

CENTRAL BASIN MUNICIPAL WATER DISTRICT

Its Poorly Planned Recycled-Water Project Has Burdened Taxpayers but May Be Moving Toward Self-Sufficiency

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Audit Highlights . . .

The Central Basin Municipal Water District (district) poorly planned its recycled-water project (project) because it:

- Overstated the project's potential for self-sufficiency by ignoring lower projections when estimating future revenue.***
- Failed to gain firm purchasing commitments before building the project.***

As a result, the district:

- Still relies on \$3 million in annual standby charges.***
- Currently distributes water costing \$1,395 per acre-foot compared to \$431 per acre-foot for imported water.***

Recent decisions to halt project expansion and seek more customers suggest the district is trying to move toward self-sufficiency.

Nevertheless, even if it meets sales goals, the district will suffer revenue shortfalls of \$1.8 million per year without standby charges.

The Joint Legislative Audit Committee requested that we review the Central Basin Municipal Water District's (district) recycled-water project (project) to determine whether the district undertook proper planning, met project goals, provided a cost-effective source of water, and fairly served its taxpayers. We found that:

Finding #1: The district inadequately planned its project.

In developing revenue projections for its project in 1991, the district assumed rapidly increasing rates for alternative, imported water from the Metropolitan Water District of Southern California (Metropolitan), but ignored other projections forecasting much lower imported water rates. The district only presented taxpayers with a highly optimistic set of forecasts when making a case for establishing a standby charge that it indicated would last for three years. In planning the project, the district also ignored the State Water Resources Control Board's advice that it gain firm customer commitments before building the project. More than nine years later, the district still relies on \$3 million in annual standby charges to support the project.

We recommended that the district reject expansions to the project that do not improve its cost-effectiveness relative to alternative water sources and that it execute binding agreements with potential customers for at least 50 percent of expected water deliveries before undertaking large capital projects.

District Action: Partial corrective action taken.

The district says it is currently evaluating the cost effectiveness of proposed project expansions and will not recommend expansions that will not be cost-effective according to its analyses. The district does not foresee undertaking large capital projects in the near future.

Finding #2: Low sales and recycled-water rates have caused the project to continue to rely on taxpayers.

More than nine years after inception, the project is only operating at 43 percent of its initially projected capacity. In addition, although the district originally predicted that it would charge customers a rate equal to 90 percent of the Metropolitan’s rate for imported water, it barely increased its recycled-water rates despite substantially higher Metropolitan rates. If the district were to increase its rate to 80 percent of the Metropolitan rate, it could increase its annual revenues by \$327,000.

We recommended that the district continue to study the feasibility of raising its recycled-water rates to increase revenues and reduce reliance on general taxpayers.

District Action: Partial corrective action taken.

On July 1, 2001, the district raised its recycled water rates by \$10 per acre-foot. The district is continuing to study its recycled water rates and develop ways to analyze the effect of operational changes that will help support future proposed rate increases.

Finding #3: Current decisions may improve the project’s finances, but the standby charge will still be needed.

The district recently halted plans for expansion of the project when its economic analysis revealed that the expansion would not be cost-effective. Current efforts to sell water to the neighboring Upper San Gabriel Valley Municipal Water District (San Gabriel) and to district customers using the existing system could, however, reduce cost per acre-foot from \$1,395 to as little as \$684. Nevertheless, costs per acre-foot would still exceed the \$431 per acre-foot cost of imported water, and annual revenue shortfalls would amount to \$1.8 million, without standby charges. In addition, sales to San Gabriel would include an “out-of-district” charge meant to compensate for the fact that San Gabriel does not contribute to the district’s standby charge. The district has not, however, analyzed the out-of-district charge to determine if it would be adequate at \$20 per acre-foot. Finally, the district will need to make adequate provision for replacement of its recycled-water system as it ages. While the district originally stated that it would set aside \$3.5 million for system replacement by fiscal year 2000–01, it had only reserved about \$1.5 million for this purpose by April 2001.

We recommended that the district prepare an analysis to support the out-of-district charge for San Gabriel and establish sufficient reserves to maintain the recycled-water system.

District Action: Pending.

The district is analyzing the out-of-district charge to determine whether it is set at an appropriate level. The related project is not due to come online until summer 2002. The district is also developing a revised reserve policy that addresses changes to its target levels. It is projecting to increase reserves by about \$1.5 million by June 30, 2002.

