



San Diego County Water Authority

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January 5, 2011

Brian Thomas
Chief Financial Officer
Metropolitan Water District of Southern California
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MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

Re: Draft Long Range Finance Plan

Dear Mr. Thomas:

We have reviewed the Draft 2010 Long Range Finance Plan (finance plan or plan) made available December 1, 2010 and provide the following comments.

The principal objective of the finance plan is to provide the member agencies with a 10-year rate forecast based on MWD's planned capital projects expenditures and resources plan implementation. The rate forecast contained in the finance plan is important to the member agencies because we will rely upon it, both to forecast our own rates and to plan local investments. Unfortunately, the draft plan has such serious flaws that it does not achieve its intended purpose: providing *a meaningful range of rates* upon which the member agencies can rely to produce their own forecasts and plan local investments.

We note two fundamental problems with the draft finance plan.

First, this plan cannot be reconciled with the 2010 IRP resources strategy adopted by the MWD board of directors. MWD is either going to invest to the limited level and extent described in the draft finance plan – which reflects current levels of investment in conservation and local project – or, it is going to implement the expansive resources strategy described in the 2010 IRP adopted by the board of directors. You can't have it both ways. If MWD is going to invest in seawater desalination and storm water recovery projects as described in the 2010 IRP, then it must include the costs of those investments in the finance plan. On the other hand, if MWD staff's recommendation is to continue expenditures at today's level, the finance plan should clearly state that, and describe how the expanded resources strategy described in the 2010 IRP would be accomplished.

Second, the core assumptions used to develop the rate forecasts are unrealistic because they fail to take into account known factors that could have a material impact on MWD water sales over the next ten years. The calculation of forecasted high rates in the plan assumes "low" deliveries of 1.8 million acre-feet while other parts of the plan states – we believe, correctly – that the low delivery potential is 1.3 million acre-feet. As you know, MWD's rates are highly sensitive to volume of water delivered, thus, the forecasted "high" rates could be off significantly.

A public agency providing a safe and reliable water supply to the San Diego region

Mr. Brian Thomas
January 5, 2011
Page 2

On a related note, MWD must factor into the finance plan member agencies' projected demands on MWD, or, non-demands as a result of conservation and other "rolling off" MWD imported water supplies. As you know, these numbers will be available in mid-2011 through updates to each agency's Urban Water Management Plan. MWD should use the time between now and then to discuss ways to stabilize MWD revenues without developing supplies for which there may be no buyers and result in rate increases that are higher than necessary. MWD must focus its finance plan on securing firm commitments to pay for existing fixed costs before it embarks upon new spending programs. It is imperative for MWD's short- and long-term fiscal sustainability to ensure MWD spending is supported by member agencies' firm contractual commitments to pay for MWD projects and programs.

Finally, you have already announced that MWD intends to conduct a review of the rate structure later this year, including the current cost-of-service methodology which is at issue in the Water Authority's litigation challenging the 2011 and 2012 rates. For the reasons described in the complaint, we believe that MWD's current cost-of-service methodology is flawed because it improperly misallocates supply related costs to rate categories other than supply. The draft finance plan is flawed because it is based on the same flawed cost-of-service methodology.

Further work on the finance plan should be integrated with the Urban Water Management Plans of the member agencies and MWD's 2011 review of the rate structure. In its current form the finance plan does not accomplish its intended purpose.

The Water Authority looks forward to participating in these discussions in 2011.

Sincerely,



Dennis A. Cushman
Assistant General Manager

Cc: Water Authority MWD Delegates