

General Manager's Message

Appendix E

The Honorable Board of Directors
Inland Empire Utilities Agency

June 17, 2015

This year, the Inland Empire Utilities Agency (IEUA), formerly known as the Chino Basin Municipal Water District (CBMWD), celebrates its 65th anniversary. Since its formation, the Agency's mission has evolved from a purveyor of water imported as a member of the Metropolitan Water District of Southern Area (MWD) to a population of approximately 80,000 people, to becoming a "water resources steward of the region" as a regional provider of wastewater treatment with domestic and industrial systems, developing energy production facilities, taking a leadership role in promoting integrated water resource management, and maintaining a high standard of community and educational outreach. Through its member agencies, the Agency now serves approximately 830,000 residents in a 242 square mile area in the southwest corner of the San Bernardino County.

The General Manager's biennial budget for Fiscal Year's (FYs) 2015/16 and 2016/17 and the Ten Year Capital Improvement Plan (TYCIP) for Fiscal Years 2015/16 through 2024/25 uphold the Agency's commitment to safeguarding and enhancing the quality of life in the Inland Empire in a sustainable and cost effective manner. A summary of the key revenues, expenses and changes in fund balance is provided in Table 1.

**Table 1: Summary of Adopted Biennial Budget FYs 2015/16 and 2016/17
(\$Millions)**

Description	FY 2015/16	FY 2016/17
Major Revenues and Funding Sources:		
Operating System Revenues	\$122.4	\$136.6
Connection Fees	\$23.3	\$30.6
Property Tax Receipts	\$41.1	\$42.4
Grants	\$8.9	\$7.7
Other	\$26.9	\$40.6
Total Revenues and Funding Sources	\$222.6	\$257.9
Major Expenses and Uses of Funds:		
Operating System Costs	\$153.2	\$150.5
Capital Improvement Plan (CIP)	\$43.9	\$52.5
Debt Service	\$23.5	\$24.7
Total Expenses and Other Uses of Funds	\$220.6	\$227.7
Net Increase (Decrease)	\$2.0	\$30.2
Beginning Fund Balance, July 1st	\$125.6	\$127.6
Estimated Ending Fund Balance, June 30	\$127.6	\$157.8

The 2015 Strategic Plan, which identifies the major initiatives to be accomplished through 2019, is the basis for the biennial budget for FYs 2015/16 – 2016/17 and TYCIP for FYs 2017-2025. These initiatives ensure the Agency continues to fulfill its mission, vision, and values and the Board's key policy objectives defined in the IEUA Business Goals; Water Reliability, Environmental Stewardship, Fiscal Responsibility, Wastewater Management and Business Practices. The summary of the key assumptions, drivers, changes, and objectives for the biennial budget and TYCIP are provided in the Executive Summary section.

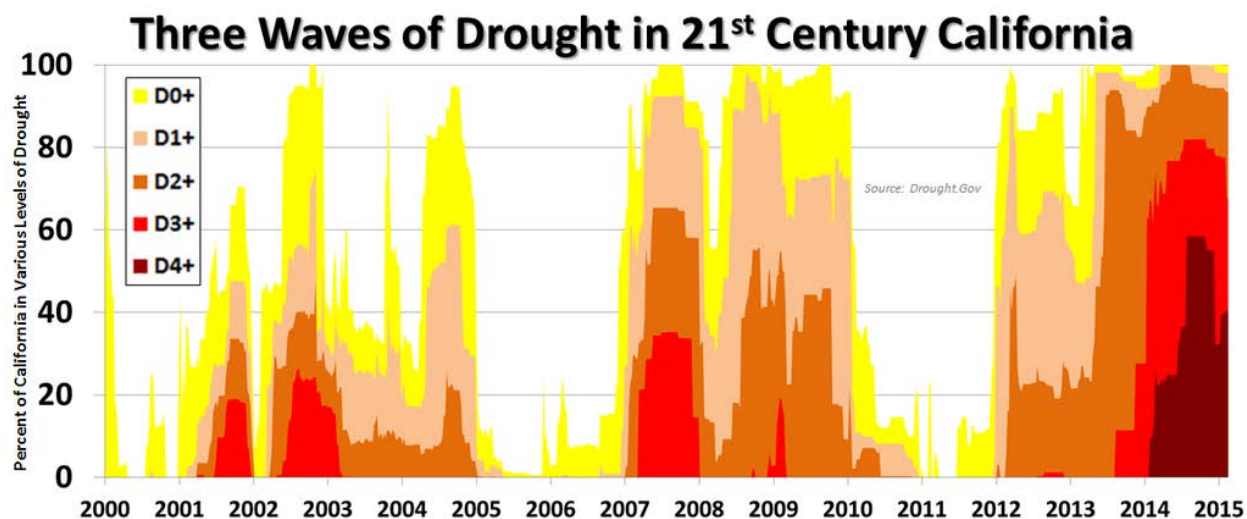
Opportunities and Challenges

Despite a weakening global economy, nearly every sector of the U.S. economy continues to show signs of steady growth. According to the Beacon Economics Quarterly Report (Q1 2015), employment levels have returned to their pre-recession high corporate profits and the equity markets are near all-time highs, and interest rates remain low. At the forefront of the growth is the California economy with nearly every key economic indicator trending in the right direction. The CalCheck Report: Updated on the California's Economic Health (May 6, 2015) describes the state's economy as "both deepening and broadening" with job growth outperforming the nation for 37 consecutive months. The state's unemployment rate has dropped significantly from a peak of 12.2% in March 2010 to 6.5% in March 2015. The higher employment level and favorable economic conditions are resulting in significantly higher revenues by the state than projected in the FY 2014/15 budget. The Governor's FY 2015/16 May revised budget reported a \$6.7 billion increase in General Fund revenues compared to the January budget. The increase was primarily driven by increased capital gains and personal income taxes.

With the state's economy in stronger footing, attention has shifted to the water shortages caused by the ongoing drought. Although drought conditions are prevalent throughout the southwestern region of the U.S.; coping with a fourth consecutive year of historically dry weather, California has become the focal point of the current drought crisis.

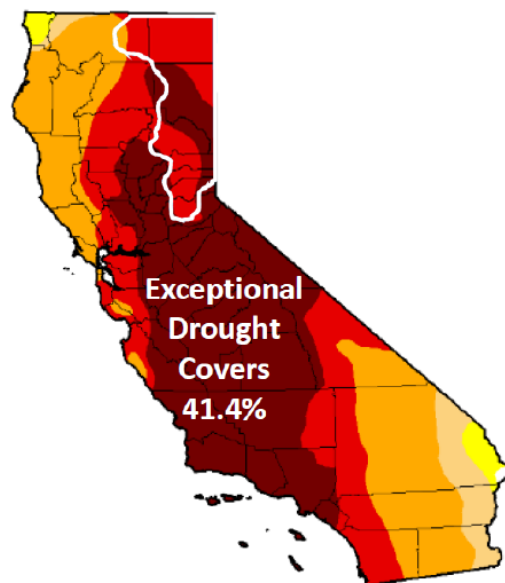
Droughts are not uncommon in California. Since the year 2000, California has experienced three waves of drought: 2001-2005, 2007-2010, and the ongoing drought of 2012. However, as depicted in the graph below, none have been as severe as the current one.

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In April 2015, the U.S. Drought Monitor reported 98 percent of California was experiencing some level of drought. Over 40 percent of the state was reported to be under “exceptional drought” conditions: the most intense rating issued by the U.S. Drought Monitor. These unprecedented drought conditions and the possibility that they will continue into a fifth consecutive year in 2016 and beyond, led to the enactment of historic sustainable groundwater laws in September 2014 aimed to protect the groundwater basins that provide more than half of the water California’s use in dry years. Agency management was a key participant in the crafting of the Sustainable Groundwater Management Act which requires local agencies to form sustainable groundwater management agencies by June 2017 and adopt sustainability plans by 2022.

In January 2014 Governor Edmund G. Brown, Jr. declared a drought state of emergency and urged for a voluntary reduction of water use by 20 percent. The Governor issued a second Executive Order in April 2014 and a directive in July 2014 adopting emergency regulations for water conservation to prevent waste and unreasonable use. The severity of California’s drought was further heightened by the Department of Water (DWR) annual measurement of the Sierra Nevada snowpack on April 1, 2015 of only 5 percent; the lowest average since 1950. This prompted the Governor to issue another Executive Order (B-29-15) calling for a statewide mandatory reduction in urban water use of 25 percent from 2013 levels by February 2016. The statewide mandate was the first in California’s history and underscores the severity of the current drought and the need to conserve diminishing water supplies across the state.



The strong leadership and foresight demonstrated by the Governor in responding to the current drought will provide long term benefits in preserving and optimizing the beneficial use of the water resources throughout the state. In addition to promoting a more holistic and collaborative approach to water resource management throughout the state, these regulations will undoubtedly transform the way Californian's think about and use water going forward.

Water Reliability

The Agency, in partnership with its member agencies, invests in a wide range of programs to promote water use efficiency, eliminate waste and unreasonable use, and enhance regional water resiliency. In support of the Governor's statewide mandate to reduce water use, the IEUA Board of Directors adopted Drought Resolution (2015-5-8) in May 2015. The Drought Resolution calls for aggressive actions to reduce outdoor water use and preserve remaining water supplies in the Chino Basin. Included in the FY 2015/16 – 2016/17 biennial budget is an expansion of the Agency's regional conservation program including; rebates for turf removal, landscape equipment upgrades, indoor water saving devices, free landscape evaluations, and increased public outreach and messaging to heighten public awareness on the urgency to preserve our regional water supplies.

Also in support of the Governor's Executive Order, MWD implemented a Water Supply Allocation Plan (WASP) Level 3, declaring a regional shortage level and reducing tier 1 allocations by 15 percent effective July 1, 2015. As a member of MWD, all of the water imported into the region by the Agency is through the State Water Project (SWP). About one fourth of the water used in the region is imported from MWD. The reduced allocation directly impact wholesale deliveries by the Agency to its member agencies. Pursuant to the Governor's Executive Order B-29-15, all of Agency's member agencies are required to reduce urban water use between 24 to 36 percent by February 2016.

To mitigate the uncertainty of SWP water supplies due to recurring drought conditions and operational constraints, over the last 20 years the Agency has invested more than \$275 million in developing and enhancing regional water supplies, including infrastructure improvements, construction of state-of-the-art recycled water and groundwater recharge facilities, and water use efficiency programs. A major facet of the Agency's integrated water resource management program is optimizing beneficial use of recycled water generated in its recycling water facilities.

In FY 2013/14, the Agency achieved a new milestone with the delivery of nearly 38,000 acre foot (AF) of recycled water; 14,000 AF of which was recharged into the Chino Basin for future use. A significant accomplishment is the completion of the Central/Wineville Area recycled water projects in July 2015. These projects will distribute recycled water to the southern part of the City of Fontana and the eastern part of the City of Ontario; completing the backbone of the regional recycled water distribution system. Total project yield is estimated between 3,000 and

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4,000 acre-feet per year (AFY); comprised primarily of additional groundwater recharged to the RP-3 and Declez basins.

The Recycled Water Program Strategy (RWPS), one of the Agency's master plans, was recently updated to help maximize the beneficial use of recycled water throughout the year by shifting towards groundwater recharge, injection and possibly direct potable reuse. The projects proposed through 2035, with a focus on the first ten years (TYCIP), address improvements necessary to either increase the ability to deliver reuse supply to groundwater recharge, or relieve capacity constraints in order to meet the demand forecast.

More information on these programs is provided in the Water Resources program section.

Environmental Stewardship

The Agency is committed to protection of the environment through conservation and sustainable practices implemented on a regional and watershed basis. Included in the biennial budget are various projects that pool together multiple agencies in the region to collaborate in large-scale water supply reliability and water use efficiency projects that could benefit the entire Santa Ana Watershed. As one of ten agencies participating in the Santa Ana River Multiple Species Habitat Conservation Plan, led by the San Bernardino Valley Municipal Water District (SBVMWD), the Agency will work closely with the U. S. Fish and Wildlife Service to mitigate any potential impact to federally-listed endangered, threatened, or special status species from future water projects in the Upper Santa Ana River region.

The Agency is also a key participant in the Santa Ana River Watershed-Scale Conjunctive Use Program (SARCUP), along with San Bernardino Valley Municipal Water District (SBVMWD), Eastern Municipal Water District (EMWD), Western Municipal Water District (WMWD), and Orange County Water District (OCWD). The primary objective of the participants, known as the Santa Ana River Watermaster Action Team (Action Team), is to develop cooperative plans for SARCUP to maximize development of local and imported water supplies as equitable partners and not to compete for grants or imported water supplies that can be used for SARCUP. These projects will be the basis for the 2015 One Water One Watershed (OWOW) grant application for \$60 million from the Department of Water Resources (DWR) Proposition 84 grant funding. The Action Team will also work collaboratively on regional water use efficiency programs and habitat restoration/Arundo removal programs.

Fiscal Responsibility

The Operating Budget for FYs 2015/16 – 2016/17 is the Agency's first biennial budget. The transition from a single year budget to a biennial budget was one of the key objectives of the IEUA Business Goal Fiscal Responsibility. Another important milestone is the adoption of five year rates and fees for FYs 2015/16 – 2019/20 for the Agency's regional wastewater and recycled water programs and the new water connection fee. Included in the FY 2015/16 – 2016/17 biennial budget are the first two years of five year rates. These multi-year rates

achieve another key policy principle; the establishment of rates and fees that fully recover the cost of providing the service. Having full of cost of service rates and fees is essential in ensuring the Agency has the fiscal fortitude to effectively address economic and environmental variability. The incremental increases over the five year period lessen the impact to ratepayers, as well as provide our member agencies with more stable and predictable forecasts.

Other key policy principles defining the adopted multi-year rates include: ensuring rates are reasonable and equitable by establishing a clear nexus between what a customer pays and the benefit of the services received, as legally mandated; making growth pay for growth by establishing a new regional water connection fee and adjusting the regional wastewater connection fee to adequately fund future capacity expansion and enhancement of existing facilities to support future growth; and eliminating reliance on property taxes to subsidize day-to-day operating costs and ensure uninterrupted service during times of revenue shortfall. Property tax receipts make up approximately 20 percent of the Agency's total revenues, including connection fees. Although the state's fiscal position has drastically improved over the last several years lessening the risk of another shift of local property taxes to cover state budget shortfalls; the next economic downturn increases the risk of another shift by the state exponentially. As noted in the Governor's FY 2015/16 May revised budget, despite higher revenues "the budget remains precariously balanced and faces the prospect of deficits in succeeding years".

Another significant milestone for the Agency is the establishment of a regional water connection fee to support future expansion and enhancement of its regional water system. Premised on the policy principle "growth pays for growth", the new water connection fee will ensure that future users pay for the benefit provided by the regional water system comprised of potable water, recycled water and groundwater recharge facilities. Based on the adopted TYCIP for FYs 2016 -2025, approximately 94 percent of the new water connection fees will be designated to support expansion and enhancement of the Agency's recycled water and groundwater recharge facilities. The remaining six percent will support investment in the Agency's regional integrated water resource management program. The Agency worked closely with its member agencies and the Business Industry Association (BIA) in establishing the new regional water connection fee. BIA recognizes the need to have a reliable and resilient water supply that supports economic development by meeting the needs of current and future customers.

The Agency continues to be committed to sustainable cost containment as demonstrated in the adopted biennial budget. The number of authorized full time equivalent (FTEs) of 290 is maintained over the two year budget period, and projected to be sustained over the ensuing three years. Succession planning for the impending retirement of the Agency's "baby boomers", many of whom are in senior positions, will be managed through an incremental reduction in the vacancy factor. Budgeted at a rate of five percent in FY 2014/15, the vacancy factor is reduced to four percent and then three percent over the next two fiscal years, respectively. Over the prior three fiscal years, the actual vacancy factor has averaged just below nine percent; indicative of the Agency's commitment to cost containment.

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In late April 2015, the Agency submitted a pre-application for an SRF loan and Proposition 1A grant for \$31 million in support of the 2015 Drought Relief Recycled Water Supply Optimization Program Phase 1 (Optimization Program). The Optimization Program will deliver an estimated 4,000 AFY of recycled water, bringing the Agency closer to its goal of 50,000 AFY of recycled water deliveries by 2025. The Agency will continue to aggressively pursue federal, state and regional grants and incentives, including rebates offered by MWD, and low interest State Revolving Fund (SRF) loans, to reduce the cost of executing the planned programs and projects included in the adopted biennial budget and TYCIP.

Wastewater Management

Although the pace of new development lost some momentum in 2015 compared to the prior fiscal year, forecasts by the Agency's member agencies indicate a rebound in new development over the next five to ten years. As a regional wastewater service provider, the Agency is required to maintain capacity within systems and facilities to meet essential service demands to protect public health and the environment. One of the key objectives included in the IEUA Business Goal Wastewater Management is to ensure that systems are managed and constructed so that 90 percent of capacity is never exceeded.

To prepare for the anticipated growth, the Agency initiated an update of some of the key long term planning documents, amongst them the Wastewater Facilities Master Plan (WFMP) last updated in 2002, the Recycled Water System Master Plan, and the Chino Basin Organics

Management Master Plan (Master Plans). The update included an assessment of the general plans for each of the Agency's member agencies to identify planned land use and growth projections through 2060. These growth forecasts served as the basis to identify future water, wastewater and organics infrastructure needs throughout the Agency's service area.

As identified in the updated WFMP, member agencies project a total of 40,523 new EDU connections over the next ten years. Approximately 60 percent of the growth is expected in the southern section of the Agency's service area; predominantly in the cities of Ontario and



Fontana. Some of the major construction projects to be executed over the next ten years include: the relocation of the Regional Plant 2 (RP-2) solids handling processes to the RP-5 facility, expansion of RP-5 liquid treatment, rehabilitation and expansion of the RP-1 solids and liquid treatment processes. The RP-2 solids handling facility is located in the City of Chino on land leased from the U. S. Army Corps of Engineers (Army Corps). Portions of the RP-2 facility are located in the 100-year flood plain. Triggering the relocation of the RP-2 facility is

the proposed raising of the maximum operation water level behind the Prado Dam to allow for greater water storage and conservation by the Army Corps and Orange County Flood Control District. As reported in the adopted TYCIP, the estimated cost of these major construction projects is about \$400 million, excluding the ultimate decommission of the RP-2 site prior to expiration of the lease in 2035.

The acquisition, construction, improvement and expansion of the Agency's regional wastewater system are supported by the regional wastewater connection fee. To ensure timely completion of capital projects, the Agency conducted an engineering study of its regional wastewater connection fee. The study determined an adjustment of \$1,182 to the existing fee of \$5,107 per new equivalent dwelling unit (EDU) connection was needed to adequately support future expansion of the regional wastewater system. A phased implementation of the necessary adjustment is included in the adopted multi-year rates.

Conclusion

Over the last twelve months, the Agency accomplished many significant milestones; none of which could have been possible without the collaboration of our member agencies, stakeholders, and dedicated Agency team. Some of these milestones will help position the Agency in a more stable fiscal and operational status to more effectively execute the planned initiatives as outlined in the adopted biennial budget and TYCIP, as well as leverage opportunities and address unplanned challenges that arise along the way. One of these challenges is meeting the Governor's mandate to reduce urban water use by 25 percent. Assisting our member agencies to meet this requirement is a top priority for the Agency. Proceeds received from the SAWPA Prop 84 grant will be used to develop a "toolkit" member agencies can use to enhance water use efficiency and mitigate the impact of the mandated cutbacks; such as expansion of the turf removal program rebates, compilation of parcel and climate data for use in the implementation of financially stable rate structures, and state-of-the-art technology to more effectively detect water leaks.

As the "Steward of the Region", the Agency is committed to sustainably enhancing the quality of life in the Inland Empire by ensuring that a clean, reliable and resilient water supply is available now in the future. These principles will continue to guide the Agency and its member agencies in developing and prioritizing initiatives to effectively address the effects of climate change and its impact to our region's vital water resources.