



Finance, Affordability, Asset Management, and Efficiency Committee

Approve Revisions to Metropolitan's Reserves Policy

July 8, 2025
Item 7-7

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Approve Revisions to Metropolitan's Reserves Policy

Subject

- Approve Revisions to Metropolitan's Reserves Policy and Direct Staff to Implement Specific Sales Projections for the proposed FY 26/27 and 27/28 Biennial Budget and CYs 27 and 28 Rates and Charges

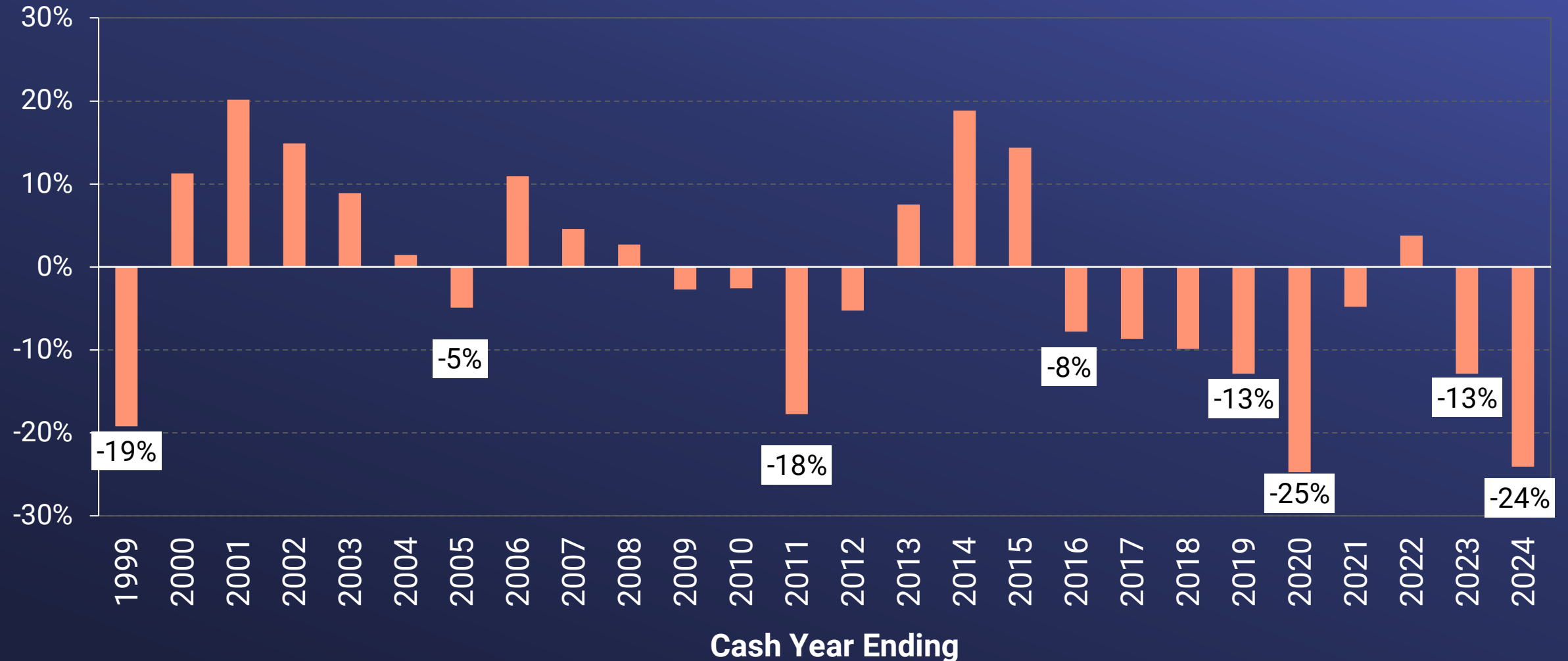
Purpose

- To present recommended revisions to Metropolitan's Reserves Policy and seek Board direction on implementing specific sales projections for the development of the FY 2026/27 and FY 2027/28 Biennial Budget

Workgroup Recommendations on Unrestricted Reserve Policy

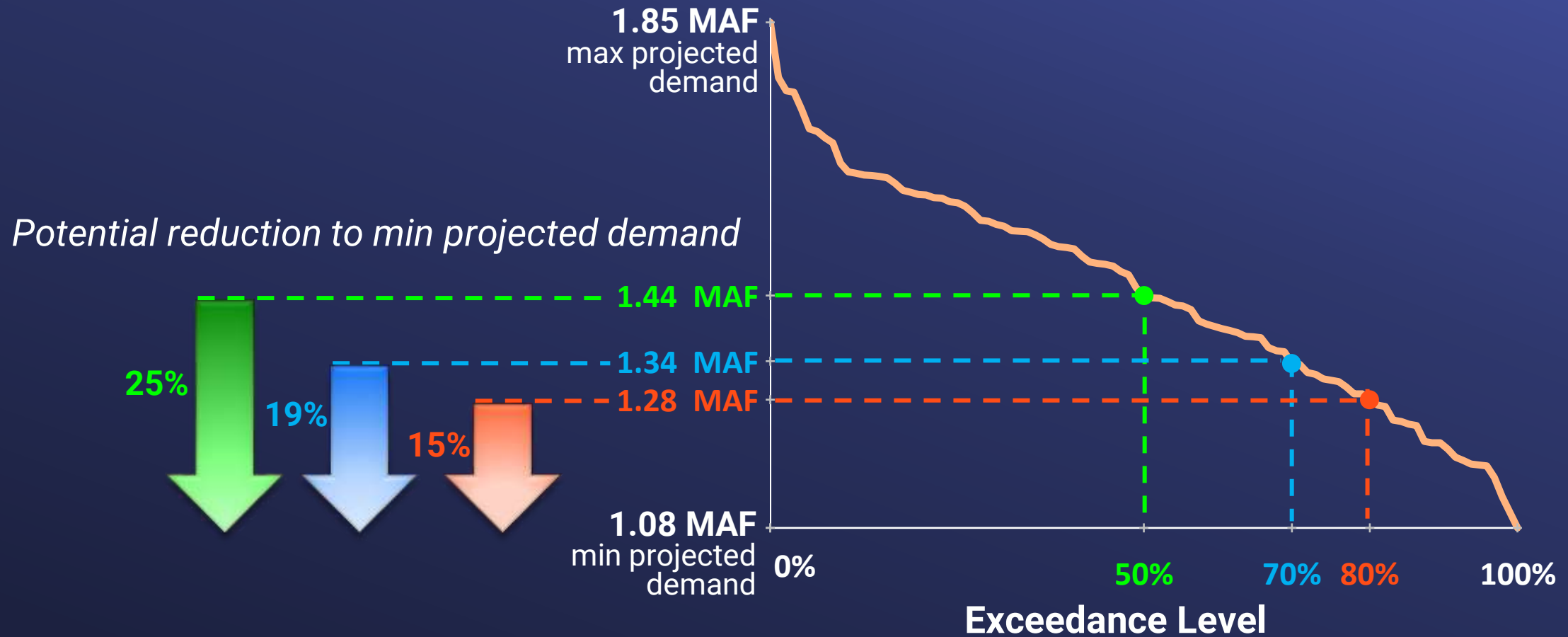
Variability Metropolitan's Historic Water Transactions

% change from budget



Projected Demand Variability

Projected Demands (MAF) for Calendar Year 2025



Recommendations: Unrestricted Reserve Policy Changes

Technical Changes:

1. Update the Percent Reserves to reflect recent water sales volatility
 - ✓ Incorporate conservative demand assumptions in rate setting into the calculation
 - Adopt policy to set water demand at 70% exceedance for rate setting with a long-term target of 80% to increase reserves
2. Recognize the disconnect between supplies and sales
 - ✓ Exclude variable costs from reserve calculations
 - ✓ No correlation between water sales and variable costs
3. Incorporate protection for treated water sales volatility
 - ✓ Include Treatment revenue requirements in the Unrestricted Reserve Minimum and Target Levels to enhance volatility protection for treated water sales revenues → Treatment Surcharge Stabilization Fund would be combined into unrestricted reserves
4. Adjust required reserve calculation to exclude one-time revenues and unawarded grants

Policy Changes

1. Update Admin Code language regarding the appropriate use of reserves in excess of target levels
2. Add language specifying the intentional use of reserve for one-time expenditures, unforeseen revenue shortfalls or increases in existing expenditures

Current Unrestricted Reserve Calculation

for June 30th, 2025, in millions of dollars

	2025/26 Budget	2026/27 Forecast	2027/28 Forecast	2028/29 Forecast
Gross Revenue Requirement	\$2,274	\$2,408	\$2,597	\$2,773
Less Property Tax	\$334	\$342	\$351	\$359
Less Interest Income, Power Sales & Misc. Revenues	\$120	\$97	\$84	\$86
Less Unawarded Grants & One-time Revenues	\$127	\$20	\$20	\$20
Less Fixed Charges				
<i>RTS Charge</i>	\$185	\$188	\$202	\$219
<i>Capacity Charge</i>	\$46	\$48	\$52	\$56
Net Water Rate Revenue Requirements	\$1,462	\$1,713	\$1,889	\$2,033
Less Variable Costs				
Treatment Surcharge Rev Req.	\$342	\$342	\$362	\$369
SWC Variable Power Costs	\$238	\$236	\$235	\$233
CRA Power Costs	\$93	\$97	\$99	\$102
Fixed Costs Recovered by Water Rate	\$789	\$1,037	\$1,193	\$1,329
Percent Reserved	17.5%	17.5%	17.5%	17.5%
Annual Amount Reserved	\$138	\$181	\$209	\$232

Minimum Reserve Level = 138 + 181 / 2 = \$229 million ← 18 months

Target Reserve Level = 138 + 181 + 209 + 232 / 2 = \$645 million ← 42 months

Proposed Refinements to Unrestricted Reserve Calc.

for June 30th, 2025, in millions of dollars

	2025/26 Budget	2026/27 Forecast	2027/28 Forecast	2028/29 Forecast
Gross Revenue Requirement	\$2,274	\$2,408	\$2,597	\$2,773
Less Property Tax	\$334	\$342	\$351	\$359
Less Interest Income, Power Sales & Misc. Revenues				
Less Unawarded Grants & One-time Revenues				
Less Fixed Charges				
<i>RTS Charge</i>	185	\$188	\$202	\$219
<i>Capacity Charge</i>	\$46	\$48	\$52	\$56
Net Water Rate Revenue Requirement	462	\$1,713	\$1,889	\$2,033
Less Variable Costs				
Treatment Surcharge R			\$362	\$369
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Fixed Costs Recovered by Water Rate	\$789	\$1,037	\$1,193	\$1,329
Percent Reserved	17.5%	17.5%	17.5%	17.5%
Annual Amount Reserved	\$138	\$181	\$209	\$232

Adjust required reserve calculation to exclude one-time revenues and unawarded grants

Maintain current flexibility to automatically adjust unrestricted reserves for new fixed charges

Incorporate protection for the treated water sale volatility

Recognize the disconnect between supplies and sales

Update % Reserved to reflect 70% exceedance demand used for rate setting

Updated Unrestricted Reserve Policy - 70% Exceedance Demand

for June 30th, 2025, in millions of dollars

	2025/26 Budget	2026/27 Forecast	2027/28 Forecast	2028/29 Forecast
Gross Revenue Requirement	\$2,274	\$2,408	\$2,597	\$2,773
Less Property Tax	\$334	\$342	\$351	\$359
Less Interest Income, Power Sales & Misc. Revenues*	\$120	\$97	\$84	\$86
Less Fixed Charges				
<i>RTS Charge</i>	\$185	\$188	\$202	\$219
<i>Capacity Charge</i>	\$46	\$48	\$52	\$56
Net Water Rate Revenue Requirements	\$1,590	\$1,733	\$1,909	\$2,053
Percent Reserved	19%	19%	19%	19%
Annual Amount Reserved	\$302	\$329	\$363	\$390

Minimum Reserve Level = \$302 + \$329 / 2 = \$467 million ← 18 months

Target Reserve Level = \$302 + \$329 + \$363 + \$390/2 = \$1,189 million ← 42 months

for 70%
Exceedance
Demand

* Misc. Revenues – Lease, Non-MA Sales, \$80M State Fund Use and Awarded Grants, excluding one-time revenues such as IRA Following Revenues, \$60M Stored Water Sales, Sales of Assets

Updated Unrestricted Reserve Policy

Reflecting new SDCWA Exchange Agreement

	2025/26 Budget	2026/27 Forecast	2027/28 Forecast	2028/29 Forecast
Gross Revenue Requirement	\$2,274	\$2,408	\$2,597	\$2,773
Less Property Tax	\$334	\$342	\$351	\$359
Less Interest Income, Power Sales & Misc. Revenues*	\$120	\$97	\$84	\$86
<i>Less SDCWA Exchange (Baseline + Additional Exchange)</i>	<i>\$177</i>	<i>\$186</i>	<i>\$189</i>	<i>\$198</i>
Less Fixed Charges				
<i>RTS Charge</i>	\$185	\$188	\$202	\$219
<i>Capacity Charge</i>	\$46	\$48	\$52	\$56
Net Water Rate Revenue Requirements	\$1,412	\$1,546	\$1,720	\$1,854
Percent Reserved	19%	19%	19%	19%
Annual Amount Reserved	\$268	\$294	\$324	\$352

Minimum Reserve Level = $\$268 + \$294 / 2$ = **\$415 million** ← 18 months

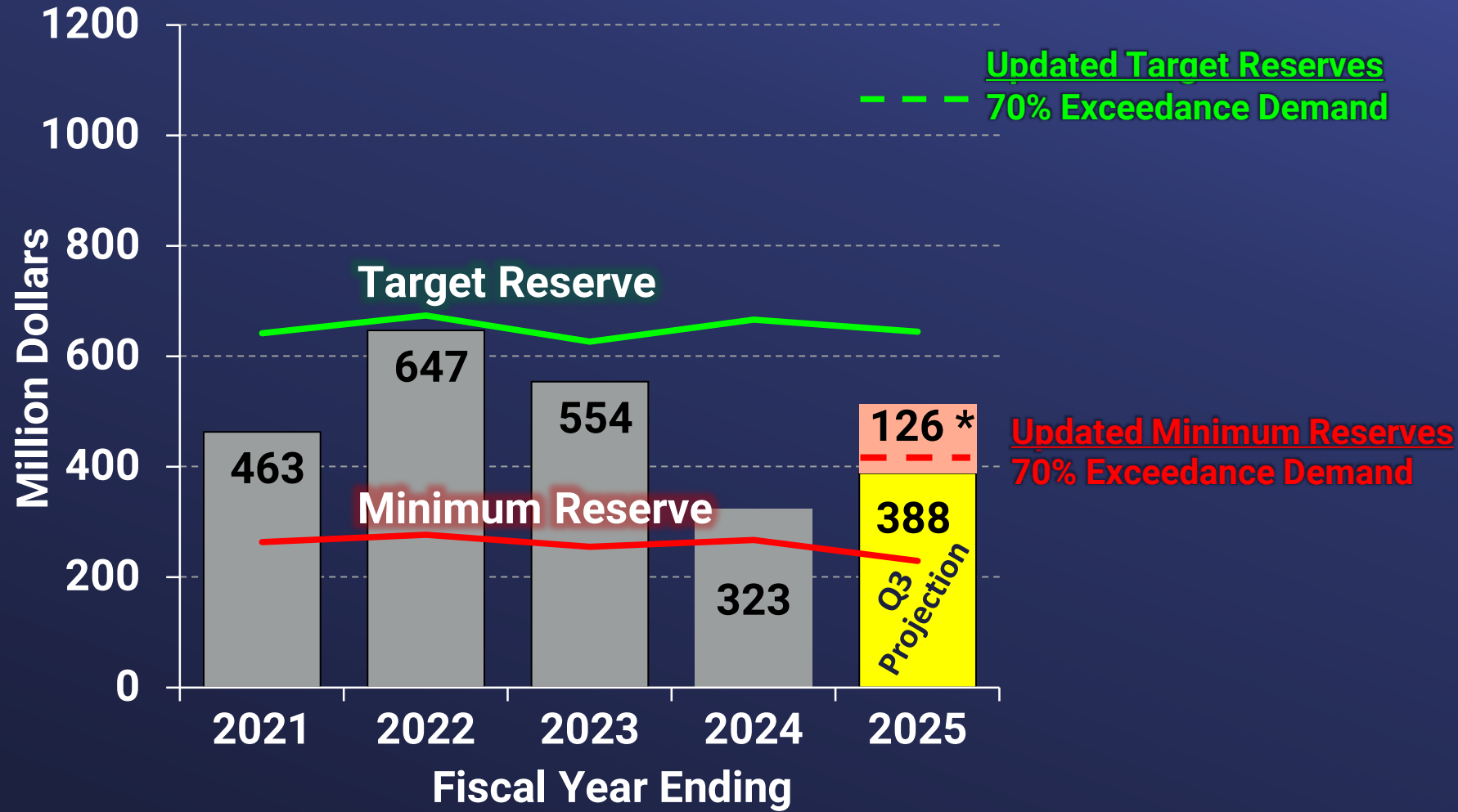
Target Reserve Level = $\$268 + \$294 + \$324 + \$352 / 2$ = **\$1,065 million** ← 42 months

Less
SDCWA
Exchange

* Misc. Revenues – Lease, Non-MA Sales, \$80M State Fund Use and Awarded Grants, excluding one-time revenues such as IRA Following Revenues, \$60M Stored Water Sales, Sales of Assets

Updated Unrestricted Reserve Policy

for June 30th, 2025, in millions of dollars



Implementation Strategy

Adopt reserve policy to set water demand at 70% exceedance for rate setting with a long-term target of 80%.

*Revenue from Reverse Cyclic Program (RCP) pre-sales

Unrestricted Reserve Policy

Approval of Methodology

The Board is not approving specific figures. The Board approves the **methodology only**.

- If approved, the methodology will be incorporated into the FY 2026/27 – 2027/28 Biennial Budget
 - Effective Date: revised reserve levels begin **July 1, 2026**
 - This will **not** impact the 2026 rates and charges
- The methodology allows adjustments for new fixed charges that are approved
 - Treatment fixed charges, property taxes, etc.
- The methodology includes reducing the revenue requirement by the amount of the SDCWA/MWD exchange agreement following the settlement

Unrestricted Reserve Policy Refinements

Policy Change – Modify language in Admin Code for appropriate use of reserves in excess of target levels

Funds in excess of the target level shall be utilized as directed by the Board for:

- Funding capital expenditures of the District in lieu of the issuance of additional debt,
- Redemption or defeasance of outstanding bonds or commercial paper,
- Addressing District's pension or OPEB (other post-employment benefit) liabilities (including but not limited to the establishment or funding of a pension trust fund), or
- Meeting other legal or financial obligations as approved by the Board.

Additional proposed policy: *“Reserves, by nature, are one-time funds; therefore, fiscal prudence dictates that they should not be used to cover ongoing expenditures.”*

Workgroup Recommendations on Conservative Water Transactions Assumptions for Rate-Setting

Conservative Water Transactions Assumptions

Recommendations

Establish a policy to set water demand projections at 70% exceedance for rate setting with a long-term target of 80%.

- ✓ This approach creates a mechanism to maintain reserves at the target level, providing additional protection against rate spikes
- ✓ A higher exceedance percentage (e.g., 80%) reflects a more conservative (i.e. lower) demand estimates, while a lower exceedance percentage (e.g., 70%) reflects a less conservative assumption and requires higher reserves to buffer against potential shortfalls

Other Potential Fixed Revenues

- Voluntary Level Pay Plan
 - Member agencies interested in a Voluntary Level Pay Plan will make recommendations to Metropolitan staff. Staff will then convene a meeting with the interested member agencies to explore the alternatives, analyze the impacts, and identify the changes to Metropolitan's policies that would be required for implementation.
- Fixed charge for Demand Management
 - Staff will evaluate fixed charges based upon the recommendations made by the Water Resources Sub-Working Group
- Expansion of the current RTS and Capacity Charge to also recover O&M costs
- Ad Valorem Property Taxes
 - Staff will evaluate the impacts on rates, charges, and reserves from increasing the ad valorem property tax rate in future budgets

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Key Components of the Proposed Resolution

The Proposed Resolution

- The Reserve Policy will be tied to the level of exceedance used in demand forecasting, with the following targets:
 - 80% exceedance = 15% reserve
 - 70% exceedance = 19% reserve
 - 50% exceedance = 25% reserve
- Modify language in Admin Code for appropriate use of reserves in excess of target levels
- Establish that Metropolitan will use a minimum of 70% exceedance for setting rates and preparing biennial budgets, with long-term policy target of 80%

Board Option

- Option #1
 - Approve revisions to Metropolitan's Reserves Policy and direct staff to implement specific sales projections for the proposed FY 26/27 and 27/28 Biennial Budget
- Option #2
 - Do not approve revisions to Metropolitan's Reserves Policy, nor direct staff to implement specific sales projections for the proposed FY 26/27 and 27/28 Biennial Budget

Staffs Recommendation

- Option #1

