



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

July 11, 2016

Randy Record, Chairman and MWD Board Members
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153
VIA EMAIL TO ALL MWD BOARD MEMBERS

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

RE: Draft Appendix A Dated 7/6/16

Board Chairman Randy Record and MWD Board Members:

This letter provides comments on the redline copy of Draft Appendix A dated 7/6/16 provided to board members via email on July 7, 2016. We believe the Draft Appendix A is misleading to the public for the reasons that have been stated in prior letters, which have not been substantively addressed by MWD; it is apparent that responses proffered by staff have been selective and incomplete.ⁱ

We incorporate by reference herein all of the comments and objections contained in our June 15, 2016 letter to the Board (Attachment 1) RE June Board meeting Board Memo 8-2: Draft Appendix A, including its incorporation of prior comments and objections. We believe MWD's Appendix A fails to accurately describe the state of MWD's current and projected water sales and financial condition, including its inability to adopt a legal rate structure or even a long range financial plan to pay for its multi-billion planned expenditures. In addition to those previously identified, our comments on the current Draft are as follows:

A-6: Intentionally Created Surplus. There is no apparent reason why the disclosure that MWD's access to the Intentionally Created Surplus (ICS) is limited should be deleted. We are not aware of any changes to the long-term forecasts that justify or support the deletion of this information. In addition, as previously noted, the Draft Appendix A fails to include any discussion of the ongoing Colorado River shortage sharing negotiations in which MWD is actively engaged. This is important information regarding the availability of MWD's Colorado River water supplies, including the possibility that it would voluntarily forego a portion of its Colorado River water supplies, where disclosure should be enhanced, not narrowed.

A-47-48: Financial Reserve Policy. The Draft Appendix states that as of May 31, 2016, MWD has set aside \$250.2 million in order to account for disputed amounts previously paid by the Water Authority in an "Exchange Agreement Set-Aside Fund;" further, that the \$408 million in unrestricted reserves no longer includes funds held in this "Set-Aside" fund. But the Draft Appendix A does not disclose all of the relevant facts involved in this dispute with the Water Authority, or that MWD continues to refuse to formally restrict the use of the Water Authority's security deposit. Instead, these funds appear to continue to do "double duty," contrary to what is legally required under MWD's Exchange Agreement with the Water Authority. At a minimum -- given the order of magnitude of the amount in controversy in the Water Authority's rate litigation, in the hundreds of millions of dollars -- MWD should fully disclose the

OTHER REPRESENTATIVE

County of San Diego

background of this dispute and that MWD is not holding these funds in the manner it has represented in the Superior Court proceedings.

A-63: Short-Term Revolving Credit Facilities. We have not previously been informed by staff that MWD has taken \$296 million from lines of credit. The Board was told in March 2016 when it authorized the sale of up to \$400 million of short-term revenue certificates, that \$250 million would be used to replace the Water Authority's security deposits that had already been spent by MWD; however, no explanation has been given for use of the other \$46 million taken against the line of credit to date. How has this money been spent by staff? What is the process for staff to report back to the Board the amount of debt it plans to sell after the initial authorization of bonds without any identified purpose?

A-64: Subordinate Revenues Obligations. We note that this section describes the impending sale of \$175 million subordinate revenue bonds to finance the Delta Island purchase, which the Draft Appendix A is intended to support. The same section also states MWD has authorization to issue another up to \$400 million of Commercial Paper Notes. We found online the attached email from Brian Thomas to staff members at Santa Clara Valley Water District, Kern County Water Agency and MWD, including Roger Patterson and the CFO Gary Breaux that attached a draft pre-construction agreement, which referenced the potential for MWD to fund \$400 million of pre-construction activities related to Delta tunnels, using its Commercial Paper authority. It appears that MWD does not have any Commercial Paper Notes currently outstanding, and we would like to know before any Commercial Paper Notes are issued how the Board will be informed of such decision. At last month's Board meeting, the General Manager denied that any such plan exists under which MWD will borrow money to pay for pre-construction costs of, or related to the Delta tunnels.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director

Attachments:

- 1) Water Authority Delegates' Letter Dated June 15, 2016 RE June Board Meeting Board Memo 8-2: Draft Appendix A
- 2) Brian Thomas' email dated September 30, 2014 re BDCP Pre-Construction Financing Simple Term Sheet

ⁱ We are also advised by staff that MWD's responses to our concerns have been independently reviewed by MWD's financial advisor Ed Soong from PRAG, Co-Bond Counsel Dan Deaton from Nixon Peabody, and Alexis Chiu of the Law Offices of Alexis Chiu. Please advise us if this is incorrect; and also, we request to be advised if any of MWD's other financial and legal advisors have reviewed and approved Mr. Breaux's responses to the Water Authority's concerns about MWD's financial disclosures in Appendix A.



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

June 15, 2016

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

VIA EMAIL TO ALL MWD BOARD MEMBERS

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: June Board Meeting Board Memo 8-2: Draft Appendix A

Dear Chairman Record and Members of the Board:

This letter responds to Gary Breaux's June 14, 2016 letter and provides comments on the redline Board Distribution Draft Appendix A dated 5/31/16 (Draft Appendix A).

I. Gary Breaux's June 14, 2016 Letter - "Narrowing Down Board Approval"

We submitted a letter dated June 11, 2016 (Attachment 1) regarding the Board's deliberation of June Board Memo 8-2 and specifically, our opposition to MWD staff's new procedure for "how best to involve [the MWD] Board in the process" of reviewing disclosures made in offering statements. At the time of our review of Board Memo 8-2, MWD staff had already withdrawn Board Memo 8-3 (authorizing issuance of up to \$175 million of subordinate water revenue bonds), so that to our knowledge, there was no bond sale pending.

On Monday, June 13, at the Finance and Insurance Committee meeting, MWD's Chief Financial Officer, Gary Breaux, "mentioned" that staff was planning to use the updated disclosures in the Draft Appendix A in connection with the remarketing of bonds "this month" -- a fact that should have been made explicitly clear in Board Memo 8-2. In a letter delivered to the Board yesterday morning (Attachment 2), Mr. Breaux also informed us for the first time that staff planned to print a preliminary official statement using the Draft Appendix A tomorrow, Thursday, June 15, thus providing one day for our review and comment.

Board Memo 8-2, the revised "Metropolitan Water District Disclosure Procedures" and Mr. Breaux's letter are collectively, unclear exactly what "interim" updates will be provided to the Board, and provide no explanation why "narrowing down board approval" of MWD's disclosures to two times a year is necessary or even advisable. We believe such a "narrowing" of the Board's role and oversight is highly inappropriate at the very time questions are being raised about the disclosures MWD is making. As stated in our June 11 letter, we may disagree over what disclosures are required, but it is essential to the process that we have an opportunity as MWD Board members to express our concerns to staff, MWD's professional advisors and our fellow Board members.

Chairman Record and Members of the Board

June 15, 2016

Page 2

Mr. Breaux's statement that "Metropolitan's financial and operating information remains fundamentally the same for many months at a time," is untrue. As we have more time available, we will provide an analysis demonstrating that this statement is untrue and that, to the contrary, MWD's financial and operating condition has actually been quite volatile over the past several years.

Mr. Breaux also explains the proposed change in MWD's procedure narrowing Board review as being based on the fact that MWD is a frequent issuer. That might be appropriate if MWD's Appendix A included relatively few changes each time MWD goes to market, but that has certainly not been the case. Numerous changes have been made to each and every draft Appendix A over the past few years, and we have provided comments on each and every one of them. The current Draft Appendix A, as an example, includes 1,009 insertions, 976 deletions and thousands of word changes, many of which are not self-explanatory.

We won't repeat all of the concerns expressed in our June 11 letter; suffice it to say that we have requested and will rely upon the General Counsel's assurance at yesterday's Board meeting that all future proposed changes to Appendix A disclosures will continue to be provided to us for review prior to preparation of any preliminary official statement or sale, or remarketing of bonds. We make this standing request as members of the MWD Board of Directors in order to meet the responsibilities we believe all public officials have in connection with the sale of municipal bonds.

II. General Comments on Draft Appendix A

We incorporate by reference all of the comments and objections contained in our October 12, 2015 letter to the Board (Attachment 3) RE Board Item 8-2: Approve and authorize the execution and distribution of Remarketing Statements in connection with the remarketing [of bonds] (including its incorporation of prior comments and objections). As noted therein, we have raised several substantive issues that have not been addressed by MWD in prior drafts of Appendix A. These include, but are not limited to, MWD's continued commingling of the Water Authority's deposit of disputed funds under the Exchange Agreement with other unrestricted funds, and misstatement of material facts that have been judicially determined in the rate litigation. For example, MWD's continued "disclosure" reporting revenues paid for the transportation of water as a MWD "water sale," thus inflating this key indicator of MWD's financial position and suggesting that MWD sales are not being permanently reduced, as they actually are. As another example, MWD reports that the decision in the rate litigation is on appeal, but does not disclose that there are other appellate cases that are inconsistent with MWD's arguments on appeal, including its contention that Proposition 26 does not apply to wholesale water suppliers.¹ This is material because MWD has stated that any change to its existing rate structure could "destabilize" MWD's rate structure and water sales.²

¹ For example, MWD is well aware of the decision in *Newhall County Water District v. Castaic Lake Water Agency*, 197 Cal. Rptr. 3d 429 (Cal. Ct. App. 2016), because it made an unsuccessful effort to have the decision depublished (Attachment 4).

² See, for example, MWD's argument at pages 14-15 and 79 of its First Pretrial Brief (Attachment 5): "A piecemeal attack on individual rate components that fails to consider all of the factors MWD's Board must consider in allocating costs and setting rates **threatens to destabilize MWD's entire rate structure**. This in

III. Specific Comments on Draft Appendix A

A-6-7 and A-22: Colorado River. Staff has failed to include any discussion of ongoing Colorado River shortage sharing proposals it is engaged in that could result in lower Colorado River water deliveries to MWD. Staff reported at the June Board meeting on the extent of California water losses that could be sustained, but indicated that it has not yet calculated any offsetting benefits.

A-8-9: Integrated Resources Plan (IRP) and Breakdown of MWD Governance. MWD staff has deleted reference to the second phase of the IRP process, in which the Board of Directors would review policy issues, along with the reference to the first phase as being limited to a "technical update." Staff is reinventing history with these edits. Staff should disclose that the MWD Board did not deliberate any policy issues associated with the 2015 IRP Update prior to its adoption, including its failure to examine or consider the impacts of MWD staff's decision to assume for IRP planning purposes only 20,000 acre-feet of planned local water supply development, when the actual number is more than 10 times that -- 205,000 acre-feet -- of local projects that are currently in the full design phase with funds appropriated or at the advanced planning stage with completed certified environmental review.

We believe this breakdown in the process of MWD board governance -- which is also demonstrated, for example, by the absence of a current Long Range Finance Plan, is a material circumstance that should be disclosed to MWD investors. At a minimum, these edits in this section should not be made because they are deleting language that more accurately describes what happened with regard to the planned -- and now, apparently abandoned -- two-phase process for development of the IRP.³

Staff is also deleting, without explanation, reference to the "core resource strategy, uncertainty buffers and foundational actions" contained in the 2015 IRP Update. Please explain.

A-10-15: State Water Project. MWD staff's proposed edits delete discussion of the Delta Stewardship Council and its role under the Sacramento San Joaquin Delta Reform Act to develop a comprehensive management plan for the Delta. The existing Appendix A reported pending litigation, but the proposed edits fail to include discussion of the outcome of the decision, requiring, among other things, that MWD and other state water contractors demonstrate a quantifiable

turn threatens the continued administration of the LRP, CCP and SDP programs because without a stable rate structure, MWD cannot ensure the continued availability of funds necessary to administer these programs and honor its contractual commitments under the programs" (page 79).

³ MWD staff has been clear in any case that it is basing spending decisions on the 2015 IRP Update, with or without Board oversight or policy review of such questions as analysis of the true demand for MWD water. See the Water Authority's January 10, 2016 letter RE Board Memo 8-3: Adopt the 2015 Integrated Water Resources Plan Update - REQUEST TO DEFER BOARD ACTION ADOPTING 2015 IRP UPDATE, OR, IN THE ALTERNATIVE, OPPOSE (Attachment 6).

Chairman Record and Members of the Board

June 15, 2016

Page 4

reduction of the demand for Delta water.⁴ This decision and its impacts on MWD, its State Water Project supplies and plans to implement the California WaterFix must be disclosed to potential investors.

A-33-35: Local Water Supplies. MWD inappropriately discusses local water supply development in the context of its IRP in order to avoid discussing "the rest of the story," that this local water supply development -- which has become cost-effective as the cost of MWD water has increased -- will permanently reduce demand for MWD water. MWD staff finally acknowledged at the June board meeting its awareness that its "current business model of paying [MWD member agencies] incentives and agencies "rolling off" is not sustainable."⁵

A-37 and A-42-43: Water Treatment. MWD's discussion in Appendix A about water treatment does not "match" the discussion of this issue during MWD's recent rate-setting process in which it was initially claimed that MWD has a legal obligation to serve treated water and needs to recover stranded costs. Later, in response to questions contradicting this claim, MWD's legal counsel admitted MWD does not have a legal obligation to serve treated water. MWD has failed to discuss the facts and circumstances that led to its recommendation to implement a fixed water treatment charge, based on reduced demand for MWD treated water; or, the fact that the Board was unable to reach agreement how to recover these stranded costs *ex post facto*. The treated water stranded cost issue may be viewed as the "canary in the coal mine" that foretells potential stranded assets on the supply side as well, if long term planning and financial issues are not meaningfully addressed by the Board and implemented through a revised 2015 IRP Update and Long Range Finance Plan or other planning process.

A-40: Cost of Service. The label titled "Cost of Service" is inappropriate as used to describe the elements of MWD's Capital Investment Plan. This confuses MWD's obligation to set its rates according to cost of service requirements of the common law, California statutes and the state Constitution.

A-43-44: Major Projects of CIP. MWD staff reports hundreds of millions of dollars of CIP cost increases relating to the Colorado River Aqueduct facilities and distribution system. Please provide the data supporting these reported cost increases and when it was previously reported to the Board of Directors.

A-44: Tax Revenues. MWD is deleting the entire paragraph explaining the limitations on its taxing authority; this is misleading. The paragraph should be left in as is, or updated as appropriate.

A-46: Water Sales Including Wheeling Revenues. MWD's revenues from wheeling should be reported separately from its "water sales." Combining these numbers disguises the extent to which MWD

⁴ "Ruling on Submitted Matter: Petitions for Writ of Mandate, Bifurcated Proceeding on Statutory Challenges (*Delta Stewardship Council Cases*, CJP No. 4758, (2016)).

⁵ See Item #7a, Integrated Resources Planning Committee, IRP Board Retreat Follow-up, Slide 8: Key Themes - MWD History and the Laguna Declaration, bullet four: "Current business model of paying incentives and agencies "rolling off" is not sustainable" (Attachment 7).

sales are reduced by member agencies that purchase water from third party sources such as the Water Authority has done.

A-48-51: Litigation Challenging Rate Structure. As noted earlier, MWD's discussion of the rate litigation should account for case law that does not support MWD's contentions on appeal, including its contention that Proposition 26 does not apply to wholesale water suppliers. See discussion and footnote 1.

MWD's description of its accounting for the disputed funds deposited by the Water Authority under the Exchange Agreement should be revised to include disclosure that the newly created "Exchange Agreement Set-Aside Fund" is in a category of "funds" that is not identified in Section 5200 of MWD's Administrative Code. Instead, staff reported yesterday that this is a "Board Directed Fund," another term which is not disclosed or described anywhere in the Administrative Code or Appendix A.⁶

It is apparent from MWD's accounting of fund balances (see pages A-54-55 discussion of MWD's financial reserve policy) that the funds paid by the Water Authority as disputed amounts under the Exchange Agreement are not being held by MWD as a security deposit, but rather, are being commingled with other unrestricted reserves the MWD board may spend in its discretion. This treatment is not only a breach of the Exchange Agreement, but contrary to statements MWD's counsel has made to the Court in the rate litigation that these funds are being held for the intended purpose of securing payment to the Water Authority if it prevails on appeal. The Water Authority's disputed funds are doing "double duty" by being available to meet MWD's minimum unrestricted reserve level at the same time they are supposed to be securing payment to the Water Authority. But the same funds can't be used at the same time for both purposes without either dipping below minimum reserves or failing to maintain the security deposit MWD is contractually required to maintain. MWD either breached its contractual obligation to the Water Authority or its representations to bond holders when it used \$104 million from its unrestricted reserves to pay for the PVID land purchase. See Attachment 3 for a complete discussion of this issue.

We object generally to the continued practice of editing Appendix A to comport with MWD's evolving litigation strategies rather than reporting and disclosing facts that are material to potential investors.

A-51: Member Agency Purchase Orders. MWD's two-tier purchase orders are completely disconnected from the cost of service and do nothing to provide any meaningful level of financial stability for MWD. There is no reason to reference them except to create the misleading impression that they accomplish one or the other of these purposes.⁷ MWD's current two-year budget assumes zero water sales at the Tier Two level.

⁶ MWD staff also reported yesterday that MWD's "Water Management Fund" - referred to at pages A-55 and A-81-82, footnotes (g) and (p) of Draft Appendix A, is a "Board Directed Fund," which is why it also is not included as a "fund" identified in Section 5200 of MWD's Administrative Code.

⁷ See, for example, November 17, 2014 letter RE Board Memo 8-1: Approve the proposed terms for Purchase Orders, etc. (Attachment 8).

Chairman Record and Members of the Board

June 15, 2016

Page 6

A-52: Classes of Water Service. Unlike other outdated text, MWD continues to report "classes of water service," even though two out of the three rates have been eliminated. Cost of service law requires MWD to establish classes of customers based on their patterns of usage, not classes of water service.

A-54-55: Financial Reserve Policy. The fact that MWD is unwilling to "set aside" the Water Authority's disputed amounts, as it is contractually required to do, may reasonably be viewed as an indication that it is financially unable to do so. MWD has already had to borrow money through a commercial line of credit in order to replace funds it spent from the security deposit.

A-57: Preferential Rights. Thank you for adding language disclosing this aspect of the outcome of the trial court decision in the rate litigation.

A-57-58: California Ballot Initiatives. MWD's edits regarding Proposition 26 are inconsistent with existing law and are litigation-driven to support its argument -- rejected by the trial court -- and appellate decisions that the MWD board is the relevant "electorate" for purposes of Proposition 26.

A-75: Projected Costs of MWD for State Water Project Water. What accounts for the substantial increases in the minimum operations, maintenance, power and replacement costs? When was this reported to the MWD Board? Please explain.

A-78-82: Historical Projected Revenues and Expenses. In recent years, MWD has not even attempted to accurately project its revenues and expenses, instead following an admitted strategy to arbitrarily collect and then decide later how to spend hundreds of millions of dollars outside of its budget and rate-setting process. Over the past five years alone, MWD collected – and has now spent – more than \$850 million outside of its budget process, shifting money from fund to fund as necessary, including funds that are not even identified in its Administrative Code, such as the Water Management Fund. MWD's turf removal program and the unplanned purchase of the land described at page A-82, paragraph (p) as a "Pay-As-You-Go expenditure for fiscal year 2015-16" typify this erratic behavior. Since this money was spent, MWD has been forced to take out commercial lines of credit in order to maintain its required reserves. MWD's Long Range Finance Plan is now more than ten years old, because the MWD Board is unwilling to make any commitments to pay MWD's future costs, or grapple with the challenges of an agency spending billions of dollars with no one on the hook to pay for it.

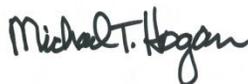
A-82-84: Management's Discussion of Historical and Projected Revenues and Expenses. Statements by management, like its IRP, fail to disclose material factors influencing the future demand for MWD water, rate increases that will be necessary to pay MWD's costs with a diminishing sales base, and the impacts of MWD's recent very large unplanned expenditures (turf removal, PVID land acquisition and acquisition of Delta islands). MWD lacks an IRP resource plan that has buy-in from the member agencies that prefer the present model in which no agency is asked to commit to pay MWD any of its costs before they are invested. This problem was identified by MWD's own Blue Ribbon Task Force more than 20-years ago but MWD has yet to address it in a meaningful way, for example, the

Chairman Record and Members of the Board
 June 15, 2016
 Page 7

Board's recent inability or unwillingness to adopt a fixed water treatment charge. This exercise will only become more difficult as MWD continues to spend large amounts of money under the present governance model imposing rates that have already been declared illegal.

We appreciate your consideration and timely response to each of these issues and to receiving reasonable notice in the future of MWD's plans to revise the disclosures contained in Appendix A and sell bonds to the public.

Sincerely,



Michael T. Hogan
 Director



Keith Lewinger
 Director



Fern Steiner
 Director



Yen C. Tu
 Director

Attachments:

- 1) Water Authority Board Members' June 11, 2016 letter RE Board Memo 8-2: Approve and Authorize Appendix A for use in the issuance and remarketing of Metropolitan's bonds - REQUEST TO TABLE OR IN THE ALTERNATIVE, OPPOSE;
- 2) Gary Breaux's June 14, 2016 letter responding to June 11 letter;
- 3) Water Authority Board Members' October 12, 2015 letter to the Board RE Board Item 8-2: Approve and authorize the execution and distribution of Remarketing Statements in connection with the remarketing [of bonds];
- 4) MWD's March 21, 2016 letter to the California Supreme Court requesting depublication of the Newhall opinion and Supreme Court order denying that request;
- 5) Respondent/Defendant MWD's First Pretrial Brief in the rate litigation (cover page and pages 14-15 and 78);
- 6) Water Authority Board Members' January 10, 2016 letter RE Board Memo 8-3: Adopt the 2015 Integrated Water Resources Plan Update - REQUEST TO DEFER BOARD ACTION ADOPTING 2015 IRP UPDATE, OR, IN THE ALTERNATIVE, OPPOSE;
- 7) See MWD PowerPoint presentation Item #7a, June 14, 2016 Integrated Resources Planning Committee, IRP Board Retreat Follow-up, Slide 8: Key Themes - MWD History and the Laguna Declaration; and
- 8) Water Authority Board Members' November 17, 2014 letter RE Board Memo 8-1: Approve the proposed terms for Purchase Orders.

Infante, Lucinda

From: Brian Thomas <thomasb@pfm.com>
Sent: Tuesday, September 30, 2014 3:01 PM
To: Breaux, Gary M; CKao@valleywater.org; Walthall, Brent; Patterson, Roger K (RPatterson@mwdh2o.com)
Subject: BDCP_Pre-Construction_Financing_Simple_Term_Sheet_09-30-14_v5_clean.docx
Attachments: BDCP_Pre-Construction_Financing_Simple_Term_Sheet_09-25-14_v4_redline-ckredits.docx; BDCP_Pre-Construction_Financing_Simple_Term_Sheet_09-30-14_v5_clean.docx

Clean and redline of document, incorporating Brent and Cindy's comments.

Talk to you soon.

Brian

Electronic mail sent through the Internet is not secure. Therefore, we cannot represent that the information in this e-mail, and any attachments, is complete, accurate, uncorrupted, timely or free of viruses or that such information will not be intercepted by third parties. This e-mail, and any attachments, contains information that is, or may be, covered by electronic communications privacy laws, and is also confidential and proprietary in nature. If you are not the intended recipient, please be advised that you are legally prohibited from retaining, using, copying, distributing, or otherwise disclosing this information in any manner. Instead, please reply to the sender that you have received this communication in error, and then immediately delete it. Thank you in advance for your cooperation.

**Bay Delta Conservation Plan (BDCP)
State Water Project Contractors
Pre-Construction Funding Agreement**

Draft Term Sheet
Simple

Department of Water Resources
And
Metropolitan Water District

September 18, 2014

Description of the transaction. The State Water Project Contractors (SWP Contractors) prefer to finance the SWP share of Pre-Construction Costs, rather than funding on a pay as you go basis. Therefore, Metropolitan has agreed that it will finance the initial phase of Pre-Construction Costs on behalf of the SWP Contractors in order to ensure the project proceeds. The basic structure of the transaction is as follows:

- a. **Metropolitan Financing.** Metropolitan will issue Commercial Paper or other forms of debt to fund the SWP Contractor share of Pre-Construction Cost. To the extent that commercial paper is used, Metropolitan intends to use its existing Commercial Paper authority. The existing program is authorized up to \$400 million outstanding at any one time, plus accrued interest. Metropolitan, on behalf of the SWP Participating Contractors, will pay all costs associated with the Commercial Paper program or other debt issued, including interest and principal, commercial paper dealer costs, standby and/or letter of credit fees, legal, financial advisory fees, rating agency fees, etc. Metropolitan will manage the debt program to ensure that funds are available for requisition and that interest costs are as low as possible. Metropolitan will notify the Participating SWP Contractors of the type of debt to be issued, and if the debt is a variable rate instrument, will provide regular reports (at least quarterly) of the interest rate incurred.
- b. **Capitalized Interest.** Metropolitan intends to fund principal and interest payments, and all other costs associated with the debt from debt proceeds for a period of three to five years.
- c. **DWR Pre-Construction Costs.** The proceeds from the debt issuance to be utilized to fund Pre-Construction activities will be requisitioned by DWR through the Design Construction Enterprise (DCE). Requisitions will be subject to the control of the DCE and the processes and procedures approved by the DCE.
- d. **SWP Participating Contractors.** Other SWP Contractors (in addition to Metropolitan) will agree to participate in the funding of Pre-Construction Costs to ensure progress (Participating SWP Contractors). The Participating SWP

- contractors would execute Pre-Construction Funding Agreements with DWR. The Participating SWP Contractors would agree to pay their share of debt service associated with the funding of the Pre-Construction Costs. The Participating SWP Contractors share of debt service will be based on the cost allocation formula developed by the SWC and approved by each Participating SWP Contractor Table A amounts of the SWP Participating Contractors. SWP Participating SWP Contractors, including Metropolitan, with a minimum of 3,000,000 acre-feet of Table A amounts would be necessary to proceed with Pre-Construction Financing.
- e. **DWR Takeout Financing.** ~~Once-If~~ DWR is able to issue debt and fund Pre-Construction activities, DWR would pay Metropolitan sufficient funds to retire all outstanding debt and costs and fees associated with managing the program (if any). At this point, ongoing funding of Pre-Construction and Construction costs would be financed by DWR.
- f. **Metropolitan Takeout Financing.** If DWR is unable to issue debt and/or the project is delayed or discontinued, Metropolitan will replace or restructure the debt over a longer time period and reimburse itself for costs and fees associated with the pre-construction financing. Metropolitan will consult with the Participating SWP Contractors prior to making decisions about replacing or restructuring the debt to ensure all Participating SWP Contractors are aware of the structure of the long-term debt financing. In addition, Metropolitan will notify the Participating SWP Contractors of the annual debt service, true interest cost and allocated shares of principal and interest within one week of closing. Metropolitan will provide preliminary indications and debt service schedules within two days of pricing. At the time that Metropolitan issues long-term debt or restructures debt into a longer term mode, or at any time thereafter, any Participating SWP Contractors will be able to pay down its~~their~~ share of outstanding debt in total, reducing the size of the takeout financing and fulfilling ~~that~~ Participating SWP Contractor's obligation to fund any debt issued to finance Pre-Construction costs.
- g. **DWR Billing.** If Metropolitan is required to fund principal and interest associated with ongoing debt as a result of DWR's inability to issue takeout financing as described above, then DWR would bill each Participating SWP Contractor's share of debt service on the annual Statement of Charges, and will take steps to collect such amounts under the same authorities and in the same manner as ~~similar to the~~ other amounts on the Statement of Charges. ~~The Statement of Charges would include a monthly charge equal to 1/12th of the annual principal and interest payments due in the following year.~~ Since Metropolitan will be funding interest, principal and other costs associated with the pre-construction financing program proceeds, SWP Participating Contractors would not be billed for any debt service costs for approximately three to five years.

- h. **Credit Mechanism.** DWR would credit or pay Metropolitan amounts equal to the amounts collected from the Participating SWP Contractors to pay for debt service in the year following collection of annual principal and interest payments.

**Bay Delta Conservation Plan (BDCP)
State Water Project Contractors
Pre-Construction Funding Agreement**

Draft Term Sheet
Simple

Department of Water Resources
And
Metropolitan Water District

September 18, 2014

Description of the transaction. The State Water Project Contractors (SWP Contractors) prefer to finance the SWP share of Pre-Construction Costs, rather than funding on a pay as you go basis. Therefore, Metropolitan has agreed that it will finance the initial phase of Pre-Construction Costs on behalf of the SWP Contractors in order to ensure the project proceeds. The basic structure of the transaction is as follows:

- a. **Metropolitan Financing.** Metropolitan will issue Commercial Paper or other forms of debt to fund the SWP Contractor share of Pre-Construction Cost. To the extent that commercial paper is used, Metropolitan intends to use its existing Commercial Paper authority. The existing program is authorized up to \$400 million outstanding at any one time, plus accrued interest. Metropolitan, on behalf of the SWP Participating Contractors, will pay all costs associated with the Commercial Paper program or other debt issued, including interest and principal, commercial paper dealer costs, standby and/or letter of credit fees, legal, financial advisory fees, rating agency fees, etc. Metropolitan will manage the debt program to ensure that funds are available for requisition and that interest costs are as low as possible. Metropolitan will notify the Participating SWP Contractors of the type of debt to be issued, and if the debt is a variable rate instrument, will provide regular reports (at least quarterly) of the interest rate incurred.
- b. **Capitalized Interest.** Metropolitan intends to fund principal and interest payments, and all other costs associated with the debt from debt proceeds for a period of three to five years.
- c. **DWR Pre-Construction Costs.** The proceeds from the debt issuance to be utilized to fund Pre-Construction activities will be requisitioned by DWR through the Design Construction Enterprise (DCE). Requisitions will be subject to the control of the DCE and the processes and procedures approved by the DCE.
- d. **SWP Participating Contractors.** Other SWP Contractors (in addition to Metropolitan) will agree to participate in the funding of Pre-Construction Costs to ensure progress (Participating SWP Contractors). The Participating SWP

- contractors would execute Pre-Construction Funding Agreements with DWR. The Participating SWP Contractors would agree to pay their share of debt service associated with the funding of the Pre-Construction Costs. The Participating SWP Contractors share of debt service will be based on the cost allocation formula developed by the SWC and approved by each Participating SWP Contractor. Participating SWP Contractors, including Metropolitan, with a minimum of 3,000,000 acre-feet of Table A amounts would be necessary to proceed with Pre-Construction Financing.
- e. **DWR Takeout Financing.** If DWR is able to issue debt and fund Pre-Construction activities, DWR would pay Metropolitan sufficient funds to retire all outstanding debt and costs and fees associated with managing the program (if any). At this point, ongoing funding of Pre-Construction and Construction costs would be financed by DWR.
- f. **Metropolitan Takeout Financing.** If DWR is unable to issue debt and/or the project is delayed or discontinued, Metropolitan will replace or restructure the debt over a longer time period and reimburse itself for costs and fees associated with the pre-construction financing. Metropolitan will consult with the Participating SWP Contractors prior to making decisions about replacing or restructuring the debt to ensure all Participating SWP Contractors are aware of the structure of the long-term debt financing. In addition, Metropolitan will notify the Participating SWP Contractors of the annual debt service, true interest cost and allocated shares of principal and interest within one week of closing. Metropolitan will provide preliminary indications and debt service schedules within two days of pricing. At the time that Metropolitan issues long-term debt or restructures debt into a longer term mode, or at any time thereafter, any participating SWP Contractor will be able to pay down its share of outstanding debt in total, reducing the size of the takeout financing and fulfilling that Participating SWP Contractor's obligation to fund any debt issued to finance Pre-Construction costs.
- g. **DWR Billing.** If Metropolitan is required to fund principal and interest associated with ongoing debt as a result of DWR's inability to issue takeout financing as described above, then DWR would bill each Participating SWP Contractor's share of debt service on the annual Statement of Charges, and will take steps to collect such amounts under the same authorities and in the same manner as other amounts on the Statement of Charges. Since Metropolitan will be funding interest, principal and other costs associated with the pre-construction financing program proceeds, SWP Participating Contractors would not be billed for any debt service costs for approximately three to five years.
- h. **Credit Mechanism.** DWR would credit or pay Metropolitan amounts equal to the amounts collected from the Participating SWP Contractors to pay for debt service in the year following collection of annual principal and interest payments.