

Rate Refinement Workgroup

Meeting #1
June 28, 2012

Agenda

- Key Issues Overview
- Existing Purchase Order Review
- Existing Rate Structure Review
- Replenishment Rate Options
- Ad Valorem Tax Rate
- Treatment Cost Recovery
- Schedule/Process to move forward

Key Issues

- Issues related to Purchase Order
 - Background
 - Observations on effectiveness of Purchase Orders
- Use of Current Water Rate Structure to meet Rate Refinement Objectives
- Replenishment
- Issues related to fixed revenues
 - Property Tax fix assumptions
 - Treatment cost recovery

Purchase Orders Background

Statement of Common Interests included in the Strategic Policy Principles of 1999:



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Statement of Common Interests

- **Financial Integrity:** The MWD Board will take all necessary steps to assure the financial integrity of the agency in all aspects of its operations.
- **Imported Water Service:** MWD is responsible for providing the region with imported water, meeting the committed demands of its member agencies.
- **Choice and Competition:** Beyond committed demands, member agencies may choose the most cost-effective additional supplies from MWD, local resource development, or market transfers. These additional supplies can be developed through a collaborative process to balance opportunities with affordability.
- **Cost Allocation and Rate Structure:** The fair allocation of costs and financial commitments for MWD's investments in supplies and infrastructure will be addressed in a revised rate structure. Committed demand has yet to be determined. The revised rate structure will address allocation of costs, financial commitment, unbundling of services, and fair compensation for services.

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Strategic Planning Steering Committee principles for selecting the preferred rate structure:



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Review of Purchase Orders

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Summary of Purchase Orders

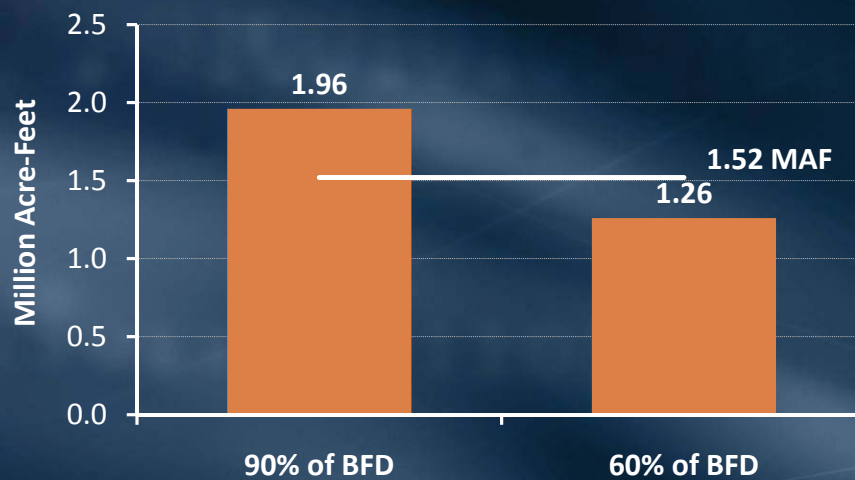
- Level of commitment was set at 60% of the IBFD to allow for wet hydrology, development of local resources
 - Growing agencies (Calleguas, Eastern, Western, Las Virgenes) had met their commitments by the end of the sixth year
 - All agencies had met their commitments mid-way through the ninth year
- Agencies not meeting their commitment only pay the Supply portion of the rates on undelivered water
- A condition of the phase out of the IAWP allowed participating member agencies to increase their Tier 1 limits for IAWP opt-outs; total of Tier 1 limit for CY 2012 is 1.96 MAF

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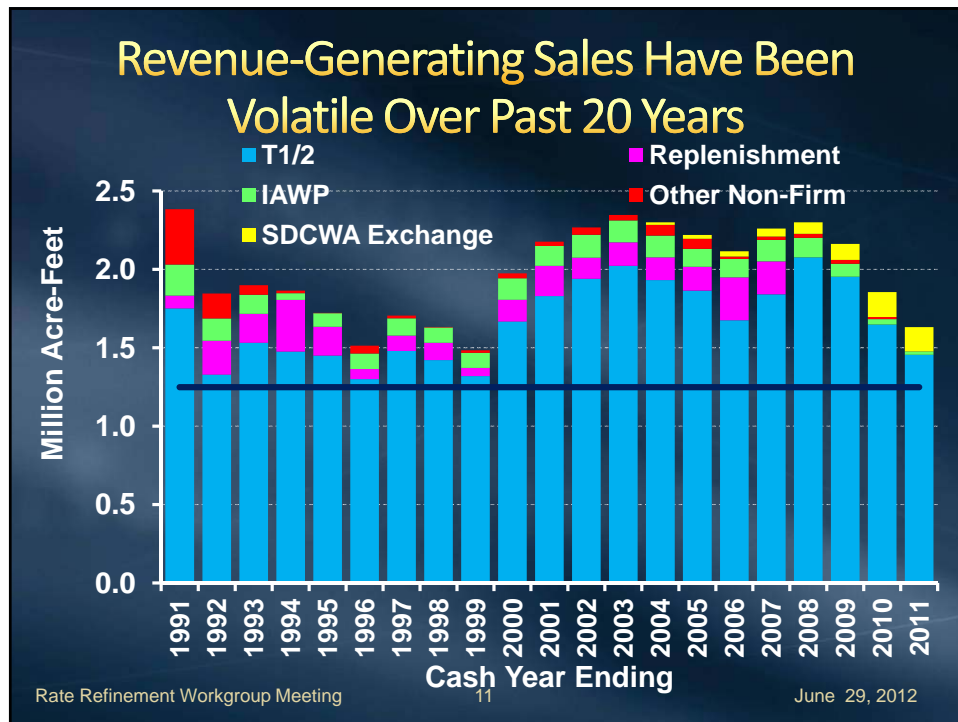
Impact of No Extension of Existing Purchase Orders, CY 2012 Tier 1 Limits



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Lessons Learned from Existing Purchase Orders

- Purchase Orders, as structured, did not provide for annual assured revenue stream
 - Reason for POs was to provide a financial commitment to Metropolitan in exchange for greater access to Tier 1 Supply rate
- Improved likelihood of realizing revenues through more conservative sales budgeting of 1.7 MAF going forward
- Improved certainty of revenues through additional fixed revenue sources

Observations/Lessons Learned from Existing Purchase Orders

- Implemented a two-tiered supply price
 - Initially, reflected the cost of a basket of resource projects to meet growing demands for supply
 - To increase the differential between Tier 1 and Tier 2, Tier 2 was revised to reflect the cost of a dry year water transfer
- Value of Tier 2 Pricing
 - Signal to invest
 - Does it need to apply every year?
 - At what level is a member agency exposed?

Observations/Lessons Learned from Existing Purchase Orders

- Continued use of purchase orders may not be necessary
- Current rate structure may be more effective way to address rate refinement objectives

Use of Current Rate Structure to Meet Rate Refinement Priorities

Rate Refinement Priorities

- Revenue Stability
- Water Management Objectives
- Replenishment Rates
- Fix Property Tax Rates
- Fixed Treatment Charges

Concepts for Using Revenue Structure to enhance Revenue Stability

- Rate structure elements unchanged
 - Unbundled, status quo
 - Use 1.7/1.75 MAF of sales/exchange to set rates
- Tier 2, Replenishment based on hydrologic/operational conditions
 - “Normal” = supply at Tier 1
 - “Dry” = Tier 2 in effect
 - “Wet” = Replenishment Rate at GM’s discretion; cost justified

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Concepts for Revenue Structure

- Tier 2 Supply Rate retained
- Option #1: Tier 2 applicable when water transfers are needed in a dry year
 - Tier 2 AF amount is calculated based on dollar costs of transfers / Tier 2 Rate (currently \$290/AF)
 - Resulting Tier 2 AF assigned pro rata to each member agency in following year based on 3-year average of firm sales
 - Every member agency shares in the additional dry year supply cost impacts; is effectively a dry-year surcharge
- Other Options
 - Roll existing calculation forward
 - Results in mismatch between allocation and need for some agencies
 - Re-establish the Initial Base Firm Demand
 - Highest firm sales in last XX fiscal years or XX-year average

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1.7 MAF: A Conservative Figure For Budget Planning



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Alternative T2 Rate Collection

Option 1 – Surcharge tied to cost of transfers

Example:

- MWD purchases \$15M of water transfers in 2012.
- The \$15M will be collected based on the T2 rate in 2013.
- The 2013 T2 Rate = \$290/AF
- In 2013 51,724 AF ($\$15\text{M} / \290) of T2 water will be assigned.
- The T2 water will be allocated to the Member Agencies based on the 3-year average firm sales (FY2009-FY2011).
- Effectively a surcharge on all firm sales.

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Alternative T2 Rate Collection

Option 1 – Surcharge tied to cost of water transfers

	3-Yr Avg Firm Sales, AF	Share	T2 Sales, AF	T2 Sales, Dollars
Anaheim	22,755	1%	723	\$ 209,632
Beverly Hills	10,841	1%	344	\$ 99,872
Burbank	10,890	1%	346	\$ 100,323
Calleguas	103,485	6%	3,287	\$ 953,360
Central Basin	57,546	4%	1,828	\$ 530,149
Compton	2,388	0%	76	\$ 22,001
Eastern	91,756	6%	2,915	\$ 845,302
Foothill	9,954	1%	316	\$ 91,701
Fullerton	9,972	1%	317	\$ 91,866
Glendale	18,152	1%	577	\$ 167,224
Inland Empire	66,096	4%	2,100	\$ 608,914
Las Virgenes	20,866	1%	663	\$ 192,231
Long Beach	31,489	2%	1,000	\$ 290,096
Los Angeles	286,457	18%	9,100	\$ 2,638,998
MWDOC	219,108	13%	6,960	\$ 2,018,539
Pasadena	20,449	1%	650	\$ 188,391
San Diego	328,385	20%	10,432	\$ 3,025,255
San Fernando	20	0%	1	\$ 184
San Marino	672	0%	21	\$ 6,194
Santa Ana	13,292	1%	422	\$ 122,455
Santa Monica	10,298	1%	327	\$ 94,874
Three Valleys	63,319	4%	2,011	\$ 583,327
Torrance	17,734	1%	563	\$ 163,371
Upper San Gabriel	20,917	1%	664	\$ 192,696
West Basin	120,540	7%	3,829	\$ 1,110,482
Western	70,834	4%	2,250	\$ 652,562
Total	1,628,216	100%	51,724	\$ 15,000,000

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Observations on Use of Rate Structure for Water Management Actions

- Links rate structure and water management actions
 - In dry years, Tier 2 is in play
 - Under Option #1, all agencies share in Tier 2
 - Under other options, agencies not staying within their Tier 1 limit pay Tier 2
- Addresses several concerns
 - Retains Tier 2 Price signal
 - Determines when Tier 2 is in effect
 - Provides revenue stability and certainty through development of additional fixed revenues

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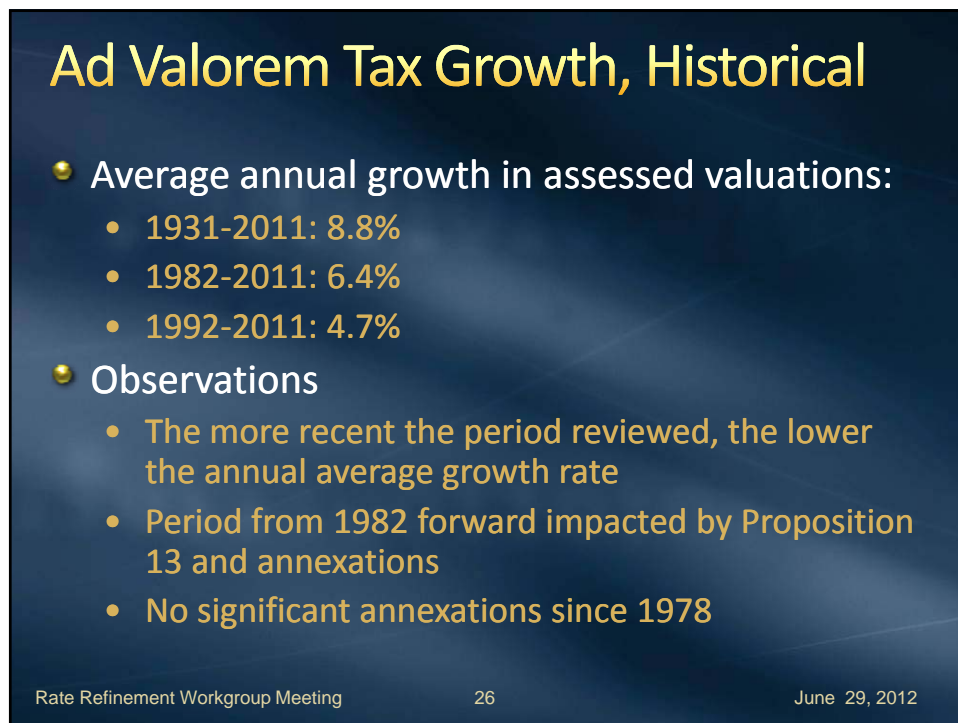
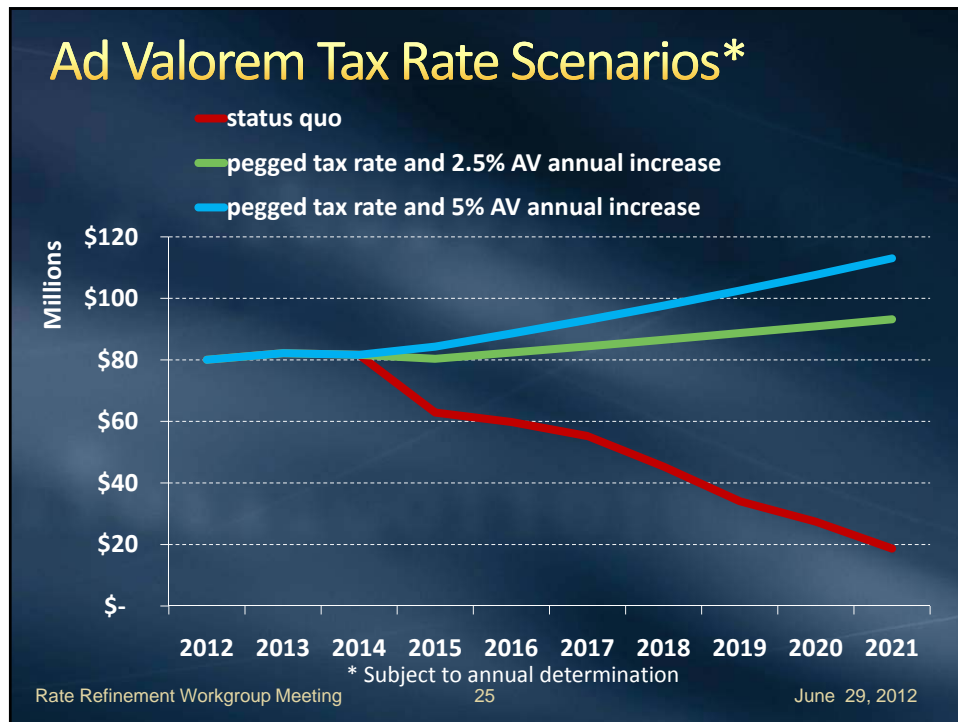
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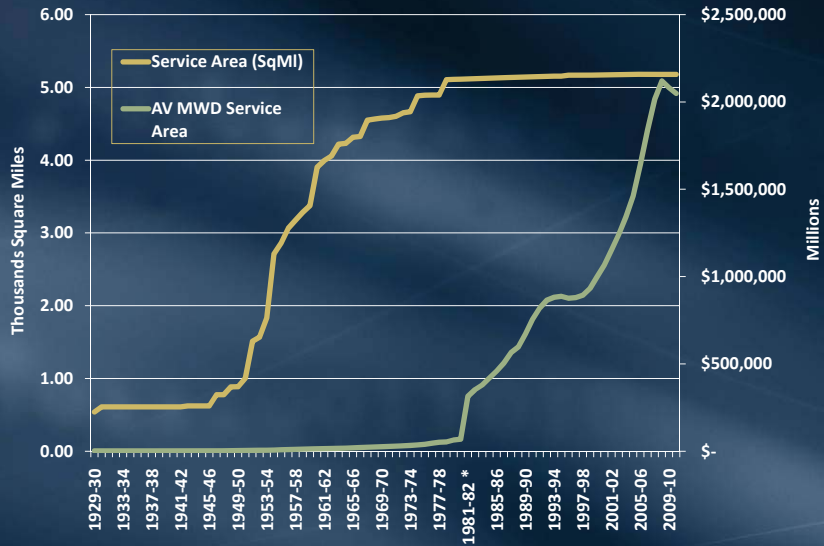
Replenishment Proposal

- Cost basis for program
- Available when surplus supplies exist
- Three Options
 - Option 1- Tier 1 full service rate
 - Option 2- Exempt from Capacity Charge calculation
 - Replenishment will be delivered only during periods when excess System Capacity exists
 - Option 3- Exempt from Capacity Charge and RTS
 - RTS applied to firm water sales; recovers the costs of conveyance capacity not used for average system demands and emergency storage; Replenishment is interruptible and discretionary and doesn't benefit from these costs

Ad Valorem Tax Rate



Annexed Area & Assessed Valuations



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Treatment Cost Recovery

Treated Water Cost Recovery

- March 2005 Board Action:
 - “Work with the member agencies and Budget, Finance, Investment and Insurance Committee to evaluate a Treated Water Capacity Charge to be considered by the Board in January of 2006 to be effective January of 2007”
- November 2005 Information letter
 - No follow-on discussion
- Rate Refinement Process
 - Many alternatives reviewed
 - Board has expressed continued concern regarding cost recovery for treatment related costs

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Treated Water Cost Recovery

- Treated water costs for FY 2012/13 from Cost of Service report
 - Fixed Demand: \$48.3M assigned to peaking
 - Fixed Standby: \$28.4M assigned to standby
 - Fixed and Variable Commodity: \$165.6M volumetric
- Develop Treatment Cost Recovery consistent with the Conveyance and Distribution system cost recovery
 - Standby costs recovered through a Treatment RTS
 - 10-year rolling average of firm treated water sales
 - Peaking costs recovered through a Treated Water Capacity Charge
 - Three year look back of summer peak day demands, phased in
 - All other costs are recovered on a volumetric basis

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Summary

- Achieve Revenue stability and certainty
 - Use existing rate structure with more conservative sales for budget and rate setting, combined with improved Treatment Cost recovery
 - Use existing rate structure to reach water management goals
 - Replenishment program based on rate structure and services that interruptible sales benefit from
- AV tax fix offsets revenues required from rates and charges
 - Frees up revenues for other purposes

Process to Move Forward

Schedule/Process to Move Forward

- Member Agency Managers meetings
 - June 15, July 13, August 24, September 14
 - Managers establish priorities and objectives
- Rate Refinement Workgroup to meet between Managers meetings
 - Friday, June 29
 - Wednesday, July 25 OR Friday, July 27
 - Wednesday, August 29 OR Thursday, August 30
 - Wednesday, September 26
- Board Information letter in October 2012
- Board Action letter in November 2012
 - Administrative Code changes

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Timeline : Rate Refinement

