



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

VIA EMAIL

February 7, 2017

Director Michael T. Hogan
Director Keith Lewinger
Director Elsa Saxod
Director Fern Steiner
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123

Dear Directors:

Re: Your letter dated July 11, 2016 regarding Draft Appendix A dated 7/6/16

This letter addresses your comments, received July 11, 2016, regarding the Board Distribution Draft of Appendix A dated July 6, 2016. This response to your comments was delayed due to the cancellation of the associated financing. Metropolitan's disclosure has since been updated and has been provided to the Board for approval at the February 2017 Board meeting along with a marked copy showing the changes to the disclosure since your prior review. Your general comments are addressed below, followed by your specific comments and Metropolitan's responses.

Appendix A provides material financial and operating information about Metropolitan to potential investors. Appendix A is prepared by Metropolitan staff and reviewed by Metropolitan's Board of Directors. Metropolitan's objective is to provide complete and accurate disclosure regarding the bonds being offered and their security and source of payment to potential investors. Appendix A is updated periodically to provide current information. Forward-looking statements or projections are based on current information such as the facts and assumptions contained within the biennial budget and ten-year financial forecast.

The General Comments in your letter incorporate by reference all of the comments and objections contained in your delegation's past letters relating to Metropolitan's authorization, execution and distribution of Offering Statements in connection with the issuance of bonds, which were most recently addressed in Metropolitan's response letter date June 22, 2016 to SDCWA's Comment Letter dated June 15, 2016.

A footnote to your letter also states the following and requests clarification:

“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.”

Although Metropolitan’s financial and legal advisors do not “approve” Metropolitan’s responses to the Water Authority’s concerns, Metropolitan’s disclosure counsel (engaged in December 2016) and financial advisor do independently review and provide input as necessary to respond to a comment or concern or to modify the disclosure document. Comments from Directors regarding Metropolitan’s disclosure document are routinely distributed to all parties working on the applicable transaction. Metropolitan’s responses to comments are prepared at the direction of Mr. Breaux, with assistance from Metropolitan’s legal staff, consultation with disclosure counsel, and with input from Metropolitan staff with knowledge relevant to the subject matter of the comment and Metropolitan’s financial advisor, as needed. After Metropolitan’s responses to Directors’ comments are distributed to the Board, the responses are also distributed to the current finance team. If a Director’s comments result in changes to the disclosure document, Metropolitan incorporates revisions as part of the normal course of disclosure preparation and finalization.

Comments on Draft Appendix A dated July 11, 2016

The following specific SDCWA comments and Metropolitan’s responses refer to the draft of Appendix A dated July 6, 2016, showing changes from the draft dated May 31, 2016 (Attachment 1).

SDCWA Comment: “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.”

Metropolitan Response: The information regarding the May 1 Upper Colorado River Basin runoff forecast was deleted because it is no longer relevant. The 2007 Guidelines for the Operation of Lake Powell and Lake Mead use the May 24-month study projections of reservoir elevations for the following January 1 in determining whether to

consider restricting Intentionally Created Surplus (ICS) water during the year. As the May 1 study showed that agencies can withdraw ICS without causing a shortage the following year, the snowpack and runoff in the Upper Basin no longer affect 2016 Colorado River water supplies. This section of Appendix A will continue to provide general information on the snowpack and reservoir storage for both of the systems from which Metropolitan obtains its main water supplies.

In regard to Colorado River shortage sharing discussions, there is at present no agreement on revising the shortage allocations provided in the 2007 Guidelines for the Operation of Lake Powell and Lake Mead, and it would be too speculative to conclude how any such discussions could affect Metropolitan.

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

Metropolitan Response: Appendix A has been updated to provide the balance in the Exchange Agreement Set-Aside Fund as of December 31, 2016. The establishment of the Exchange Agreement Set-Aside Fund, which holds the aforementioned balance, and information regarding the nature of the components comprising such balance per the exchange agreement requirements and the extent to which such components relate to amounts identified in the rulings on appeal in the rate litigation, are also described in Appendix A. In regard to additional background on this dispute, SEC guidance emphasizes the need for disclosures to be clear and concise to avoid misleading investors and the need to avoid overly detailed or legalistic presentations which can be confusing or misleading.

SDCWA Comment: “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?”

Metropolitan Response: At no time did Metropolitan spend the funds it is required to set aside pursuant to the exchange agreement between Metropolitan and SDCWA. As disclosed in Appendix A, Metropolitan has transferred the amount of charges disputed by SDCWA into the Exchange Agreement Set-Aside Fund. In April 2016, Metropolitan drew \$125 million from each Short-Term Revolving Credit Facility, for a total of \$250 million, and deposited these amounts in Metropolitan’s unrestricted financial reserves. On July 1, 2016, Metropolitan also drew \$45,785,000 from the US Bank N.A., Short-Term Revolving Credit Facility. This was done through the issuance of the Tax Exempt Revolving Notes, 2016 Series B-1. Proceeds were used to refund two series of Metropolitan’s revenue bonds: \$31,220,000 Water Revenue Refunding Bonds, 2012 Series E-3 (3.50 % Coupon), and \$14,565,000 Water Revenue Refunding Bonds, 2014 Series G-1 (2.00% coupon). Both bonds were callable at Metropolitan’s option, beginning July 1, 2016, with a Scheduled Mandatory Tender Date of October 1, 2016. Staff was planning to refund these bonds in mid-September with an issuance of variable rate refunding bonds. However, the interest rate on the 2016 Series B-1 Notes is a variable rate of 70% of One Month LIBOR, plus a basis point spread and the interest rate on the 2016 Series B-1 Notes was less than 1.00%. Therefore, debt service savings were realized with the interim refunding of the 2013E-3 and 2014 G-1 bonds. As is our usual practice, staff updated the Finance and Insurance Committee on this transaction at the next meeting. The 2016 Series B-1 Notes were refunded on September 21, 2016 and the current amount outstanding on the Short Term Revolving Credit Facilities is \$250 million.

SDCWA Comment: “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.”

Metropolitan Response: The Board would be informed of any decision to issue Commercial Paper Notes, whether to fund pre-construction activities or otherwise, at a Finance and Insurance Committee meeting and Board Meeting prior to issuance.

SDCWA Directors

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Thank you for your comments on Metropolitan's Appendix A. We have carefully reviewed and considered them and circulated them to our finance team, including disclosure counsel, financial advisor and underwriters.

Sincerely,

A handwritten signature in blue ink, appearing to read "Gary Breau".

Gary Breau
Assistant General Manager/
Chief Financial Officer

cc: J. Kightlinger
MWD Board Members
SDCWA Board of Directors and Member Agencies

Attachment 1— Appendix A Board Distribution Draft dated July 6, 2016, showing changes from the Board Distribution Draft dated May 31, 2016