



Special Finance, Affordability, Asset Management, and Efficiency Committee

Overview of Potential Business Model Refinements

June 23, 2025
Item 9-5

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Overview of Potential Business Model Refinements

Subject

- Potential Business Model Refinements

Purpose

- Inform the Board on the recommended proposals for Treated Water Cost Recovery, Unrestricted Reserve Policy Refinements, Conservative Water Demand Projections, and Other Fixed Revenues

Treated Water Cost Recovery

Metropolitan System Use by Member Agencies

- Metropolitan plays a critical role in supporting the region's water reliability by delivering both treated and untreated water tailored to the infrastructure and operational needs of its 26 member agencies
 - Fifteen (15) member agencies – Beverly Hills, Calleguas, Compton, Foothill, Fullerton, Glendale, Las Virgenes, Long Beach, Pasadena, San Fernando, San Marino, Santa Ana, Santa Monica, Torrance, and West Basin – receive only treated water
 - One (1) agency, Inland Empire, exclusively takes untreated water
 - Ten (10) agencies – Anaheim, Burbank, Central Basin, Eastern, Los Angeles, MWDOC, San Diego, Three Valleys, Upper San Gabriel, and Western – receive a combination of both treated and untreated supplies
- Over the past five years, agencies limited to treated water have accounted for approximately 44 percent of total annual treated water sales

Summary of work completed to-date

Treated Water Cost Recovery

13 Workshops since May 2024

- **Participants:** member agency managers, Metropolitan staff from Finance, Integrated Operations Planning and Support Service and Water Quality teams
- Reviewed key concerns/issues raised by MA's during Budget Adoption with the Treatment Surcharge
- Discussed goals and objectives of the Treated Water Cost Recovery workgroup, previously adopted Policy Principles on Treated Water, and revised past efforts on Treated Water Cost Recovery
- Evaluated MWD's treatment operations, capacity, utilization, cost, and Cost of Service with the support of a rate consultant
 - *Metropolitan provided comprehensive data, including daily flow records for all member agency meters from 2014 through 2023; historical treatment plant capacity utilization (by facility and in aggregate); connected capacity by member agency; treatment plant capacities; a review of COS fundamentals; and member agency treated water demands over the same period*
 - *Metropolitan staff conducted multiple rounds of detailed financial and operational analyses, including evaluations of usage data, cost allocations, hypothetical agency-specific impacts, and year-to-year agency bill change analyses*

Guiding Framework for Rate Design Solutions

Consistent with 2017 Adopted Policy Principles and Feedback



Treatment Rates & Charges Should:

1. Be consistent with industry standard cost of service principles

- Provide a clear nexus between member agency cost responsibility and benefits received
 - “Rate charged should reflect the cost of having capacity reserved and available for the customer” (AWWA M1 Principles of Water Rates, Fees, and Charges, 7th Edition)

2. Align treatment rates with treatment services received

- a) Align the treated water cost recovery with (1) the service commitments and (2) infrastructure capital investments made by Metropolitan
- b) Reflect the cost to maintain the treatment capacity and the treatment benefits received for average, peaking and standby uses
- c) Evaluate the portion of standby capacity that provides regional drought reliability

3. Enhance rate stability and predictability

- a) Recover a portion of the treatment cost on fixed charge(s)
- b) Working closely with Member Agencies to continue to identify opportunities to partially or fully decommission unneeded treatment infrastructure & minimize future O&M & capital expenditures
- c) Continue obtaining member agency commitment to utilize new or expanded future capacity

Evaluating Treated Water Cost Recovery

Workgroup developed treated water cost recovery alternatives for Peaking and Standby capacity use:

- 6 Treatment Peaking Alts evaluated
- 9 Treatment Standby Alts evaluated
- 5 separate proposals introduced by MA: January 2025, February 2025, March 2025, March 14 2025, and March 14 2025 with Summer Peak

Leading Proposal, supported by managers representing 18 member agencies

- Option 1 – March 14, 2025 Proposal, Annual Peak Day

Alternative Proposal, proposal by manager representing 1 member agency

- Option 2 – March 14, 2025 Alternative Proposal, Summer Peak Day

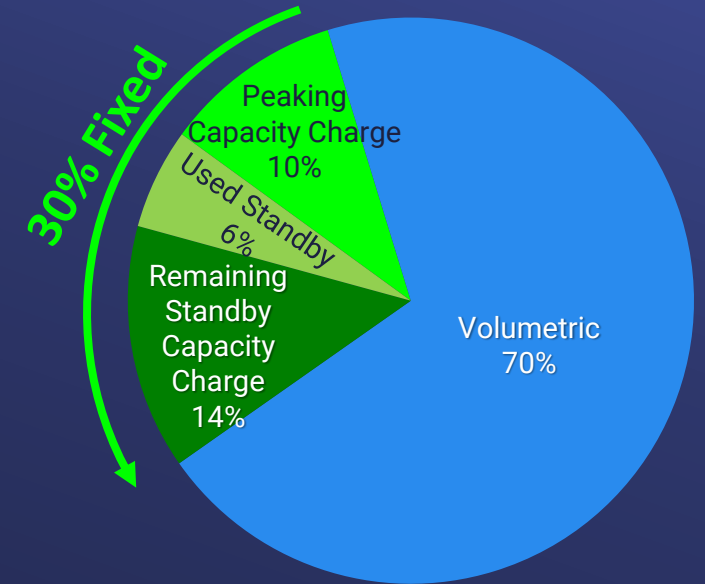
There is broad recognition that action is necessary, as the current 100% volumetric structure is inconsistent with the Board's previously adopted Policy Principles on Treated Water

Leading Proposals

Support for proposals: 20 received responses (18 for Opt 1, 1 for Opt 2, 1 Neutral)

Features	Option 1: Mar 14, 2025 Proposal w/ Annual Peak (Support by 18 MAs)	Option 2: Mar 14, 2025 Alt Proposal w/ Summer Peak (Proposed by 1 MA)
Peaking Capacity Charge	A fixed charge would be collected based on a 3-year trailing maximum annual peak day demand in CFS	A fixed charge would be collected based on a 3-year trailing maximum summer peak day demand in CFS
	Treatment peaking capacity costs <u>~10%</u> of total treatment costs based on allocated revenue requirements	
Standby Capacity Charge	<p>Used Standby Capacity Charge: A fixed charge for used standby capacity would be collected based on a 10-year trailing annual standby use, i.e. 10-year maximum annual use minus average use in AF</p> <p>Remaining Standby Capacity Charge: A fixed charge for remaining standby capacity would be collected based on 5-yr trailing maximum annual use in AF</p> <p>This charge inclusive of the Peaking and Used Standby Charge would add up to 30% of the Treatment Revenue Requirements, unless the allocated combined costs are less than 30%.</p>	
Volumetric	Remaining (~70%) of treatment costs	

Treatment Revenue Requirements



Adjustments / Certifications to Peaking Flows for All Alternatives

- Similar to the existing Capacity Charge, treated water peaking flows resulting from Metropolitan's operational requests (e.g., shutdowns, service disruptions, wet year operations, dry year operations) do not reflect member agency demand on Metropolitan and therefore, will not be included in an agency's peaking calculations; and,
- All data and adjustments would be fully documented and validated by each agency, following the existing process for RTS and Capacity Charges

Implementation of New Charges

Member Agency managers support implementation strategies to minimize initial impacts and provide opportunities for MA to adjust operations accordingly

Treatment peaking capacity charge:

- 3-year phase-in billing determinants (Annual or Summer)

Treatment standby capacity charges:

- Used Standby Capacity: 10-year phase-in
- Remaining Standby Capacity: 5-year phase-in

Items for further review

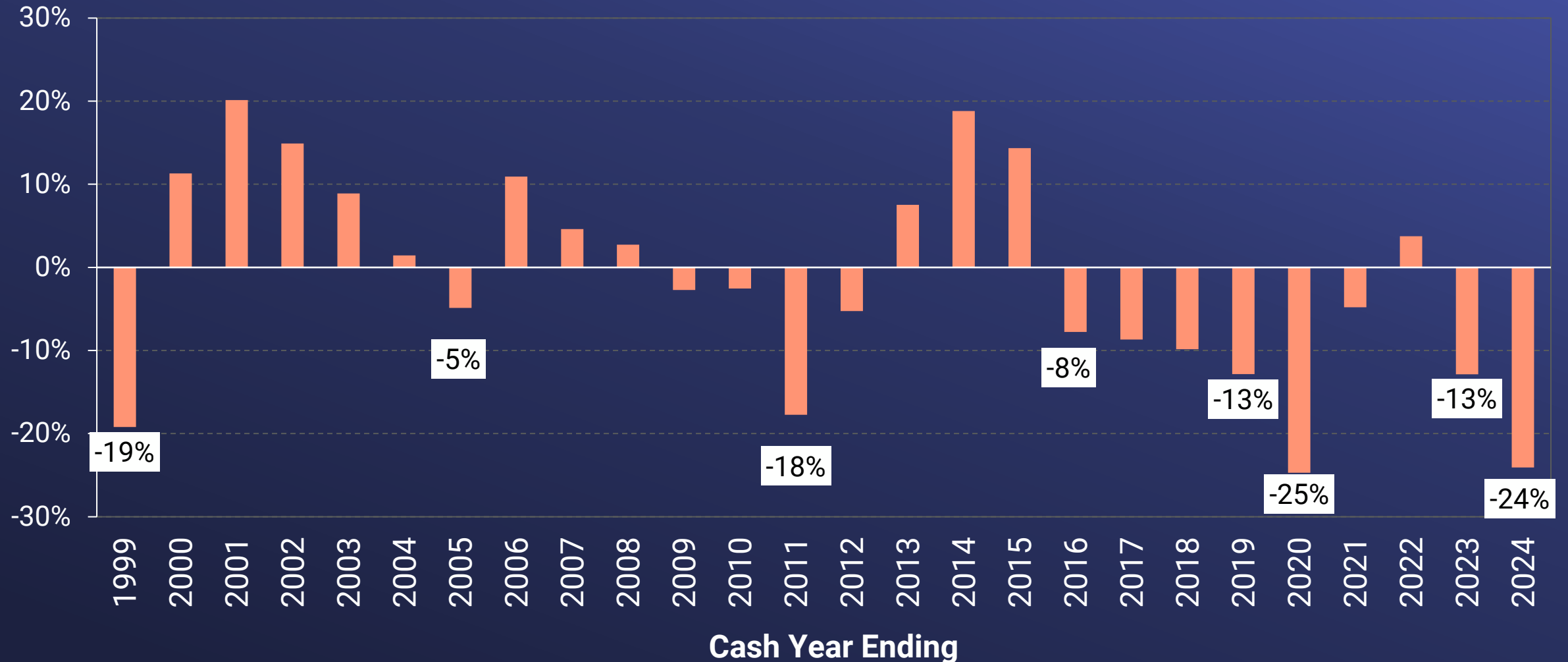
The Financial Sub-Working Group identified four items for further review in advance of the FY2028/29 budget process

- Potential Regional Drought Reliability charge;
- Considerations related to incremental peaking billing determinants;
- Refinement of the unused standby capacity charge to better reflect potential use of standby capacity rather than relying solely on volumetric usage; and
- Collaboration with member agencies to identify opportunities to partially or fully decommission unneeded treatment infrastructure

Workgroup Recommendations on Unrestricted Reserve Policy

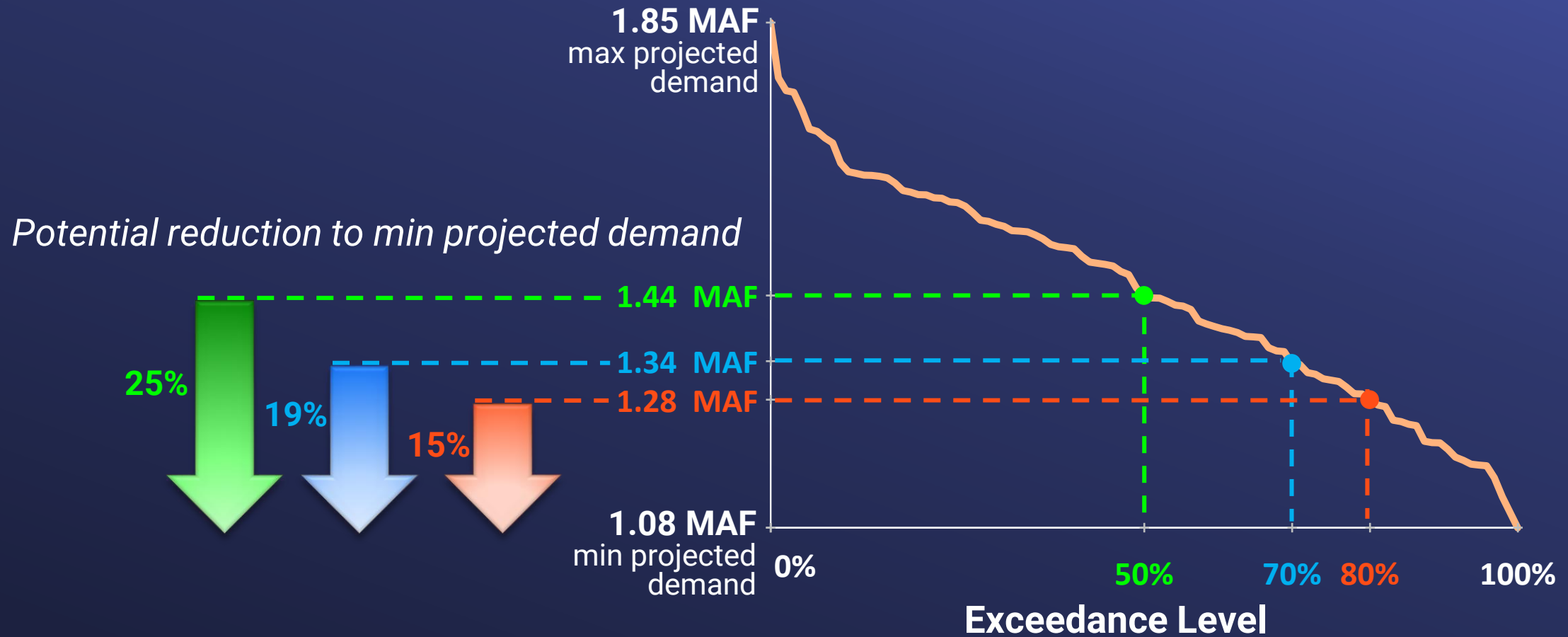
Variability Metropolitan's Historic Water Transactions

% 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%.
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
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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 reflecting 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

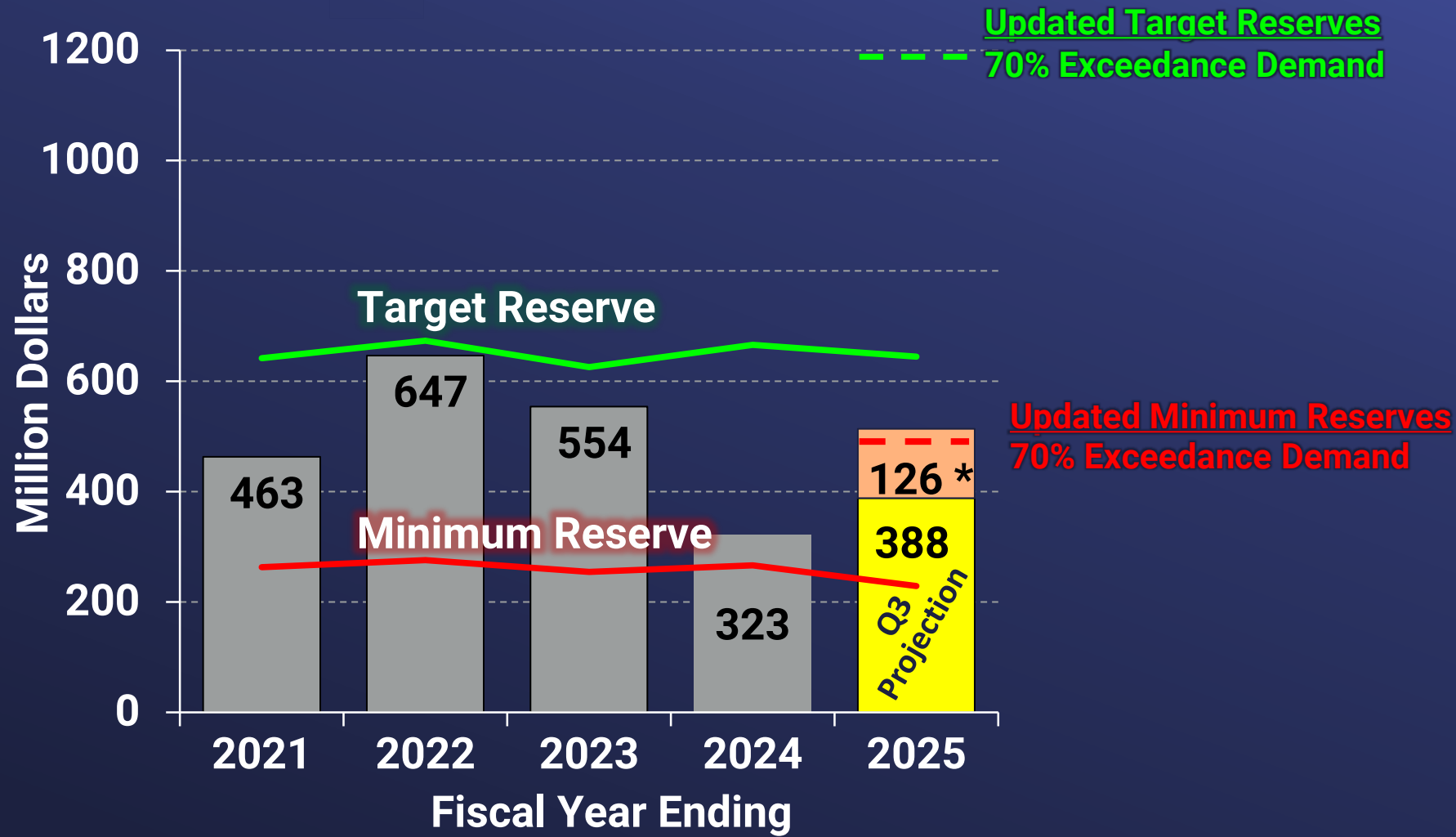
Target Reserve Level = \$302 + \$329 + \$363 + \$390 / 2 = \$1,189 million ← 42 months

for 70%
Exceedance
Demand

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

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 Water Rate Settings

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

Other Fixed Revenues

- Voluntary Level Pay Plan
 - Member agencies interested in a Voluntary Level Pay Plan will make recommendations to Metropolitan staff. Staff will 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 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

Next Steps

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|-----------|--|
| July 2025 | Board Action to Approve a Treated Water Cost Recovery Rate Structure to be included with the staff proposal for the FY 26/27 and 27/28 Biennial Budget and CYs 27 and 28 Rates and Charges |
| July 2025 | Board Action to Approve Revisions to Metropolitan's Reserves Policy and Direct Staff to Implement Specific Sales Projections for the proposed FY26/27 and 27/28 Biennial Budget |

