REVIEW OF LONDON MOEDER ADVISORS "*RAINBOW MWD & FALLBROOK PUD COST-BENEFIT ANALYSIS OF SDCWA MEMBERSHIP*"

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The LMA Report contains three sections, each of which I consider in turn.

1. Fixed Charge Analysis

LMA note that, over the period 2010 – 2019, SDCWA received approximately $1.233 billion in revenue from fixed charges from member agencies – the customer service charge, storage charge, supply reliability charge and infrastructure access charge. The charges paid by FPUD and RMWD over that period amounted to approximately $56 million, or 4.5% of the SDCWA total.

LMA go on to observe that between 2010 and 2019 there were a total of 908,302 to 925,093 meter equivalents served by the SDCWA system. FPUD and RMWD consistently comprised approximately 2.7% to 2.9% of all meter equivalents served by SDCWA.

LMA note that had FPUD and RMWD's share of all SDCWA member agency fixed charges been the same as their share of meter equivalents (2.8%), FPUD and RMWD would have paid a total of $34.5 million in fixed charges to SDCWA over the period 2010 – 2019, instead of $56 million. LMA imply that FPUD and RMWD paid more than their fair share of SDCWA fixed charges.

I disagree.

While SDCWA allocates the total fixed charge revenue to be raised through the infrastructure access charge among member agencies in proportion to their share of the meter equivalents served by the Authority, it allocates the total revenue to be raised through each of the other three fixed charges in proportion to member agencies' share of the three- or five-year rolling average of all water purchases or M&I water purchases.

That FPUD's and RMWD's combined share of all fixed charges is 4.5% while their combined share of meter equivalents is 2.8% reflects the fact, on average, *FPUD and RMWD customers use more water per meter equivalent than do customers of the other SDCWA member agencies.*

By way of example, in FY 2019, FPUD and RMWD together accounted for 5.9% of the water supplied by SDCWA to member agencies, while at the same time accounting for 2.9% of the meter equivalents. Specifically, In FY 2019 FPUD and RMWD received 22,253 AF from SDCWA for use by their 26,542 meter equivalents (ME), amounting to a usage of 0.8384 AF per ME. In FY 2019, the other member agencies combined received 356,277 AF for use by 898,551 ME, amounting to an average usage of 0.3965 AF per ME. *The average usage of SDCWA water per meter equivalent within the FPUD and RMWD service areas in FY 2019 was more than twice that of the other member agencies* (0.8384 AF/ME versus 0.3965 AF/ME).

Based on my own experience of analyzing the costs of municipal water supply systems in California, I see no reason for apportioning the fixed costs of water supply among wholesale customers of a supply agency like SDCWA based on the member agencies' shares of the total number of meter equivalents serviced by the wholesale agency.

From an economic perspective, it is more appropriate to allocate fixed costs among member agencies based on (i) their share of annual water deliveries, or on something like (ii) their share of peak hourly or daily deliveries. Those variables are more likely to drive the fixed costs experienced by SDCWA than the number of meter equivalents serviced by the individual member agencies.

2A. Benefits Received by FPUD and RMWD

The LMA report equates the degree to which FPUD and RMWD benefit from their membership in SDCWA with the share of their water supply *not* "received from" MWD.

For example, the report states that, prior to 2020, 85% of FPUD's water supplies "were received directly from MWD facilities," the remaining 15% being received from SDCWA facilities. From this, the report infers that FPUD benefits from SDCWA membership only for 15% of its water supply.

LMA makes a parallel argument with respect to RMWD.

This argument is not correct.

Even if FPUD and RMWD were to receive *all* of their water supply as treated water from MWD's Skinner Water Treatment Plant delivered to them via flow control facilities owned by MWD, all of that water is a benefit of their SDCWA membership. FPUD and RMWD would not be in a position to receive a single drop of water from the Skinner Plant if (1) SDCWA were not a member agency of MWD, (2) had not contracted with MWD to receive that water, and (3) had not forborne to deliver the entirety of that water to *other* SDCWA member agencies.

Some of the water from Skinner is QSA water that belongs to SDCWA, not MWD. The rest of the water from Skinner is MWD water (from the State Water Project or obtained under MWD's rights to Colorado River water) which has been purchased by SDCWA from MWD as a member agency. Either way, all of the water received by FPUD and RMWD from Skinner belongs to SDCWA and comes to FPUD and RMWD as a benefit of their membership in SDCWA. FPUD and RMWD cannot assert a sort of riparian right to water flowing in MWD-owned facilities through their service areas.

Therefore, LMA's conclusion that, over the period 2010 – 2019, FPUD and RMWD benefited from their membership of SDCWA only in the amount of $6.5 million is not correct.

2B. Benefit – to – Cost Ratio

The LMA Report's benefit-cost analysis is not correct.

The measurement of the benefits received by FPUD and RMWD is not correct for the reason I have stated above (in 2A).

The measurement of the "fair share of fixed charges" attributed by LMA to FPUD and RMWD is not correct for the reason I have stated above (in 1).

Consequently, the estimate in the Report that FPUD and RMWD have subsidized the remaining member agencies by $49.5 million over the period 2010 – 2019 lacks foundation and is incorrect.

The same observation applies to the statements in the LMA report that (1) during the years of 2010 through 2019, FPUD and RMWD achieved a benefit-to-cost ratio of 0.12 from the payment of fixed charges, and (2) the remaining MDCWA member agencies have benefited from this imbalance representing a benefit-to-cost ratio of 1.04. Both statements lack foundation and are incorrect.

3. Reallocation of Fees

The LMA Report assesses the financial impact of FPUD and RMWD de-annexation on the remaining member agencies. The report observes that, between 2010 and 2019, FPUD and RMWD paid SDCWA an average of approximately $5.6 million annually in fixed charges. The report goes on to state that $5.6 million per year "represents the hypothetical amount that SDCWA will have to re-allocate to the remaining member agencies in order to avoid an increase in variable water rates."

The statement just cited is not correct, for two reasons.

First, under de-annexation, in addition to the loss of revenues from the fixed charges considered by LMA (the customer service charge, storage charge, supply reliability charge and infrastructure access charge), SDCWA would also lose some quantum of revenue from property taxes, capacity charges and the availability standby charge. These revenues are used to finance some of SDCWA's fixed costs of operation that would still be incurred by SDCWA for the benefit of its member agencies after de-annexation.

Secondly, SDCWA also uses a large portion (in fact, the majority) of the revenue from its variable water rates to cover fixed costs of operation. Under de-annexation, SDCWA's water rate revenue would go down but it would still incur the same fixed costs that are paid for through variable water rates.

With a reduced volume of water delivered due to the de-annexation of FPUD and RMWD but the same fixed costs, SDCWA would have to raise not only its fixed charges but also its variable water rates in order to offset the revenue loss.

Consequently, LMA's estimate of $5.6 million for the annual financial impact of de-annexation on the remaining SDCWA member agencies is a significant understatement.