

# CENTRAL BASIN MUNICIPAL WATER DISTRICT

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

REPORT NUMBER 2000-115, APRIL 2001

Central Basin Municipal Water District's response as of September 2002

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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.***

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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 told us it currently evaluates the cost-effectiveness of proposed project expansions, and will not recommend a project expansion to the board if the analysis results in the

project not being cost-effective. In July 2002, the City of Vernon (Vernon) signed an agreement with the district to buy up to 1,500 acre-feet of recycled water per year in anticipation of Vernon's building a pipeline extension for its proposed electrical generation facility. The district also signed a memorandum of understanding (MOU) with Vernon to explore the use of recycled water by businesses and industries in Vernon. As part of this MOU the district will pursue letters of commitment from interested recycled water customers.

**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.***

The district raised its recycled water rates by \$10 per acre-foot on July 1, 2001, and by another \$6 per acre-foot on July 1, 2002. An August 2002 study found that the district's recycled water rates are currently between 49 percent and 62 percent of those for imported water. The consultant recommended that the district gradually increase its recycled water rates until they approach 70 percent to 80 percent of that charged for imported water, but not at the cost of slowing expansion of the recycled water program.

**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: Corrective action taken.***

An August 2002 cost-of-service study found that the district’s additional charge of \$20 per acre-foot for customers outside of its district reflects higher unit costs for these customers, calculated on a cost-of-service basis. In addition, the district’s board adopted a revised reserve policy outlining designated fund targets. Staff recommended using 10 percent of the projected capital asset replacement cost to determine the target level for the Capital Asset Replacement Fund and 2 percent for the Emergency Repairs Fund.

