- **Board of Directors**
  Finance, Audit, Insurance, and Real Property Committee

7/11/2023 Board Meeting

7-5

Subject

Adopt Ordinance No. 152 determining that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $500 million to finance a portion of capital expenditures and waive the full reading of Ordinance No. 152 (two-thirds vote of the Board); the General Manager has determined that the proposed action is exempt or otherwise not subject to CEQA

Executive Summary

The Board's adoption of Ordinance No. 152 (**Attachment 1)** would allow Metropolitan to issue an aggregate principal amount not-to-exceed $500 million of revenue bonds to fund a portion of board-approved capital expenditures. Funding a portion of capital expenditures with revenue bonds instead of exclusively using operating revenues is consistent with sound financial policy. Bond financing enables Metropolitan to (1) accelerate spending for certain projects, which offsets rising inflationary pressures; and (2) spread large capital expenditures over time so future rate payors share in the cost burden for capital investments (generational equity). Adopting Ordinance No. 152 is a prerequisite to the Board approving separate resolutions authorizing specific revenue bond transactions with an aggregate principal amount up to $500 million. Ordinance No. 152 does not alone authorize the issuance of any specific revenue bond.

The Metropolitan Water District Act (MWD Act) authorizes Metropolitan to finance capital expenditures through use of revenue bonds, so long as the voters within Metropolitan's service area have previously approved such a financing mechanism, and so long as the Board, by a two-thirds vote, determines that the interests of the district require use of revenue bonds to finance capital expenditures, the costs of which will be too great to be paid out of the district's ordinary annual income and revenue (operating revenues). The voters approved such a financing mechanism in 1974, and this letter proposes that the Board find that the current interests of Metropolitan require the issuance of revenue bonds to finance a portion of capital expenditures in the aggregate principal amount of $500 million.

The $500 million figure represents an estimate of revenue bond financing currently anticipated for several fiscal years. As it has in the past, the Board may also approve other capital expenditures not anticipated in the adopted budget, the capital investment plan, or the ten-year financial forecast, and capital expenditures may exceed the projections in an adopted biennial budget.

Details

The MWD Act provides that Metropolitan may borrow money, incur indebtedness and issue bonds or other such indebtedness. The Board has utilized this method of financing since voters approved the use of long-term revenue bonds as an alternative to pay-as-you-go financing in 1974. Metropolitan has a manageable debt load, which has declined in recent years, compared to overall assets.

The MWD Act has three prerequisites for the issuance of revenue bonds, which include bonds, notes, loans or other evidences of indebtedness, to finance capital expenditures: (1) voter approval of the issuance and sale of revenue bonds; (2) the adoption of an ordinance determining that the interests of Metropolitan require the use of revenue bonds to finance a portion of capital expenditures; and (3) the adoption of a resolution authorizing the issuance of a specific series of revenue bonds The first prerequisite was satisfied in 1974, and is discussed further below. The proposed Ordinance No. 152 would satisfy the second prerequisite to issue revenue bonds.

Subsequent Board action, through the adoption of revenue bond resolutions, will be required to issue revenue bonds up to the aggregate principal amount of $500 million authorized under Ordinance No. 152.

As referenced above, in 1974, the voters in Metropolitan's service area approved the use of long-term revenue bonds as an alternative to funding capital expenditures exclusively with operating revenues. The MWD Act also requires that the Board, by a two-thirds vote, authorize the issuance of revenue bonds by adopting an ordinance finding the interests of the district require the use of revenue bonds for the purposes set forth in Section 237 of the MWD Act, the cost of which will be too great to be paid out of operating revenues. Section 237 provides for the use of revenue bonds for financing the acquisition, construction, or completion of capital projects "necessary or convenient to carry out the objects or purposes of the district," including "any preliminary and incidental expenses." This letter proposes that the Board determine the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $500 million to finance a portion of capital expenditures, consistent with the current biennial budget, projected capital expenditures for the current biennial period, and the approved capital expenditure forecasts.

Revenue bonds are required because the Board anticipated certain capital expenditures in the capital investment plan in the last adopted biennial budget, and the costs of planned capital expenditures exceed the amount to be generated from operating revenues in all years of the Ten-Year Financial Forecast. Without revenue bonds to fund capital expenditures, either rates must increase more than expected or fewer capital projects than are planned can go forward. The interests of Metropolitan require the issuance of revenue bonds, as contemplated in the board-adopted biennial budget for FY 2022/23 and 2023/24, to support funding of the projects in the capital investment plan and the average rate increases contemplated in the Ten-Year Financial Forecast.

A balanced approach to financing future capital expenditures with both operating revenues and revenue bond proceeds will also help mitigate increases in water rates, provide financial flexibility, and support sound revenue bond debt service and fixed charge coverage ratios. These factors will help Metropolitan maintain strong bond credit ratings, which provide tangible benefits to ratepayers in the form of reduced debt service costs. Strong credit ratings provide better access to capital markets, lower interest rates, and better terms on a broad range of debt products. Prudent financial management policies have resulted in bond ratings of AAA from Standard & Poor's, Aa1 from Moody's, and AA+ from Fitch Ratings for Metropolitan's senior lien revenue bonds.

Ordinance No. 152 would provide the foundational authorization to allow for the Board's consideration of revenue bond issuances to finance any capital expenditures approved by the Board. The $500 million authority proposed in Ordinance No. 152 is based on an estimate of revenue bond financing anticipated for several fiscal years.

Additionally, from time to time, when expenditures are necessary or convenient to carry out the purposes of the district, the Board may approve capital expenditures other than, or in addition to, those contemplated by the then-current capital investment plan and may also approve the issuance of revenue bonds authorized by this Ordinance No. 152 to finance all or a portion of those capital expenditures.

The MWD Act requires ordinances to be introduced on a day prior to the time of the Board's adoption of the ordinance. Ordinance No. 152 was introduced at the Board's regular meeting in June. General law cities typically require the reading of the full text of an ordinance unless the full reading is waived. Following a process that is similar to a general law city, Option #1 waives the full reading of Ordinance No. 152.

Policy

Metropolitan Water District Act Section 61: Ordinances, Resolutions and Orders

Metropolitan Water District Act Section 63: Roll Call on Ordinances

Metropolitan Water District Act Section 64: Ordinances; Introduction; Adoption

Metropolitan Water District Act Section 65: Ordinances – Effective Date

Metropolitan Water District Act Section 123: Borrowing, Limitation

Metropolitan Water District Act Section 237: Revenue Bond Purposes. The ordinance in this item is subject to a two-thirds vote requirement.

Metropolitan Water District Administrative Code Section 11104: Delegation of Responsibilities

By Minute Item 52790, dated April 12, 2022, the Board approved the FY 2022/23 and 2023/24 biennial budget, approved appropriations and funding of capital expenditures, and approved a Ten-Year Financial Forecast.

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is not defined as a project under CEQA (State CEQA Guidelines Section 15378(b)(4) and 15378(b)(5)) because it involves the creation of government funding mechanisms or other government fiscal activities which do not involve any commitment to any specific project which may result in a direct or indirect physical impact on the environment and organizational or administrative activities and general policy and procedure making that would not result in a direct or indirect physical change to the environment.

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt Ordinance No. 152, determining that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $500 million to finance a portion of Metropolitan's capital expenditures and waive the full reading of Ordinance No. 152 (two-thirds vote of the Board). (**Attachment 1.**)

Fiscal Impact: Adoption of Option #1 will have no direct financial impact to Metropolitan but will allow the Board to take future actions to finance a portion of Metropolitan's capital expenditures with revenue bonds. Future board action is required for approval of future revenue bonds.

Business Analysis: Option #1 will enable the Board to authorize the issuance of revenue bonds, through future adoption of revenue bond resolutions, to finance future capital expenditures.

Option #2

Do not adopt Ordinance No. 152.

Fiscal Impact: Option #2 may have a negative financial impact on Metropolitan by precluding the use of revenue bond proceeds to fund a portion of capital expenditures. The Board may not consider the approval of future revenue bond issues, without making the determinations in the proposed Ordinance No. 152. Metropolitan may have to use additional reserves to fund capital costs, and/or increase water rates higher than projected in the Ten-Year Financial Forecast.

Business Analysis: Option #2 will reduce Metropolitan's financial flexibility by precluding the use of revenue bond proceeds to finance future capital expenditures. Metropolitan may have to curtail funding capital projects.

Staff Recommendation

Option #1

6/30/2023

Katano Kasaine *Date*
Assistant General Manager/
Chief Financial Officer

6/30/2023

Adel Hagekhalil *Date*
General Manager

Attachment 1 - Ordinance Of The Board Of Directors Of The Metropolitan Water District Of Southern California Determining That The Interests Of The District Require The Use Of Revenue Bonds In The Aggregate Principal Amount Of $500,000,000 To Finance A Portion Of Capital Expenditures

Ref# cfo12686828

THE METROPOLITAN WATER DISTRICT OF
SOUTHERN CALIFORNIA

ORDINANCE 152

ORDINANCE OF THE BOARD OF DIRECTORS
OF THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
DETERMINING THAT THE INTERESTS OF THE DISTRICT REQUIRE THE USE OF
REVENUE BONDS IN THE AGGREGATE PRINCIPAL AMOUNT OF $500,000,000 TO
FINANCE A PORTION OF CAPITAL EXPENDITURES

The Board of Directors of The Metropolitan Water District of Southern California (the "Board") hereby finds that:

1. Pursuant to Chapter 1.6 of Part 5 of the Metropolitan Water District Act (California Statutes 1969, Chapter 209, as amended, hereinafter sometimes referred to as the "Act"), the Board of The Metropolitan Water District of Southern California (the "District"), on March 12, 1974, adopted Ordinance No. 126, calling a special election to be held within the District on June 4, 1974, for the purpose of submitting to the qualified voters of said District the following proposition:

> To permit use of long-term bonds backed by water revenues as an alternative to pay-as-you-go financing, shall the Board of Directors of the Metropolitan Water District of Southern California be authorized to issue and sell revenue bonds under Chapter 1.6, Part 5, Metropolitan Water District Act?

2. Said election was duly and regularly held, and said proposition received the affirmative vote and assent of a majority of all of the qualified voters of the District voting on said proposition, and therefore the Board is authorized to issue and sell revenue bonds under Chapter 1.6 of Part 5 of the Act.

3. Revenue bonds means bonds, notes, loans, or other obligations or evidences of indebtedness, as provided for in the Act and California Government Code.

4. The ability to ensure a reliable supply of high-quality water for the District's 26 member agencies depends upon the District's ongoing ability to fund operations and maintenance, maintain and augment local and imported water supplies, fund replacements and refurbish existing infrastructure, and invest in system improvements.

5. Ordinance 151 was adopted by the Board on September 15, 2020, finding that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of $500,000,000 to fund a portion of the District's capital investment plan expenditures, the cost of which is too great to be paid out of the ordinary annual income and revenue of the District.

6. Of the $500,000,000 aggregate principal amount of revenue bonds authorized under Ordinance 151, all but $167.935 million have been issued.

7. On April 12, 2022, the Board approved a biennial budget for FY 2022/23 and FY 2023/24, containing capital expenditures of $300 and $300 million, respectively, of which 55 percent is anticipated to be funded by debt proceeds.

8. On April 12, 2022, the Board approved a ten-year financial forecast for FY 2022/23 through FY 2031/32 (the "Ten-Year Financial Forecast"), forecasting annual capital expenditures of $300 million for FY 2022/23 and FY 2023/24 and increasing from $372 million up to $1,202 million in FY 2024/25 through FY 2030/31, of which some portion of each year is anticipated to be funded by debt proceeds. The Ten-Year Financial Forecast provides an estimated forecast of future capital expenditures.

9. On April 12, 2022, the Board approved the use of $270 million in operating revenues to partially fund the capital investment plan for FY 2022/23 and FY 2023/24. The capital investment plan identifies the capital priorities of the District for the fiscal years of the adopted budget.

10. In order to fully fund the capital investment plan and board-approved bond-financed projects for the Antelope Valley East Kern (AVEK) High Desert Water Banking Program and conservation program adopted by the Board on April 12, 2022, $463.9 million in revenue bonds would be required in FY 2022/23 and FY 2023/24. As of June 30, 2023, Metropolitan has issued $228.22 million of revenue bonds to support its capital improvement program. To support the remaining budget authorization of revenue bonds totaling $235.68 million, a capacity of $167.935 million under Ordinance 151 is currently available. This Ordinance would provide support for these bond issues and provide capacity for debt issued in future years.

11. Debt financing in future FYs of the Ten-Year Financial Forecast is assumed at amounts ranging from $165 million to $1,002 million per fiscal year.

12. The Board may, from time to time, approve capital expenditures other than or in addition to those contemplated by the capital investment plan at the time of the then-current biennial budget.

13. From time to time, capital projects that have been undertaken are delayed, redesigned, or deferred by the District for various reasons.

14. This Ordinance would support future board actions for debt financing over several years for capital expenditures approved by the Board as provided in the then-current biennial budget, capital investment plan, ten-year financial forecast, and as otherwise approved by the Board, which collectively would not exceed $500,000,000.

15. Using debt to finance a portion of capital expenditures will provide the District with additional financial flexibility to fund capital expenditures that are necessary or convenient to carry out the purposes of the District while mitigating increases in water rates and charges.

16. This Ordinance was introduced at the regular meeting of the Board held on June 13, 2023.

NOW, THEREFORE, the Board of Directors of the District, DOES HEREBY RESOLVE, DETERMINE AND ORDER as follows:

The interests of The Metropolitan Water District of Southern California require the use of revenue bonds in the aggregate principal amount of $500,000,000 to finance a portion of the District's capital expenditures, the cost of which is too great to be paid out of the ordinary annual income and revenue of the District.

I HEREBY CERTIFY that the foregoing is a full, true and correct copy of an Ordinance adopted by a two-thirds (2/3) vote of the total vote of the Board of Directors of The Metropolitan Water District of Southern California at its meeting held on July 11, 2023.

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Secretary of the Board of Directors
of the Metropolitan Water District
of Southern California