



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager

VIA EMAIL

June 22, 2015

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

Dear Directors:

Your letter dated June 5, 2015 (received June 7, 2015) regarding Board Letter 8-2

This letter addresses your comments, received June 7, 2015, on Draft Appendix A to the Official Statement for Metropolitan's Special Variable Rate, Water Revenue Refunding Bonds, 2015 Series A-1 and 2015 Series A-2, as attached to Board Letter 8-2. 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 for each bond offering 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 comments from prior letters regarding Metropolitan's authorization, execution and distribution of Official Statements in connection with the issuance of bonds, which were most recently addressed in Metropolitan's response letter dated March 17, 2015 ("March 2015 Response") to SDCWA's Comment Letter dated March 9, 2014 ("March Letter"). Metropolitan's March 2015 Response (see Attachment 1) was electronically provided to all SDCWA directors and copied to Metropolitan's Board of Directors on March 17, 2015.

Regarding your terminal comment relating to over-collection of \$803 million from Metropolitan's member agency rate payers, Metropolitan disagrees with the underlying assertion and the unsupported suggestion that Metropolitan may be subjected to claims related to the revenues collected for water service to its member agencies.

Comments on Draft Appendix A dated May 28, 2015

The following specific SDCWA comments and Metropolitan's responses refer to the draft of Appendix A dated May 28, 2015, showing changes from the February 26, 2015 draft (Attachment 2).

A-7: Metropolitan's Water Supply and A-8-9: Drought Response Actions. MWD continues to understate the severity of MWD's current water supply conditions. See Attachment 1: March 6, 2015 letter to MWD board RE Water Supply Management Strategies including Use of Storage. Regarding drought response actions, it is unclear -- if not misleading -- for MWD to state that the conservation program largely made up of turf removal "is expected to result" in annual water savings of 80,000 acre-feet in the context of discussion of the current drought and without a time reference. No one, not even MWD itself, has estimated current or near-term annual water savings of that magnitude as a result of these expenditures; indeed, even long-term Turf Removal Program results are uncertain. MWD should also disclose that its recent action to increase conservation program spending, primarily turf removal spending, leaves MWD with limited available funding to purchase water transfers if the drought persists, or to replenish depleted storage reserves if supplies become available, *without adopting significant water rate increases*. See Attachment 2: May 8 and May 25, 2015 letters to the MWD board RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program – Oppose and RE: Board Memo 5-1: Authorize (1) Additional funding for conservation incentives; and (2) Implementation of modification to the Turf Removal Program.

Metropolitan Response: Board Letter 5-1 dated May 26, 2015 states that total water savings for Option #3, the Option approved by the Board, is projected to be 800,000 acre-feet over the next ten years. Those numbers are consistent with the annual estimate in Appendix A. However, Metropolitan has revised Appendix A to state the ten year estimate and removed the annual estimate. In addition, it is projected that Metropolitan will have up to \$480 million in the Water Rate Stabilization Fund and Revenue

Remainder Fund to fund the purchase of water transfers and/or replenish storage in fiscal year 2015-16.

A-11: Water Transfers and Exchanges. What is the addition of the term "acquisition" to this section of the draft Appendix A intended to convey?

Metropolitan Response:

Thank you for your comment. The term is duplicative and will be removed from Appendix A.

A-26: Intentionally-Created Surplus Program. This section, as amended, more accurately describes potential limitations on MWD's access to intentionally-created surplus (ICS) as a result of current water supply and storage conditions. This information was not provided to the board at the time it voted to declare the Water Supply Condition 3 and implementation of the Water Supply Allocation Plan at a Level 3 Regional Storage Level.

Metropolitan Response: The potential that shortage conditions on the Lower Basin of the Colorado River could limit Metropolitan's access to ICS reserves, as well as other supply uncertainties, were disclosed to the Board when the Board voted to declare the Water Supply Condition 3 and implementation of the Water Supply Allocation Plan at a Level 3 Regional Storage Level in Board Letter 8-3, dated April 14, 2015.

A-33-34: Water Supply Allocation Plan. The draft Appendix A states that, "[i]mplementation of the Water Supply Allocation Plan at a Level 3 Regional Shortage Level is anticipated to reduce supplies delivered by MWD to MWD's member agencies by 15 percent and water sales to approximately 1.8 million acre-feet." However, this month's Water Surplus and Drought Management (WSDM) Plan states that demand at Level 3 equates to 1.93 million acre-feet, more than 100,000 acre-feet more than stated in the draft Appendix A. Under current water supply and storage conditions, this discrepancy is material; please provide information to reconcile these numbers or correct the staff WSDM report or draft Appendix A.

Metropolitan Response:

The June 2015 Water Surplus and Drought Management Plan report states that "the regional demand limit" at Level 3 is estimated to be 1.93 million acre-feet, not that demands at Level 3 equate to 1.93 million acre-feet. In other words, the aggregate amount of water available to member agencies without an allocation surcharge is estimated to be 1.93 million acre-feet. However, Metropolitan estimates that member agencies will purchase, in aggregate, 100,000 acre-feet lower than the full amount available to them without an allocation surcharge. When the Water Supply Allocation Plan was approved by the Board in April, Metropolitan initially estimated that the regional demand limit (the aggregate amount of water available to member agencies without a surcharge) would be 1.9 million acre-feet, and therefore the corresponding

member agency demands estimate was 100,000 acre-feet less, or approximately 1.8 million acre-feet. The 1.8 million acre-feet figure is provided in Appendix A.

A-35: Los Angeles Aqueduct. The Agreement between DWR, Antelope Valley-East Kern Water Agency and MWD contains specific limitations regarding the use of the subject turnout for delivery of non-State Water Project water annually to the City of Los Angeles. Why is the language at the bottom of page A-35 being deleted?

Metropolitan Response: The changes were made to this language in Appendix A to better reflect the terms of the Agreement.

A-58: Litigation Challenging Rate Structure. What is your reasoning for deleting the statement that, “[a]mounts held pursuant to the Exchange Agreement are transferable to SDCWA to pay any amounts awarded by the court in the event SDCWA prevails in its claim for breach of the Exchange Agreement”? We disagree with the change because it conceals a large potential liability from MWD’s bondholders, and is inconsistent with MWD’s prior practice of disclosure, its litigation position that the interest-bearing is a set-aside to pay for possible damages, and the fact that MWD has already been held liable for breaching the Exchange Agreement.

Metropolitan Response: Thank you for your comment. This was an inadvertent change and the sentence has been reinserted.

A-61: Water Standby Charges. In an effort to avoid the application of Proposition 26, MWD has argued (unsuccessfully) in the rate litigation that it does not "impose" its water standby charge. The suggested edit at page A-61 is purely litigation-driven and a matter of form over substance; it is misleading to state or suggest that MWD does not impose a water standby charge.

Metropolitan Response: This change aligns the language in the Official Statement to Resolution 9191, Continuing the Water Standby Charge for Fiscal Year 2015/16, adopted by the Board on May 12, 2015.

A-87: Historical and Projected Revenues and Expenses. This table includes the transfer and expenditure of monies from the Water Management Fund and Water Rate Stabilization Fund, but does not identify expenditures from the Water Stewardship Fund. We assume that these fund transfers will be used for to pay for the Conservation and Turf Removal Program, as approved by the Board at its May 26, 2015 Special Workshop. The Board also approved the transfer and use of monies from the Water Stewardship Fund, and yet the table does not reflect the transfer and use of this fund.

Metropolitan Response: Use of monies from the Water Stewardship Fund for conservation related expenses is not expected until fiscal year 2015-16. The table referred to in Appendix A reflects budgeted fiscal year 2015-16 financial operations, per the Board’s adopted 2015-16 biennial budget. Projections for the current fiscal year include actual financial results through March 31, 2015, and revised projections for the balance of fiscal year 2014-15.

SDCWA Directors

June 22, 2015

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Thank you for your comments on Metropolitan's Official Statement. We have carefully reviewed and considered them and circulated them to our bond counsel team, financial advisor, and underwriters. Appendix A will be revised to address certain comments as described in this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary Breaux". The signature is fluid and cursive, with a long horizontal stroke at the end.

Gary Breaux

Assistant General Manager/Chief Financial Officer

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

Attachment 1— Metropolitan's Response Letter dated March 17, 2015 to SDCWA's Comment Letter received March 9, 2015 (dated March 9, 2014).