years to prove that it has done so. This presents a substantial risk of ongoing and continued litigation unless and until MWD changes its cost-of-service and rate-setting practices.

A-81 BDCP costs. Please confirm what BDCP costs have been included on the Table at page 81.

A-84 Historical and projected revenues and expenses. MWD's projected revenues and expenses have been arbitrarily established. No member of the public or investor could know what MWD's projected revenues and expenses will be, given the arbitrary manner in which MWD has established its budget and rates as described above. Further, MWD has a poor record of projecting future rate increases; its rates have more than doubled over the past ten years, which is materially more than projected by MWD. Its future rate projections -- which include investments that may be made in the BDCP -- will supposedly result in rate increases lower not higher than in the past. This is not logical or based on any credible cost analysis or rate projections.

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

Sincerely,



Fern Steiner
Director



Michael T. Hogan
Director



Keith Lewinger
Director



Vincent Mudd
Director