

GENERAL MANAGER'S MESSAGE

The Honorable Board of Directors
Inland Empire Utilities Agency

June 21, 2017

I am pleased to submit the Inland Empire Utilities Agency (IEUA/Agency) biennial budget for Fiscal Years 2017/18 and 2018/19 (FYs 2017/18 & 2018/19 budget) and the Ten-Year Capital Improvement Plan for Fiscal Years 2017/18 – 2026/27 (FY 2018-2027 TYCIP). The FYs 2017/18 & 2018/19 biennial budget and FY 2018-2027 TYCIP include the operational, capital and debt service expenditures necessary to 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 key focus of the FYs 2017/18 & 2018/19 budget is the continued investment in Agency and regional assets. Over the next 10 years, population in the southern section of the Agency's service area is expected to double, so included in the FY 2018-2027 TYCIP is the expansion and improvement of existing Agency facilities to meet the needs of future growth and optimization of the wastewater collection system, wastewater treatment system and the regional recycled water distribution system (RRWDS). To prepare for the anticipated growth, included in the FY 2018-2027 TYCIP is the RP-5 Liquid and Solids Treatment Expansion project (RP-5 Expansion project) that will double plant capacity from 15 to 30 million gallons per day (MGD), and relocate solids handling processing from Regional Plant No. 2 (RP-2). The RP-2 solids handling facility is 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 in the 100-year flood plain. Relocation of the RP-2 facility is being triggered by 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 by 2021.

Opportunities and Challenges

Over the next 5 years, nearly 45 percent of Agency employees will be eligible to retire. Timely recruitment of skilled personnel is crucial to ensure effective transfer of knowledge and skills to the next generation of Agency employees. Included in the FYs 2017/18 & 2018/19 budget is a succession pool of ten positions to support timely recruitment of critical positions throughout the organization. Timely upkeep of Agency facilities and equipment is another key objective. Included in the biennial budget is support for the Agency's maintenance department ongoing transition from a corrective to a predictive and preventive maintenance strategy. Over time, the benefit of performing maintenance on equipment only when it is warranted, a proactive versus reactive approach, will result in lower maintenance costs. An important part of the transition is continual investment in training personnel to develop the necessary skills to implement and support this maintenance strategy.

After five years of epic drought, California experienced one of the wettest winter seasons in nearly a century of record-keeping. The final reading of the snow level in the Sierra Nevada mountains on May 1, 2017, reported the snowpack at 190 percent of the historic average; an unprecedented

improvement from zero snow pack reported just two years earlier in May 2015. The damage to the Oroville Dam in northern California in early February 2017 brought to the light the State's aging infrastructure and its ability to handle the vast amount of water expected from the unprecedented rainfall and impending snowmelt as temperatures begin to warm. Since the year 2000, California has experienced four waves of drought; however, no drought in the last 100 years was as severe as the last one. Experts and State water officials expect these extreme cycles of dry and wet weather to continue as global temperatures continue to rise.

Water Reliability

The Sierra Nevada mountain range is a key source of water supply. The ample supply of water expected from the snow melt coupled with the statewide water savings achieved through conservation is anticipated to provide sufficient supplies of water throughout the State. This is good news for IEUA and its retail water agencies. All of the water IEUA imports from the Metropolitan Water District of Southern California (MWD) is delivered through the State Water Project (SWP) system. To mitigate for the uncertainty of the SWP water supplies, over the past 15 years, more than \$500 million was invested by IEUA and its retail agencies to drought-proof the region by expanding groundwater, stormwater, recycled water and conservation programs and facilities. These investments also leveraged the region's ability to secure hundreds of millions of dollars in state and federal grants and loans. As a result, when the record-breaking drought of 2012 began the region was prepared. Throughout this unprecedented time, sufficient water supply was available to meet the water needs of the region without constraining new development or economic growth.

Optimizing beneficial use is also the goal of the Recycled Water Program Strategy (RWPS), one of the Agency's master plans, and a major part of the Agency's integrated water resource management program. Over the next two years, in partnership with Chino Basin Watermaster, Chino Basin Water Conservation District and its member agencies, the Agency is investing approximately \$40 million to improve the Agency's regional recycled water distribution system (RRWDS) and expand capacity of groundwater basins. IEUA remains committed to providing reliable and cost-effective water supplies, and promoting sustainable water use efficiency. The additional water supply is essential in supporting future growth and economic development for the region.

Environmental Stewardship

Making water conservation a way of life and establishing long term water use efficiency standards is a key objective of the Governor. The Agency, in partnership with its member agencies, will continue to invest in a wide range of regional programs to promote water use efficiency, eliminate waste and unreasonable use, and enhance regional water resiliency in alignment with the Governor's long term objective. Many of these projects are part of the Agency's Integrated Water

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Resources Plan (IRP) completed in 2015. The 2015 IRP is intended to anticipate future water supply challenges and to ensure that continued investments in water resources and water use efficiency meet the future water needs of the region.

As one of ten agencies participating in the Santa Ana River Multiple Species Habitat Conservation Plan (HCP), led by the San Bernardino Valley Municipal Water District (SBVMWD), IEUA 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. 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 to benefit the entire Santa Ana Watershed.

One such project is the Santa Ana River Conservation and Conjunctive Use Program (SARCCUP). IEUA, along with SBVMWD, Eastern Municipal Water District, Western Municipal Water District, and Orange County Water District, comprise the Santa Ana River Watermaster Action Team (Action Team). The primary objective of SARCCUP is 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 to benefit the Santa Ana River Watershed. These projects were 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.

The Agency is committed to protection of the environment through conservation and sustainable practices implemented on a regional and watershed basis. More information on these programs is provided in the Water Resources program section.

Wastewater Management

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 systems are managed and constructed so that 90 percent of capacity is never exceeded. The acquisition, construction, improvement, and expansion of the Agency's regional wastewater system are supported by the regional wastewater connection fee. Included in the biennial budget and FY 2018-2027 TYCIP is the continued pace of new development of 3,000 new wastewater connections over the next two years.

The Agency's Wastewater Facilities Master Plan (WFMP), updated in 2015, reported member agencies' forecasts of 40,523 new equivalent dwelling units (EDU) connections through 2025. Most of the new development is anticipated in the cities of Chino, Fontana and Ontario. The most current forecast provided by member agencies in November 2016 estimates almost 36,500 new connections through 2027.

Fiscal Responsibility

The Operating Budget for FYs 2017/18 – 2018/19 is the Agency’s second biennial budget. An important policy principle of the multi-year rates was the establishment of rates and fees that fully recover the cost of providing the service, as well 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. 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 is consistent with the principle of having “growth pay for growth.” Based on actual and projected expenditures through FY 2016/17 and assumptions in the biennial budget, the Agency is on track to achieving full cost of service rates by FY 2019/20. No adjustment to the adopted multi-year rates and fees were made for FYs 2017/18 and 2018/19.

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. Included in the FYs 2018/19 & 2018/19 budget is a succession pool of 10 positions to support timely recruitment of critical positions throughout the organization.

The State Revolving Fund (SRF) loan program is an important source of funding for the RP-5 Expansion and RP-1 Rehabilitation projects. Additionally, the Agency submitted a letter of interest to the U.S. Environmental Protection Agency (EPA) for a Water Infrastructure Finance and Innovation Act (WIFIA) loan. The Agency will continue to aggressively pursue federal, state and regional grants and incentives, including low interest SRF loans and grants, and rebates offered by MWD to support its regional water use efficiency projects. Optimizing low interest loans and grant funding will help reduce the cost of executing the planned programs and projects included in the FY 2017/18 and 2018/19 budget and FY 2018-2027 TYCIP.

Conclusion

The last fiscal year was another successful year for the Agency, its member agencies, and key stakeholders in the region. In addition to meeting the Governor’s mandate to reduce water use by 25 percent and increasing the amount of water stored in the Chino Basin by nearly 100,000 AF during one of the worst drought periods in history; hydraulic control in the Chino Basin was officially achieved in February 2016. After 15 years of collaboration, planning and investing for Chino Basin Watermaster (Watermaster) Parties and the IEUA, and many other regional stakeholders, achieved a long-standing initiative to Improve the quality of the Chino Basin’s groundwater and outflow to Orange County.

Further advancement to improve water quality in the Chino Basin was achieved following years of collaborative efforts between IEUA, three public agencies, four private companies, and the U.S. Department of Defense regarding historical use of an industrial cleaning solvent that seeped into

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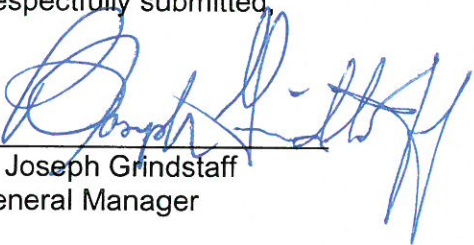
the area's groundwater, creating the South Archibald Plume. IEUA led discussions to plan the implementation of a permanent cleanup solution, which resulted in the development of several agreements and actions between the parties in September 2016 that include cleanup of this longstanding contaminated groundwater.

As part of its ongoing cost containment initiative, the Agency refinanced the 2008A Revenue Bonds in January 2017 resulting in net present value savings of \$37 million over the life of the bonds and a reduction in outstanding debt of over \$57 million. By leveraging historically low market rates, the Agency reduced annual debt service costs by approximately 36 percent resulting in positive cash flow savings averaging around \$3 million per year.

All of IEUA's accomplishments are possible due to the collaboration of our member agencies, stakeholders and dedicated Agency staff. Most 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 FY 2017/18 and 2018/19 budget and FY 2018-2027 TYCIP.

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 and 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 and continued economic development.

Respectfully submitted,


P. Joseph Grindstaff
General Manager