THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

BOARD ACTION

- **Board of Directors**
  Finance and Insurance Committee

4/12/2022 Board Meeting

Revised 7-3

Subject

Approve the proposed biennial budget for fiscal years 2022/23 and 2023/24, which includes the Capital Investment Plan and revenue requirements for fiscal years 2022/23 and 2023/24 and the ten-year forecast; adopt resolutions fixing and adopting the water rates and charges for calendar years 2023 and 2024; the General Manager has determined that the proposed actions are exempt or otherwise not subject to CEQA

Executive Summary

This letter presents information on and recommendations for the Proposed Biennial Budget and revenue requirements for fiscal years (FY) 2022/23 and FY 2023/24, water rates and charges for the calendar year (CY) 2023 and CY 2024, the Ten-Year Financial Forecast (Ten-Year Forecast), and the Cost of Service Reports (COS) supporting the rates and charges options outlined below. The Proposed Biennial Budget covers a transitional period of strategic long-term planning at Metropolitan, while at the same time needing to address near-term challenges, such as high inflation and a deepening drought emergency due to low State Water Project (SWP) supplies.

Before the General Manager presented the initial budget and rates proposal in February, staff had already worked to reduce what would have been double-digit increases to a proposal of 8 percent rate increases per year. On February 7, 2022, at Budget Workshop #1, staff presented the Proposed Biennial Budget, which has since been updated, to the Finance and Insurance (F&I) Committee, including the proposed increases to the rates and charges for CYs 2023 and 2024, the COS Report, Capital Investment Plan (CIP), and Ten-Year Forecast. The revenue requirements for FYs 2022/23 and 2023/24, which are derived from the Proposed Biennial Budget, lead to overall rate increases of 8 percent in each of CYs 2022/23 and 2023/24.

Since Budget Workshop #1, the F&I Committee held three additional workshops that focused on the development of the CIP, staff responses to board questions, updates to the Proposed Biennial Budget, and the applicability of Metropolitan Water District Act Section 124.5. The Board also held a public hearing on March 8, 2022, for the public to provide comments on the proposed budget, rates, and charges. Additionally, the Board received information on various alternative budget and rate scenarios and requested that staff bring forward for consideration a rate option that is closer to the prior long-term rate projection of 5 percent. The outcome of this lengthy and transparent budget process is the presentation of three options, summarized below and detailed throughout this letter.

Key Driver for Rate Increases

The proposed rate increases are primarily driven by: (1) the catch-up for the loss of the Water Stewardship Rate (WSR) revenue; (2) a decrease in projected water transactions; (3) and projected increases for State Water Project (SWP) and Colorado River Aqueduct (CRA) power costs and fixed State Water Contract (SWC) costs; and higher departmental Operations and Maintenance (O&M) costs driven by high inflation and increasing Delta Conveyance Planning expenditures.

Option 1 is the updated Proposed Biennial Budget, which recommends overall rate increases of 8 percent in CY 2023 and 8 percent in CY 2024. Highlights of this option include the following:

- Implements measures to limit annual increases in Departmental O&M expenditures to approximately 3 percent per year, while adding 20 regular full-time employees (FTE) positions to support board initiatives of Sustainability, Resilience & Innovation, Diversity, Equity & Inclusion, and Equal Employment Opportunity, and support key operational needs. The remaining staffing needs are unfunded. The Departmental O&M budget also includes $20M for planning activities related to the Regional Recycled Water Program (RRWP) and incorporates negotiated labor increases, allowable merit adjustments, and increased benefit costs.
- Recommends appropriating $600 million (M) to CIP for FYs 2022/23 and 2023/24. Maintains PAYGO funding at $135M per year to limit rate impacts at the expense of decreasing revenue bond coverage and of not meeting MWD's revenue bond coverage target of 2.0 times.
- Funds $99M in contributions for the Delta Conveyance Project (DCP) planning activities. These contributions will be funded from a combination of rates and the California WaterFix refund of $34.5M received in 2019.
- Continues to support demand management programs, including a proposed increase in funding for the Conservation Program to $86M over the biennium, $36M of which is anticipated to be bond-financed. Staff, however, requests authority to bond finance the entire Conservation Program to provide flexibility in case of revenue shortfalls.
- Bond finance the AVEK High Desert Program to reduce short-term rate impacts.
- Allows Metropolitan to meet the fixed charge minimum coverage target of 1.2 times over the biennial period but will not allow Metropolitan to achieve its revenue bond target of 2.0 times during the biennium or the ten-year forecast period.
- Draws $55.2 million from reserves over the biennium.
- Long-term overall rate increases are projected at 5 percent per year and include the full-scale RRWP but not the DCP. This projection is subject to changes based on many factors, including the implementation of the 2020 IRP and updated water transactions.

Other Actions to Mitigate Rate Impacts

In bringing forward Option 1, staff carefully reviewed all means available that would allow Metropolitan to fulfill its mission to the highest degree while also limiting overall rate increases to the member agencies, recognizing that they too are contending with drought, system investment needs, and affordability concerns. Metropolitan has and will continue to be persistent in its search for new revenue sources, which potentially include state and federal grant opportunities, beneficial water exchanges, and partnerships that leverage investments in Metropolitan's system. Staff continues to work with the Governor's office and the Legislature to advocate for funding for Metropolitan's emergency drought projects and the RRWP. Additionally, Metropolitan is exploring low-interest loans through the State Revolving Funds and researching federal project financing options. Metropolitan's existing assets, such as real estate, may also pose opportunities to serve their strategic function for Metropolitan while at the same time generating revenue. Finally, the General Manager has initiated an organizational assessment to evaluate opportunities to improve operations and become more efficient in the delivery of Metropolitan's services. Altogether, Metropolitan is taking action on all fronts to mitigate rate impacts on its member agencies but, at the same, is proposing a budget (Option 1) that prudently manages the overall financial position of Metropolitan.

Option 2 reduces the overall rate increases to 6.5 percent in each of CYs 2023 and 2024. The following changes to the Proposed Biennial Budget (Option 1) are necessary to achieve these rates reductions:

- Increase the budgeted departmental vacancy rate for FTE positions from 2 percent to 5 percent to reflect current conditions. The higher vacancy rate is assumed to persist through FY 2031/32. This reduces the Departmental O&M budget by $24M over the biennium. **However, there is a risk that some savings might not materialize as savings from unfilled positions are often spent on overtime or temporary labor. Also, the savings might not be maintained if the vacancy rate decreases.**
- Update the Local Resource Projects (LRP) projection to reflect the expectation that no new agreements will be added during the biennial budget period.

- Under this option, the long-term rate outlook shows rates increasing by 6 percent in FY 2024/25, 5.5 percent from FY 2025/26 through FY 2028/29, and 5 percent thereafter.
- Revenue bond coverage decreases to 1.4 times in FY 2023/24.
- Additional risks as compared to Option 1: savings might not materialize or be maintained, and increased risk of large reserves draws that necessitate unplanned rate increases or higher future rates.

Option 3 reduces overall rate increases to 5.5 percent in each of CYs 2023 and 2024. This is achieved by making the following changes from Option 2:

- Assume Metropolitan receives $10M in grant funding per year to offset O&M expenditures through FY 2031/32.
- Reduce the Departmental O&M budget by another $10M over the biennial budget period**. These cuts have substantial impacts on operations, research and planning, and staff development, as explained in this letter.**
- Long-term rate increases would increase to 6 percent beginning in FY 2024/25 before dropping down to 5 percent in FY 2029/30.
- Additional risks as compared to Option 2: grants might not be obtained, and increased risk of large reserves draws that necessitate unplanned rate increases or higher future rates.

Attached to this board letter are documents corresponding to each budget option presented above, as well as resolutions reflecting the calculations for Option 1. Metropolitan will publish a final Budget, Cost of Service Report, Engineer's Report, and appropriate resolutions to reflect the final option adopted by the Board. Notice of the proposed budget, rates, charges, review of the applicability of the ad valorem property tax limitation, and the public workshops and hearings were provided to the member agencies, the Board, and the public in advance of the budget, rates, and charges process. All documents provided to the Board in connection with the actions proposed in this board letter have been posted online, along with other supporting and background material and any comments received by Metropolitan.

Description

OVERVIEW

The Proposed Biennial Budget covers a transitional period of strategic planning at Metropolitan. Over the next two fiscal years, Metropolitan will be completing the 2020 Integrated Resources Plan, continuing a rate refinement process, undertaking a long-term financial plan, and addressing Metropolitan's role as it approaches 100 years. The findings and recommendations that come out of these strategic planning initiatives will be considered by the Board and, if adopted, incorporated into future biennial budgets. In addition to the upcoming key strategic planning period, the biennium also starts in a time of emergency drought, when the world appears to be coming out of a pandemic that caused detrimental health and economic impacts, and great inflation and product shortages. Therefore, the options presented in this letter strike a balance between addressing the challenges of this transitional period and attempting to do so with the least amount of financial impact on Metropolitan's member agencies.

Funding Strategic Priorities

The proposed budget options align with the General Manager's proposed Business Plan for FYs 2022/23 and 2023/24, which sets out Metropolitan's strategic priorities. The five strategic priorities will guide the General Manager's Business Plan to drive new initiatives toward organizational improvements and overall resilience:

- ***Empower the workforce and promote diversity, equity, and inclusion.***
- ***Sustain Metropolitan's Mission with a Strengthened Business Model.***
- ***Adapt to Changing Climate and Water Resources.***
- ***Protect Public Health, Regional Economy, and Metropolitan Assets.***
- ***Partner with Stakeholders and the Communities We Serve.***

Key Budget Assumptions

Underlying all three of the proposed budget options are the following key assumptions:

- ***Water transactions projection****:* Water transactions include water sales, exchanges, and wheeling, which can be greatly impacted by hydrologic conditions. Metropolitan's Water Resource Management Group projected water transactions to be 1.59 million acre-feet (MAF) for FY 2022/23 and 1.54 MAF for FY 2023/24 and to remain between 1.5 and 1.6 MAF over the next ten years.
- ***State Water Project and Colorado River:*** For FYs 2022/23 and 2023/24, Metropolitan's SWP supplies are projected to be 0.41 MAF and 0.82 MAF, respectively. These projections are based on a 15 percent SWP allocation for CY 2022 and 40 percent for CY 2023 and account for the utilization of Metropolitan's SWP supply programs. After CY 2023, the SWP allocation is set at the median forecast of 50 percent. For FYs 2022/23 and 2023/24, Colorado River diversions are projected to be 1.007 MAF and 0.923 MAF, respectively, and account for the utilization of Metropolitan's Colorado River supply programs.
- ***Capital Investment Plan:*** CIP expenditures are budgeted at $300M in each of the biennial budget years. The capital expenditures for the full RRWP are not included in the biennium but are included in the Ten-Year Forecast starting in FY 2024/25. Detailed information about the CIP can be found in the CIP Appendix, **Attachment 1**.
- ***Ad valorem tax rate:*** The Proposed Biennial Budget assumes that the Board maintains the ad valorem tax rate at the current level of 0.0035 percent of assessed value, as the Board has done since FY 2013/14. This is projected to generate ad valorem tax revenues of $163.1M in FY 2022/23 and $168.3M in FY 2023/24.

Key Drivers for Rate Increases

The proposed rate increases are primarily driven by: (1) the catch-up for the loss of the Water Stewardship Rate (WSR) revenue; (2) a decrease in projected water transactions; (3) projected increases for State Water Project (SWP) and Colorado River Aqueduct (CRA) power costs and fixed State Water Contract (SWC) costs; and, (4) higher departmental O&M costs driven by high inflation and increasing DCP planning expenditures.

Water demands are projected to decrease by 60 thousand acre-feet over the proposed biennial budget period, from 1.60 MAF to 1.54 MAF, and are expected to continue to decline to 1.51 MAF by FY 2025/26. The lower water demand projection is the reason why our current rate projections are higher than was previously forecasted.

Financial Reporting Change

The Proposed Biennial Budget has been prepared on a cash basis instead of a modified-accrual basis. Financial reports will continue to be prepared on a full-accrual basis of accounting in accordance with promulgated rules of the Governmental Accounting Standards Board and Generally Accepted Accounting Principles. The staff has reviewed the impacts of budgeting and reporting on a modified-accrual basis over the last nine years and has determined that the benefits expected to be achieved did not manifest as thought. Reporting against the cash-based budget provides the most transparent reporting of available unrestricted reserves. Additionally, rather than saving a significant amount of staff time, the modified-accrual basis of accounting increased the amount of time required to maintain modified-accrual data and report against this basis of budgeting. Therefore, the staff proposes a change from a modified-accrual basis method of accounting to a cash-basis method. If approved by the Board pursuant to Section 5106 of the Administrative Code, the adopted budget will reflect this change.

Table 1 below summarizes the proposed revenue requirement and expenditure totals for the Proposed Biennial Budget (Option 1), as well as for Options 2 and 3.

Table 1: Expenditures and Revenue Requirements for Proposed Budget Options

in millions of dollars

	Option 1		Option 2		Option 3	
Options/Fiscal Year	**FY 2022/23**	**FY 2023/24**	**FY 2022/23**	**FY 2023/24**	**FY 2022/23**	**FY 2023/24**
State Water Contract Power	$ 211.6	$ 258.6	$ 211.6	$ 258.6	$ 211.6	$ 258.6
Colorado River Aqueduct Power	105.9	85.6	105.9	85.6	105.9	85.6
Departmental O&M	608.9	616.7	597.3	604.5	589.1	602.3
State Water Contract OMP&R & Capital	440.1	468.2	440.1	468.2	440.1	468.2
Supply Programs (cash funded portion)	66.7	64.1	66.7	64.1	66.7	64.1
Delta Conveyance Planning (net of CWF refund)	30.0	34.5	30.0	34.5	30.0	34.5
Demand Management (cash funded portion)	50.8	54.9	50.8	49.1	50.8	49.1
PAYGO	135.0	135.0	135.0	135.0	135.0	135.0
Debt Service	288.0	301.0	288.0	301.0	288.0	301.0
Sub-Total Expenditures	**$ 1,937.0**	**$ 2,018.6**	**$ 1,925.3**	**$ 2,000.6**	**$ 1,917.2**	**$ 1,998.4**
Increase/(Decrease) in Required Reserves	11.0	7.9	6.1	6.9	5.5	7.1
Property Taxes Revenues	(163.1)	(168.3)	(163.1)	(168.3)	(163.1)	(168.3)
Other Revenues	(72.0)	(57.4)	(72.0)	(57.4)	(82.1)	(67.5)
Total Revenue Requirement	**$ 1,712.9**	**$ 1,800.7**	**$ 1,696.3**	**$ 1,781.8**	**$ 1,677.6**	**$ 1,769.7**

OPTION 1 – PROPOSED BIENNIAL BUDGET

Rates and Charges

Overall rate increases of 8 percent effective each year, on January 1, 2023, and January 1, 2024, are appropriate to cover the costs in the Proposed Biennial Budget for FYs 2022/23 and 2023/24, meet financial policy guidelines with the exception of revenue bond coverage, and maintain steady rates for the future according to current assumptions. Before the Proposed Biennial Budget was presented in February, the General Manager had already taken steps to reduce the rate impact over the biennial budget period by focusing on actions to lower cash expenditures, including bond financing certain supply and conservation programs, limiting departmental O&M requests for new positions and discretionary budget increases, holding steady the level of PAYGO funding, and applying the CA WaterFix refund to DCP planning costs. Highlights of this option include the following:

- Implements measures to limit annual increases in Departmental O&M expenditures to approximately 3 percent per year, while adding 20 regular FTE positions to support board initiatives of Sustainability, Resilience & Innovation SRI, Diversity, Equity & Inclusion DE&I, and Equal Employment Opportunity EEO, and support key operational needs. The Departmental O&M budget also includes $20M for planning activities related to the RRWP and incorporates negotiated labor increases, allowable merit adjustments, and increased benefit costs.
- Recommends appropriating $600M to CIP for FYs 2022/23 and 2023/24. Maintains PAYGO funding at $135M per year to limit rate impacts at the expense of decreasing revenue bond coverage and of not meeting MWD's revenue bond coverage target of 2.0 times.
- Funds $99M in contributions for the DCP planning activities. These contributions will be funded from a combination of rates and the California WaterFix refund of $34.5M received in 2019.
- Continues to support demand management programs, including a proposed increase in funding for the Conservation Program to $43M annually, $36M of which is anticipated to be bond-financed over the biennium. Staff requests authority to bond finance the entire Conservation Program to provide flexibility in case of revenue shortfalls.
- Bond finance the AVEK High Desert Program to reduce short-term rate impacts.
- Allows Metropolitan to meet the fixed charge minimum coverage target of 1.2 times over the biennial period but will not allow Metropolitan to achieve its revenue bond target of 2.0 times during the biennium or the ten-year forecast period.
- Draws $55.2 million from reserves over the biennium.

- Long-term overall rate increases are projected at 5 percent per year and include the full-scale RRWP but not the DCP. This projection is subject to changes based on many factors including the implementation of the 2020 IRP and updated water transactions.

The specific elements of the proposed rate increase effective January 1, 2023, and January 1, 2024, are shown below in Table 2.

Table 2: Option 1 – Proposed Rates and Charges

Rates & Charges Effective January 1st	Adopted 2022	Proposed 2023	% Increase (Decrease)	Proposed 2024	% Increase (Decrease)
Tier 1 Supply Rate ($/AF)	$243	$329	35%	$355	8%
Tier 2 Supply Rate ($/AF)	$285	$532	87%	$540	2%
System Access Rate ($/AF)	$389	$381	-2%	$412	8%
System Power Rate ($/AF)	$167	$169	1%	$190	12%
Treatment Surcharge ($/AF)	$344	$367	7%	$373	2%
Full Service Untreated Volumetric Cost ($/AF)					
Tier 1	$799	$879	10%	$957	9%
Tier 2	$841	$1,082	29%	$1,142	6%
Full Service Treated Volumetric Cost ($/AF)					
Tier 1	$1,143	$1,246	9%	$1,330	7%
Tier 2	$1,185	$1,449	22%	$1,515	5%
Readiness-to-Serve Charge ($M)	$140	$157	12%	$175	11%
Capacity Charge ($/cfs)	$12,200	$10,800	-11%	$11,800	9%
Overall Rate Increase			**8%**		**8%**

Capacity and RTS Charges by member agencies are reflected on pages 108 and 110, respectively, of the FYs 2022/23 and FY 2023/24 Cost of Service Report for Proposed Water Rates and Charges – Option 1 (**Attachment 2**).

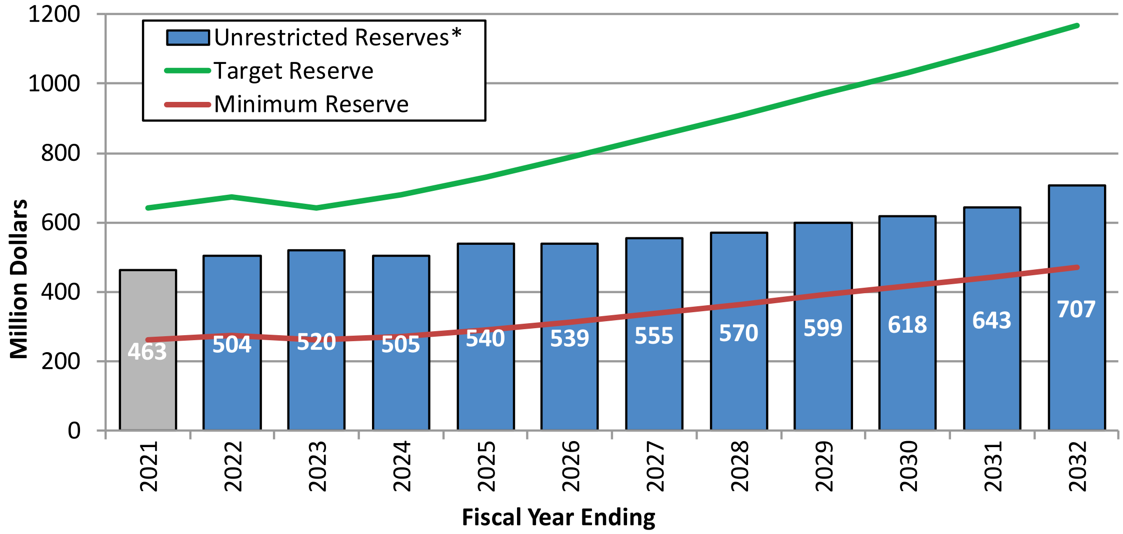
The analysis in the COS Report supports the proposed rates and charges. The proposed CYs 2023 and 2024 water rates and charges are based on Metropolitan's current methodology for developing rates and charges to produce the necessary revenue required to cover costs. The proposed rates and charges also exclude a separate rate or charge to recover demand management costs, as a result of Metropolitan's Board action on November 23, 2021, which directed staff to recover 100 percent of demand management costs from Metropolitan's supply rate elements in the future rate and charge proposals. Accordingly, all demand management costs (regardless of funding source, such as bond financing or current revenues) are functionalized as supply and collected on the Tier 1 and Tier 2 supply rates. However, because there are no projected Tier 2 transactions in the biennium, the demand management costs are recovered entirely by the Tier 1 supply rate.

10-Year Financial Forecast

The Proposed Biennial Budget sets the foundation for consistent, reasonable rate increases over the ten-year planning period. Overall rate increases from FY 2022/23 through FY 2031/32 are projected to start at 8 percent each year for the next biennium and lower to 5 percent thereafter. The complete Ten-Year Forecast is presented in **Attachment 1** and includes the implementation of the full RRWP but does not include the costs for the DCP.

The long-term rate projections for all options presented in this report are highly influenced by the addition of the full-scale RRWP, which is assumed to begin construction in FY 2024/25 and affect the 2025 to 2032 rates and charges. The allocation of the RRWP costs to the rates and charges is based on preliminary information and might substantially change as a result of an upcoming COS study for the RRWP. In addition, the 10-year rate forecasts do not include the DCP which would substantially increase the rate projections.

Figure 1: Option 1 – Projected Rate Increases, Reserves and Financial Indicators, Ten-Year Forecast



Overall Rate Inc.	3.0%	4.0%	8.0%	8.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.1%	5.0%
Water Transactions, MAF**	1.52	1.60	1.59	1.54	1.54	1.51	1.53	1.53	1.54	1.55	1.55	1.57
Rev. Bond Cvg	2.0	1.6	1.5	1.5	1.8	1.7	1.8	1.7	1.7	1.7	1.8	1.7
Fixed Chg Cvg	2.0	1.6	1.5	1.5	1.8	1.7	1.8	1.7	1.7	1.7	1.7	1.6
PAYGO, $M	110	135	135	135	175	175	175	175	200	200	200	200

* includes Revenue Remainder and Water Rate Stabilization Fund
** includes water sales, exchanges, and wheeling

Bond Coverage Ratio

Revenue bond debt service coverage is one primary indicator of credit quality and is calculated by dividing net operating revenues by debt service. Metropolitan's debt management policy is to maintain an annual revenue bond coverage ratio of at least 2.0 times. Over the Ten-Year Forecast, Metropolitan's revenue bond coverage ratio is not expected to be achieved. In addition, Metropolitan also measures the total coverage of all fixed obligations after payment of operating expenditures. Metropolitan's fixed charge coverage ratio target is 1.2 times. The Ten-Year Forecast projects that Metropolitan's fixed charge coverage ratio is at least 1.5 times over the ten-year period, which helps maintain favorable credit ratings and access to the capital markets with low borrowing costs.

OPTION 2

Rates and Charges

This option reduces the overall rate increases to 6.5 percent in each of CYs 2023 and 2024. The following changes to the Proposed Biennial Budget (Option 1) are necessary to achieve these rate reductions:

- Increase the departmental budget vacancy rate for FTE positions from 2 percent to 5 percent to reflect current conditions. The higher vacancy rate is assumed to persist through FY 2031/32. This reduces the Departmental O&M budget by $24M over the biennium. However, there is a risk that some savings might not materialize as savings from unfilled positions are often spent on overtime or temporary labor. Also, the savings might not be maintained if the vacancy rate decreases.
- Update the Local Resource Projects (LRP) projection to reflect the expectation that no new agreements will be added during the biennial budget period.
- Under this option, the long-term rate outlook shows rates increasing by 6 percent in FY 2024/25, 5.5 percent from FY 2025/26 through FY 2028/29, and 5 percent thereafter.

- Revenue bond coverage decreases to 1.4 times in FY 2023/24.
- Additional risks as compared to Option 1: savings might not materialize or be maintained, and increased risk of large reserves draws that necessitate unplanned rate increases or higher future rates.

The specific elements of the proposed rate increase effective January 1, 2023, and January 1, 2024, are shown below in Table 3.

Table 3: Option 2 – Proposed Rates and Charges

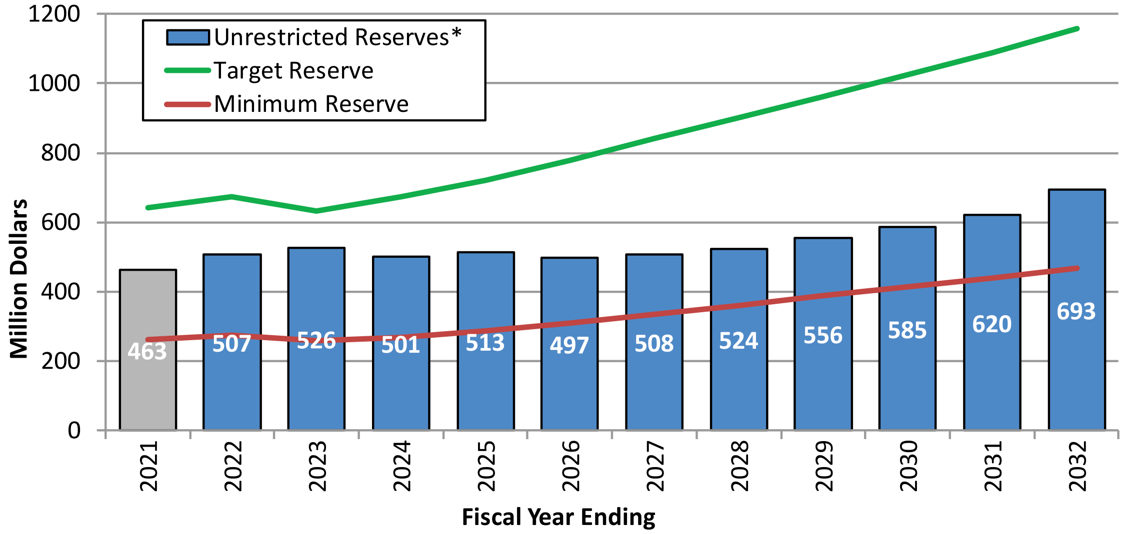
Rates & Charges Effective January 1st	Adopted 2022	Proposed 2023	% Increase (Decrease)	Proposed 2024	% Increase (Decrease)
Tier 1 Supply Rate ($/AF)	$243	$325	34%	$341	5%
Tier 2 Supply Rate ($/AF)	$285	$531	86%	$532	0%
System Access Rate ($/AF)	$389	$375	-4%	$401	7%
System Power Rate ($/AF)	$167	$167	0%	$187	12%
Treatment Surcharge ($/AF)	$344	$360	5%	$363	1%
Full Service Untreated Volumetric Cost ($/AF)					
Tier 1	$799	$867	9%	$929	7%
Tier 2	$841	$1,073	28%	$1,120	4%
Full Service Treated Volumetric Cost ($/AF)					
Tier 1	$1,143	$1,227	7%	$1,292	5%
Tier 2	$1,185	$1,433	21%	$1,483	3%
Readiness-to-Serve Charge ($M)	$140	$156	11%	$172	10%
Capacity Charge ($/cfs)	$12,200	$10,700	-12%	$11,500	7%
Overall Rate Increase			**6.5%**		**6.5%**

Capacity and RTS Charges by member agencies are reflected on pages 108 and 110, respectively, of the FYs 2022/23 and FY 2023/24 Cost of Service Report for Proposed Water Rates and Charges – Option 2 (**Attachment 3**).

10-Year Financial Forecast

Under this option, the long-term rate outlook shows rates increasing by 6 percent in FY 2024/25, 5.5 percent from FY 2025/26 through FY 2028/29, and 5 percent thereafter. Additionally, the forecasted minimum bond coverage ratio steps down from 1.5 times to 1.4 times.

Figure 2: Option 2 – Projected Rate Increases, Reserves and Financial Indicators, Ten-Year Forecast



Overall Rate Inc.	3.0%	4.0%	6.5%	6.5%	6.0%	5.5%	5.5%	5.5%	5.5%	5.0%	5.0%	5.0%
Water Transactions, MAF**		1.60	1.59	1.54	1.54	1.51	1.53	1.53	1.54	1.55	1.55	1.57
Rev. Bond Cvg	2.0	1.6	1.5	1.4	1.7	1.6	1.7	1.7	1.7	1.8	1.8	1.8
Fixed Chg Cvg	2.0	1.6	1.5	1.4	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.6
PAYGO, $M	-	135	135	135	175	175	175	175	200	200	200	200

* includes Revenue Remainder and Water Rate Stabilization Fund
** includes water sales, exchanges, and wheeling

<u>OPTION 3</u>

Rates and Charges

This option achieves an overall rate increase of 5.5 percent in both of CYs 2023 and 2024. This is accomplished by making the following changes to Option 2:

- Assumes Metropolitan receives $10M in grant funding per year to offset O&M expenditures through FY 2031/32.
- Reduce the Departmental O&M budget by another $10M over the biennial budget period. These cuts have a substantial impact on Metropolitan's operations and research and planning programs, as detailed in Table 4 below.
- Long-term rate increases would increase to 6 percent beginning in FY 2024/25 before dropping down to 5 percent in FY 2029/30.
- Additional risks as compared to Option 2: grants might not be obtained, and increased risk of large reserves draws that necessitate unplanned rate increases or higher future rates.

Table 4: Summary of Key O&M Budget Cuts and Impacts

Research and Planning Impacts

- Cancel Feather River Watershed Climate Modeling effort (including co-funding to sponsors) and cut spatial analysis work (remote sensing data analysis, machine learning, analytics on agricultural and urban areas) back by half; this would reduce the ability to understand climate change impacts and monitor the effectiveness of water efficiency actions.
- Cut Delta-related studies and projects including collaborative science work on salmon recovery, the relative risk of fish entrainment modeling, and delta smelt and NGO participation in Collaborative Science and Adaptive Management Program; limit work on other pilot studies and modeling as well as cutting several inspection trips and the level of engineering and agricultural coordination support for the Delta Islands.
- Cut cost-sharing agreements with other agencies and academic institutions on scientific studies, resulting in missed collaborative opportunities on Metropolitan's science objectives.

Operations Impacts

- Limit the scope of the Seismic Resilience Strategy including the number of seismic assessments of Metropolitan infrastructure; additionally, postpone a variety of scheduled system vulnerability and reliability studies that would identify corrective action to maintain the system's reliability.
- Extend shutdowns (e.g., the 7-day shutdown could extend to 14 days or more) or defer or cancel some shutdowns to reduce overtime. Extending shutdowns could result in a significant impact on member agencies as many agencies do not have sufficient local supplies to withstand an extended shutdown period.
- Cut WSO materials and supplies: (1) pipe/valves and tools (10 percent), which increases the risk to system reliability and potential for emergency repairs; (2) laboratory supplies (6 percent) with a commensurate reduction in water quality tests that may impact the ability to do extended research into emerging water quality issues and trends.
- Cut WSO field travel to support work in remote areas in response to potential deferment of select shutdowns.
- Cut director inspection trips from 65 to 40, with more local/one-day and shared trips between two or more directors, and far fewer trips to Hoover Dam and the State Water Project/Delta; cut state and legislative inspection trips from one every year to one every two years.
- Cut travel, training, and conferences, resulting in reduced staff development and professional and technical opportunities.
- Cuts in IT outside services and materials and supplies which will result in slower response time to unplanned outages, possible increase in system downtime, and limited ability to respond to ad hoc requests and system enhancements.
- Cut IT training which will greatly decrease innovation and ability to support new technology.
- Cancel IT project implementations related to procurement, contracting, HR systems improvement, and other projects which may impact district productivity and vendor experience.

Table 5: Option 3 – Proposed Rates and Charges

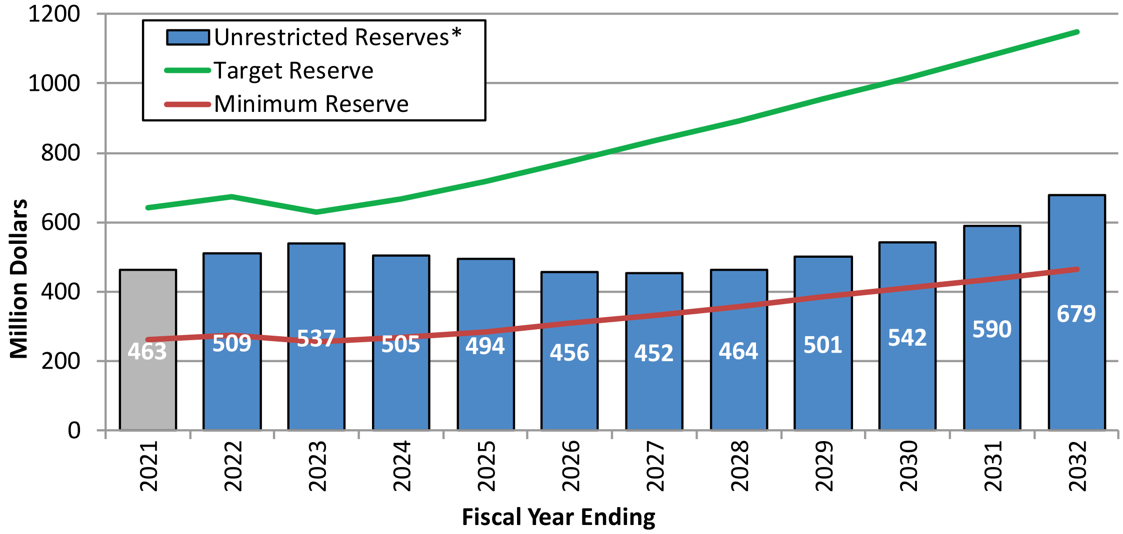
Rates & Charges Effective January 1st	Adopted 2022	Proposed 2023	% Increase (Decrease)	Proposed 2024	% Increase (Decrease)
Tier 1 Supply Rate ($/AF)	$243	$323	33%	$335	4%
Tier 2 Supply Rate ($/AF)	$285	$531	86%	$532	0%
System Access Rate ($/AF)	$389	$370	-5%	$393	6%
System Power Rate ($/AF)	$167	$166	-1%	$183	10%
Treatment Surcharge ($/AF)	$344	$356	3%	$357	0%
Full Service Untreated Volumetric Cost ($/AF)					
Tier 1	$799	$859	8%	$911	6%
Tier 2	$841	$1,067	27%	$1,108	4%
Full Service Treated Volumetric Cost ($/AF)					
Tier 1	$1,143	$1,215	6%	$1,268	4%
Tier 2	$1,185	$1,423	20%	$1,465	3%
Readiness-to-Serve Charge ($M)	$140	$155	11%	$169	9%
Capacity Charge ($/cfs)	$12,200	$10,600	-13%	$11,400	8%
Overall Rate Increase			**5.5%**		**5.5%**

Capacity and RTS Charges by member agencies are reflected on pages 108 and 110, respectively, of the FYs 2022/23 and FY 2023/24 Cost of Service Report for Proposed Water Rates and Charges – Option 3 (**Attachment 4**).

10-Year Financial Forecast

This option targets overall rate increases of 5.5 percent in both CYs 2023 and 2024. Overall rate increases from FY 2022/23 through FY 2031/32 are projected to start at 5.5 percent each year for the biennium and increase to 6 percent through FY 2028/29, then decrease to 5 percent thereafter. As in Option 2, the bond coverage ratio reaches a minimum of 1.4 times in FY 2023/24.

Figure 3: Option 3 – Projected Rate Increases, Reserves and Financial Indicators, Ten-Year Forecast



Overall Rate Inc.	3.0%	4.0%	5.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%	5.0%	5.0%	5.0%
Water Transactions, MAF**	1.52	1.60	1.59	1.54	1.54	1.51	1.53	1.53	1.54	1.55	1.55	1.57
Rev. Bond Cvg	2.0	1.6	1.5	1.4	1.7	1.6	1.7	1.7	1.7	1.8	1.8	1.8
Fixed Chg Cvg	2.0	1.6	1.5	1.4	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.7
PAYGO, $M	110	135	135	135	175	175	175	175	200	200	200	200

* includes Revenue Remainder and Water Rate Stabilization Fund
** includes water sales, exchanges, and wheeling

COST OF SERVICE ANALYSIS

The proposed water rates and charges to support the estimated revenue requirements were developed using the COS methodology previously approved by the Board and implemented since the Board adopted the current rate structure in October 2001 and implemented it in January 2003. More recently, the Board modified the manner of allocating demand management costs by directing staff in November 2021 to recover all demand management costs through the supply rate elements. Metropolitan, a wholesaler, provides full-service water service (treated or untreated) to its member agencies. Metropolitan has one class of customers: its member agencies. The level of rate unbundling in Metropolitan's rate structure provides transparency to show that rates and charges recover only those functions involved in the applicable service and that no cross-subsidy of functions exists. Metropolitan's COS process and resulting unbundled rate structure ensure that its wholesale customers pay for only those services they elect to receive. COS reports have been prepared for each rate option and are found as **Attachments 2, 3, and 4** to this letter.

PUBLIC PROCESS

The following table gives an account of the public process carried out regarding the Proposed Biennial Budget and proposed water rates and charges for CYs 2023 and 2024. In addition to the Board process, staff presented information to Metropolitan's member agencies at monthly Member Agency Managers Meetings.

February 7, 2022	F&I Committee, Workshop #1
February 11, 2022	Notice of public hearing regarding proposed rates and charges transmitted to member agencies
February 22, 2022	F&I Committee, Workshop #2
February 24, 2022	Notice of public hearing regarding Section 124.5 transmitted to Legislature
March 7, 2022	F&I Committee, Workshop #3
March 8, 2022	A public hearing on proposed water rates and charges and applicability of the tax rate limit pursuant to Section 124.5 of the MWD Act
March 22, 2022	F&I Committee, Workshop #4
April 11, 2022	F&I Committee, Recommended Biennial Budget, Calendar Year rates and charges, and applicability of Section 124.5 tax rate limit
April 12, 2022	Board **action** regarding Biennial Budget, Calendar Year rates and charges, and applicability of Section 124.5 tax rate limit

Following this process, and having received and evaluated all comments, this board letter proposes that the Board approve the Proposed Biennial Budget, including the CIP, and rates and charges, presented as Option 1, and provides two alternative options.

Policy

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

Metropolitan Water District Act Section 124.5: Ad Valorem Tax Limitation

Metropolitan Water District Act Section 130: General Powers to Provide Water Services

Metropolitan Water District Act Section 133: Fixing of Water Rates

Metropolitan Water District Act Section 134: Adequacy of Water Rates; Uniformity of Rates

Metropolitan Water District Act Section 134.5: Water Standby or Availability of Service Charge

Metropolitan Water District Administrative Code Section 4304: Apportionment of Revenues and Setting of Water Rates

Metropolitan Water District Administrative Code Section 11104: Delegation of Responsibilities

Metropolitan Water District Administrative Code Section 5106: Accounting System

Metropolitan Water District Administrative Code Section 5107: Biennial Budget Process

Metropolitan Water District Administrative Code Section 5109: Capital Financing

Metropolitan Water District Administrative Code Section 5200(b): Funds Established

By Minute Item 51828, dated December 10, 2019, the Board directed staff to: (1) incorporate the 2019/20 fiscal-year-end balance of the Water Stewardship Fund to fund all demand management costs in the proposed FYs 2020/21 and 2021/22 Biennial Budget; and (2) to not incorporate the Water Stewardship Rate or any other rate or charge to recover demand management costs, with the proposed rate and charges for CYs 2021 and 2022.

By Minute Item 52603, dated November 23, 2021, the Board directed staff to incorporate the 100 percent Supply Alternative as the demand management cost recovery method used in the proposals for rates and charges.

California Environmental Quality Act (CEQA)

CEQA determination for Options 1, 2, and 3:

The proposed actions are not defined as a project under CEQA (Public Resources Code Section 21065, State CEQA Guidelines Section 15378) because the proposed actions will not cause either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment and involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed actions are not defined as a project because they involve 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 potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines). Finally, if it can be seen with certainty that there is no possibility that the proposed actions in question may have a significant effect on the environment, the proposed actions are not subject to CEQA (Section 15061(b)(3) of the State CEQA Guidelines).

Board Options

Option #1

a. Approve the FY 2022/23 and FY 2023/24 Proposed Biennial Budget with overall rate increases of 8 percent in ~~FY~~ CY 2023 and 8 percent in ~~FY~~ CY 2024, which includes:
   - (i) Appropriation of $3,131.0M for Metropolitan O&M and operating equipment, power costs on the Colorado River Aqueduct, SWC operations, maintenance, power and replacement costs and SWC capital charges, demand management programs including the local resources and Conservation Credits Program, and costs associated with supply programs, for FYs 2022/23 and 2023/24;
   - (ii) A continuing appropriation of $589.0M for FY 2022/23 and FY 2023/24 for debt service on Metropolitan general obligation and revenue bonds;
   - (iii) Bond financing $84.4M for the AVEK High Desert Program over the biennium, and
   - (iv) Bond financing $36.0M of the budgeted Conservation Program over the biennium;

b. Authorize the use of $270M in operating revenues to fund the Capital Investment Plan for FYs 2022/23 and 2023/24;

c. Determine that the revenue requirements to be paid from rates and charges are $1,712.9M in FY 2022/23 and $1,800.7M in FY 2023/24;

d. Approve the Ten-Year Financial Forecast, as shown in the Proposed Biennial Budget FY 2022/23 and FY 2023/24;

e. Approve water rates effective January 1, 2023, and January 1, 2024, as shown in Table 2 above;

f. Adopt the Resolution Fixing and Adopting Water Rates To Be Effective January 1, 2023, and 2024, in the form of **Attachment 5**;

g. Adopt the Resolution Fixing and Adopting A Readiness-To-Serve Charge Effective January 1, 2023, in the form of **Attachment 6**;

h. Adopt the Resolution Fixing and Adopting A Capacity Charge Effective January 1, 2023, in the form of **Attachment 7**; and

i. Authorize a change in the method of installing, keeping, and rendering all accounts from a modified-accrual basis method of accounting to a cash-basis method of accounting for the purpose of budgeting.

Business Analysis: Option 1 provides adequate funding for O&M needs, targets a minimum bond coverage ratio of 1.5 times, maintains funding for all demand management programs, and ensures that Metropolitan has sufficient resources to meet upcoming challenges and execute on the General Manager's strategic priorities. Under this option, the Ten-Year Financial Forecast anticipates a 5 percent overall rate increase beginning in ~~FY 2024/25~~ CY 2025 and remaining at that level through ~~FY 2031/32~~ CY 2032.

Option #2

a. Approve the FY 2022/23 and FY 2023/24 Proposed Biennial Budget with overall rate increases of 6.5 percent in ~~FY~~ CY 2023 and 6.5 percent in ~~FY~~ CY 2024, which includes:
   (i) Appropriation of $3,101.4M for Metropolitan O&M and operating equipment, power costs on the Colorado River Aqueduct, SWC operations, maintenance, power and replacement costs and SWC capital charges, demand management programs including the local resources and Conservation Credits Program, and costs associated with supply programs, for FYs 2022/23 and 2023/24;
   (ii) A continuing appropriation of $589.0M for FY 2022/23 and FY 2023/24 for debt service on Metropolitan general obligation and revenue bonds;
   (iii) Bond financing $84.4M for the AVEK High Desert Program over the biennium, and
   (iv) Bond financing $36.0M of the budgeted Conservation Program over the biennium;
b. Authorize the use of $270M in operating revenues to fund the Capital Investment Plan for FYs 2022/23 and 2023/24;
c. Determine that the revenue requirements to be paid from rates and charges are $1,696.3M in FY 2022/23 and $1,781.8M in FY 2023/24;
d. Approve the Ten-Year Financial Forecast, as shown in the Proposed Biennial Budget FY 2022/23 and FY 2023/24;
e. Approve water rates effective January 1, 2023, and January 1, 2024, as shown in Table 3 above;
f. Adopt the Resolution Fixing and Adopting Water Rates To Be Effective January 1, 2023, and 2024, in the form of **Attachment 5**, as will be updated to reflect the calculations and resulting rates pursuant to Option 2;
g. Adopt the Resolution Fixing and Adopting A Readiness-To-Serve Charge Effective January 1, 2023, in the form of **Attachment 6**, as will be updated to reflect the calculations and resulting RTS Charge pursuant to Option 2;
h. Adopt the Resolution Fixing and Adopting A Capacity Charge Effective January 1, 2023, in the form of **Attachment 7**, as will be updated to reflect the calculations and resulting Capacity Charge pursuant to Option 2; and
i. Authorize a change in the method of installing, keeping, and rendering all accounts from a modified-accrual basis method of accounting to a cash-basis method of accounting for the purpose of budgeting.

Business Analysis: Option 2 lowers the recommended overall rate increases from 8 percent to 6.5 percent in each of CYs 2023 and 2024 ~~CYs 2022/23 and 2023/24~~, which is made possible by increasing the assumed FTE vacancy rate and placing a moratorium on new LRP agreements in the biennium. The bond coverage decreases to 1.4 times in FY 2023/24 and, additionally, the 10-Year Financial Forecast anticipates a rate increase of 6 percent in CY 2025, ~~FY 2024/25,~~ 5.5 percent from CY 2026 ~~FY 2025/26~~ through CY 2029 ~~FY 2028/29~~ and 5 percent thereafter.

Option #3

a. Approve the FY 2022/23 and FY 2023/24 Proposed Biennial Budget with overall rate increases of 5.5 percent in ~~FY 2022/23~~ CY 2023 and 5.5 percent in CY 2024 ~~FY 2023/24~~, which includes:
   (i) Appropriation of $3,091.1M for Metropolitan O&M and operating equipment, power costs on the Colorado River Aqueduct, SWC operations, maintenance, power and replacement costs and SWC capital charges, demand management programs including the local resources and Conservation Credits Program, and costs associated with supply programs, for FYs 2022/23 and 2023/24;
   (ii) A continuing appropriation of $589.0M for FY 2022/23 and FY 2023/24 for debt service on Metropolitan general obligation and revenue bonds;
   (iii) Bond financing $84.4M for the AVEK High Desert Program over the biennium, and
   (iv) Bond financing $36.0M of the budgeted Conservation Program over the biennium;
b. Authorize the use of $270M in operating revenues to fund the Capital Investment Plan for FYs 2022/23 and 2023/24;
c. Determine that the revenue requirements to be paid from rates and charges are $1,677.6M in

FY 2022/23 and $1,769.7M in FY 2023/24;

d. Approve the Ten-Year Financial Forecast, as shown in the Proposed Biennial Budget FY 2022/23 and FY 2023/24;
e. Approve water rates effective January 1, 2023, and January 1, 2024, as shown in Table 5 above;
f. Adopt the Resolution Fixing and Adopting Water Rates To Be Effective January 1, 2023, and 2024, in the form of **Attachment 5**, as will be updated to reflect the calculations and resulting rates pursuant to Option 3;
g. Adopt the Resolution Fixing and Adopting A Readiness-To-Serve Charge Effective January 1, 2023, in the form of **Attachment 6**, as will be updated to reflect the calculations and resulting RTS Charge pursuant to Option 3;
h. Adopt the Resolution Fixing and Adopting A Capacity Charge Effective January 1, 2023, in the form of **Attachment 7**, as will be updated to reflect the calculations and resulting Capacity Charge pursuant to Option 3; and
i. Authorize a change in the method of installing, keeping, and rendering all accounts from a modified-accrual basis method of accounting to a cash-basis method of accounting for the purpose of budgeting.

Business Analysis: Option 3 lowers the recommended overall rate increases from 8 percent to 5.5 percent in each of CYs ~~2023~~ 2022/23 and ~~2024~~2023/24, primarily made possible through cutting departmental O&M budgets in addition to increasing the assumed FTE vacancy rate, placing a moratorium on new LRP agreements in the biennium, and assuming $10M in annual grant funding. The bond coverage decreases to 1.4 times in FY 2023/24 and, additionally, the 10-Year Financial Forecast anticipates a 6 percent overall rate increase beginning in CY 2025~~FY 2024/25~~ and remaining at that level through CY 2029 ~~FY 2028/29~~ before decreasing to 5 percent.

Staff Recommendation

Option #1

4/8/2022

Katano Kasaine Date
Chief Financial Officer/
Assistant General Manager

4/8/2022

Adel Hagekhalil Date
General Manager

Attachment 1 – Proposed Biennial Budget FY 2022/23 and FY 2023/24 and the associated Ten-Year Financial Forecast

Attachment 2 – Metropolitan Water District of Southern California, Fiscal Years 2022/23 and FY 2023/24 Cost of Service Report for Proposed Water Rates and Charges – Option 1

Attachment 3 – Metropolitan Water District of Southern California, Fiscal Years 2022/23 and FY 2023/24 Cost of Service Report for Proposed Water Rates and Charges – Option 2

Attachment 4 – Metropolitan Water District of Southern California, Fiscal Years 2022/23 and FY 2023/24 Cost of Service Report for Proposed Water Rates and Charges – Option 3

Attachment 5 – Resolution Fixing and Adopting Water Rates to be Effective January 1, 2023, and January 1, 2024 – Option 1

Attachment 6 – Resolution Fixing and Adopting a Readiness-To-Serve Charge Effective January 1, 2023 – Option 1

Attachment 7 – Resolution Fixing and Adopting a Capacity Charge Effective January 1, 2023 – Option 1

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