

FC 1025 (11/18/09)

Meeting Date: 1/12/10
Agenda Item:
Unclassified Manager: D. Taylor
Extension: 3068
Director(s): All

BOARD AGENDA MEMO

SUBJECT: Work Study Session on Preliminary FY 2010-11 Groundwater Production Charge Analysis

RECOMMENDATION:

Discuss the preliminary FY 2010-11 groundwater production charge analysis prepared by staff and provide comment.

SUMMARY:

Staff has prepared the preliminary FY 2010-11 groundwater production charge analysis for Board review. The analysis includes a discussion of water use assumptions, issues related to the state water project tax, agricultural preservation and perchlorate response, and two preliminary groundwater production charge projections. Staff is seeking Board input to incorporate into the development of the groundwater production charge recommendation.

The groundwater production charge recommendation will be detailed in the annual report on the protection and augmentation of water supplies that will be filed with the Clerk of the Board on February 26, 2010. The public hearing on groundwater production charges is scheduled to open on April 13, 2010. It is anticipated that the Board would set the FY 2010-11 groundwater production charges by April 27, 2010, which would become effective on July 1, 2010.

Rate Setting Process

The rate setting process will be conducted consistent with the District Act and Board resolution 99-21. The applicability of Proposition 218 to the groundwater production charge has not been finally determined by the Courts. However, consistent with the requirements of the California constitution, staff will prepare a "cost of service" analysis by customer class, including groundwater, treated water, surface water and recycled water users and conduct a majority protest procedure for groundwater production charges. Staff will introduce a resolution regarding the procedure for Board approval at the January 26, 2010 Board meeting. Under the current draft procedure, notices are scheduled to be mailed to well owners on February 26, 2010 and written protests would be accepted until the close of the public hearing scheduled for April 27, 2010. Staff is analyzing the impacts on water supply due to loss of revenue should a successful protest occur.

The District Act defines the purposes for which groundwater production charges can be imposed on a particular zone of benefit. Those purposes are:

- 1) Pay for construction, operation and maintenance of imported water facilities
- 2) Pay for imported water purchases

SUBJECT: Work Study Session on Preliminary FY 2010-11 Groundwater Production Charge Analysis

- 3) Pay for constructing, maintaining and operating facilities which will conserve or distribute water including facilities for groundwater recharge, surface distribution, and purification and treatment
- 4) Pay for debt incurred for purposes 1, 2 and 3

Staff is in the process of conducting an annual evaluation of the activities that can be paid for by groundwater production charges.

Resolution 99-21 guides staff in the development of the pricing structure to charge recipients for the various direct and indirect benefits received. The pricing policy calls for managing water supplies through pricing to obtain the effective utilization of the water resources of the District. Staff will continue to recommend pricing designed to achieve the regulatory purpose of the effective use of available resources according to the policy.

Water Use Assumptions

Staff anticipates that reduced water usage, consistent with 15% mandatory conservation, will continue through FY 2011-12 and will begin to return to pre-drought usage in FY 2012-13, a revenue reduction of approximately \$10 million each year. By FY 2013-14, District managed water use will have returned to just over 300,000 acre-feet from roughly 280,000 acre-feet in FY 2009-10.

Issue #1: State Water Project Tax Clarification

The District has been collecting the State Water Project Tax since the 1980's. The tax pays for imported water from the State Water Project. It has been alleged recently that the District is "double dipping," or collecting for State Water Project costs once with the tax and then again with groundwater production and treated water charges. This allegation is false. State Water Project costs have never been budgeted twice, and revenue generated from groundwater production and treated water charges has never exceeded net revenue requirements by the amount of the State Water Project costs or tax.

Issue #2: Agricultural Preservation

The District Act limits agricultural groundwater production charges to 25% of the municipal and industrial (M&I) groundwater production charges. In 1991 the Board established an open space credit to set agricultural groundwater production charges at 10% or less of the M&I charge offsetting lost revenue with 1% ad valorem property taxes. To the extent that Proposition 218 applies to the groundwater production charge, it requires that costs to end users be proportional such that one class of users is not subsidizing another. While the applicability of Proposition 218 to the groundwater production charge has not yet been finally determined by the Courts, the District is committed to responding to the concerns embodied in the constitutional amendments.

For purposes of the preliminary financial analysis, staff assumes that the open space credit would be increased by roughly \$3.5M to maintain the current agricultural groundwater production charge setting policy. Since water utility 1% ad valorem property taxes are insufficient to cover this increase, another revenue source must be used to continue the historic practice of keeping agricultural rates at 10% or less of M&I charges. Staff is considering whether 1% ad valorem property taxes from the General Fund or the Watershed Stream Stewardship Fund may be viable revenue sources.

SUBJECT: Work Study Session on Preliminary FY 2010-11 Groundwater Production Charge Analysis

Issue #3: Perchlorate Response Settlement

In 2003 the District responded aggressively on behalf of South County groundwater users to the discovery of perchlorate contamination in South County Zone W-5. Perchlorate response costs have been funded by Water Utility reserves, not south county water users, under the expectation that the responsible party would reimburse the District for those costs. The responsible party will reimburse the District for certain costs based on the terms of a yet to be signed court supervised settlement agreement. A balance of roughly \$4.4M remains to be paid back to Water Utility reserves. For purposes of the preliminary financial analysis in order to protect against rate spikes, staff has phased in the repayment by south county groundwater users (both agricultural and non-agricultural) over a 3 to 4 year time frame.

Groundwater Production Charge Projections


Staff has prepared two preliminary groundwater production charge projections for Board review. The first assumes no increase in the M&I groundwater production charge in both zones for FY 2010-11 followed by annual increases of just under 9% in the North County zone W-2 and roughly 3.5% in South County zone W-5 for the next few years. This projection would fund a continuation of the operational level of service currently budgeted and the proposed FY 2010-11 CIP. The second projection assumes no increase in the M&I groundwater production charge in both zones for FY 2010-11 followed by annual increases of less than 4% in both zones for the next few years. This projection would require a \$3M ongoing reduction in operations costs and \$550M reduction in the FY 2010-11 CIP over the next 10 years.

FINANCIAL IMPACT:

Discussed in the Power Point presentation (Attachment 1).

ATTACHMENTS:

Attachment 1: Power Point Presentation.



**Santa Clara Valley
Water District**SM

**Work Study Session on Preliminary FY
2010/11 Groundwater Production
Charge Analysis**

January 2010

Attachment 1
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Presentation Outline

- Schedule
- Rate Setting Process
- Water Use
- Issues
 - State Water Project Tax Clarification
 - Agricultural Preservation
 - Perchlorate Response Settlement
- Financial Analysis
 - Groundwater Production Charge Projections (2 options)
 - Cost of Service Analysis
- Discussion/Wrap up

Attachment 1
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2010 schedule

January	February	March	April
<ul style="list-style-type: none"> • 12 Board meeting: preliminary groundwater production charge analysis • 19 Agricultural Advisory meeting: preliminary groundwater production charge analysis • 20 Water Retailers meeting: preliminary groundwater production charge analysis • 26 Board meeting: initial review of FY 10-11 CIP • 26 Board meeting: Rate setting process resolution • 27 Water Commission meeting: preliminary groundwater production charge analysis 	<ul style="list-style-type: none"> • Board meeting: CEO check-in (review of budget) • 09 Board meeting: set date of public hearing • 26 File Report and mail well owners notice: Protection and Augmentation of Water Supplies (PAWS) Report 	<ul style="list-style-type: none"> • Board meeting: CEO check-in (review of budget) • 10 Water Retailers Meeting: Groundwater production charge recommendation discussion (Date TBD) 	<ul style="list-style-type: none"> • 05 Agricultural Advisory meeting: Groundwater production charge recommendation discussion • 06 Water Commission meeting: Groundwater production charge recommendation discussion • 08 Landscape Advisory meeting: Groundwater production charge recommendation discussion • 13 Board meeting: open public hearing on groundwater charges • 20/21/22 Board Meetings: Budget work study sessions • 27 Board meeting: Close hearing & adopt groundwater production charges

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Rate Setting Process

Proposition 218: Imposes specific requirements depending on the type of revenue being raised. The applicability of Proposition 218 to the groundwater production charge has not yet been finally determined by the Courts.

Approach for FY 2010-11:

- Transparent process consistent with Prop 218
- Prepare “cost of service” analysis by customer class
 - Groundwater Users
 - Treated Water Users
 - Surface Water Users
 - Recycled Water Users
- Implement majority protest procedure

Attachment 1
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Rate Setting Process

Majority Protest Procedure:

- Resolution regarding procedure will be agendized for January 26, 2010 Board meeting
- Notices are scheduled to be mailed to well owners on February 26, 2010
- Written protests would be accepted until the close of the public hearing (April 27, 2010)
- Staff is analyzing the impacts on water supply due to loss of revenue should a successful protest occur

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Rate Setting Process

District Act Section 26.3: Defines purposes of groundwater production charges that can be imposed on a zone of benefit

1. Pay for construction, operation and maintenance of imported water facilities
2. Pay for imported water purchases
3. Pay for constructing, maintaining and operating facilities which will conserve or distribute water including facilities for groundwater recharge, surface distribution, and purification and treatment
4. Pay for debt incurred for purposes 1, 2 and 3

Approach for FY 2010-11:

- Annual evaluation of activities that can be paid for by groundwater production charges

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Rate Setting Process

Resolution 99-21: Water Utility taxing and pricing policy guides staff in the development of the overall structure to charge recipients for the various direct and indirect benefits received

- Key concept – “water supplies are managed, through taxing and pricing, to obtain the effective utilization of the water resources of the District...”

Approach for FY 2010-11:

- Continue to recommend pricing that will achieve the effective use of available resources according to the policy

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Water use assumptions

Water Use Projections for Revenue Calculation Purposes (1,000s AF)

	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
North County M&I	226.08	226.08	226.08	234.08	242.08	242.08
North County Ag	0.44	0.44	0.44	0.44	0.44	0.44
South County M&I	26.2	27.2	28.2	30.2	31.2	32.2
South County Ag	26.3	26.3	26.3	27.3	28.3	28.3
South County Recycled	1.8	2.2	2.2	2.4	2.4	2.6
Total	280.82	282.22	283.22	294.42	304.42	305.62

Water Use Assumption for FY 2010-11

1. Reduced usage consistent with 15% mandatory conservation (roughly 280,000 acre-feet of District water use)
 - Assumes ramp back to “normal” water use over FY 2012-13 and FY 2013-14 (roughly 300,000 acre-feet of District water use by FY 2013-14)

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Presentation Outline

- Schedule
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- Water Use
- • **Issues**
 - State Water Project Tax Clarification
 - Agricultural Preservation
 - Perchlorate Response Settlement
- Financial Analysis
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 - Cost of Service Analysis
- Discussion/Wrap up

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Issue 1: State Water Project Tax Clarification

“Double dipping” allegations are false

Background:

1. State Water Project costs are considered “voter approved debt” such that the District can offset the costs with the State Water Project Tax

The Facts:

1. The District has been collecting the State Water Project Tax since the 1980’s
2. The State Water Project Costs have never been budgeted “twice”
3. Revenue generated from groundwater production and treated water charges has never exceeded net revenue requirements by the amount of the State Water Project costs or tax

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Issue 2: Agricultural Preservation

Background

- District Act limits Agricultural GWP (Groundwater Production) charge to 25% of the M&I GWP charge
- Resolution 99-21 (Pricing Policy) recognizes groundwater conservation benefits associated with preservation of open space and establishes Board policy to set agricultural GWP charges at 10% or less of the M&I GWP charge (using open space credit)

Issue

- Under Prop 218, costs to end users must be “proportional” such that one class of users is not subsidizing another. To the extent applicable to groundwater production charges, proposition 218 trumps the District Act.*

* Note that this issue is currently the subject of ongoing litigation

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Issue 2: Agricultural Preservation

Alternatives (for discussion purposes)

1. Set the Agricultural GWP charge equal to the M&I GWP charge
 - Would eliminate the Open Space Credit
 - Would result in rate shock to agricultural community
2. Increase Open Space Credit by roughly \$3.5M to maintain current Agricultural GWP charge setting policy
 - Water Utility 1% ad valorem property taxes are insufficient to cover this increase, another source must be found

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Issue 3: Perchlorate Response Settlement

Background

- In 2003 the District responded aggressively on behalf of South County groundwater users to the discovery of perchlorate
- Perchlorate response costs were funded by Water Utility Reserves under the expectation that Olin would reimburse the District
- Under the terms of the pending final settlement between the District and Olin, Olin will reimburse certain costs

Issue

- A balance of roughly \$4.4M remains to be paid back

\$6.8M	spent by District on Perchlorate response
+\$0.8M	interest expense
-\$1.2M	reimbursed by Olin
-\$1.5M	anticipated reimbursement from Olin
<u>-\$0.5M</u>	grant from Environmental Protection Agency
\$4.4M	Balance

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Issue 3: Perchlorate Response Settlement

Assumption (for discussion purposes)

- South County groundwater users (both Ag and M&I) pay back the balance over time to avoid rate spikes
- Current financial projections assume pay back over 3 to 4 years

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Financial Analysis: Prior Year Groundwater Production Charge Projection

Prior Year Projection	Bdgt					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
No. County (W-2) M&I GWP charge (\$/AF)	\$520	\$555	\$595	\$620	\$665	\$710
Y-Y Growth %	0.0%	6.7%	7.2%	4.2%	7.3%	6.8%
So. County (W-5) M&I GWP charge (\$/AF)	\$275	\$300	\$325	\$350	\$380	\$415
Y-Y Growth %	0.0%	9.1%	8.3%	7.7%	8.6%	9.2%

Assumptions:

1. Reduced water use consistent with 15% mandatory conservation from FY 10 – FY 12 returning to pre-drought usage in FY 13
2. Reductions in operations costs for FY 10 budget are “permanent”
 - FY 10 operations cost budget was \$5.5M lower than FY 09 budget
3. This projection would fund the adopted FY 10 CIP

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Financial Analysis: Current Year Projection #1 – No Increase, Fund FY 11 CIP

For Discussion
Purposes

Projection #1 - No Increase in FY 11	Bdgt					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
No. County (W-2) M&I GWP charge (\$/AF)	\$520	\$520	\$565	\$615	\$670	\$730
Y-Y Growth %	0.0%	0.0%	8.7%	8.8%	8.9%	9.0%
So. County (W-5) M&I GWP charge (\$/AF)	\$275	\$275	\$285	\$295	\$305	\$315
Y-Y Growth %	0.0%	0.0%	3.6%	3.5%	3.4%	3.3%
Operating & Capital Reserve	\$39,414	\$23,935	\$24,147	\$27,325	\$29,681	\$32,538
Sr. Lien Debt Svc Cov Ratio (1.25 min)	2.51	2.23	2.27	2.33	2.15	1.84
South County Cumulative Deficit	(\$8,481)	(\$7,283)	(\$5,003)	(\$3,002)	(\$1,155)	\$960

Assumptions:

1. Reduced water use consistent with 15% mandatory conservation from FY 10 – FY12 ramping to pre-drought usage by FY 14
2. Operations cost projection consistent with level of service provided in FY 10 budget
3. This projection would fund the proposed FY 11 CIP

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Financial Analysis: Current Year Projection

#2 – No Increase, Modified Growth

For Discussion Purposes

	Bdgt					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Projection #2 - Flat, Modified Grwth						
No. County (W-2) M&I GWP charge (\$/AF)	\$520	\$520	\$540	\$560	\$580	\$600
Y-Y Growth %	0.0%	0.0%	3.8%	3.7%	3.6%	3.4%
So. County (W-5) M&I GWP charge (\$/AF)	\$275	\$275	\$285	\$295	\$305	\$315
Y-Y Growth %	0.0%	0.0%	3.6%	3.5%	3.4%	3.3%
Operating & Capital Reserve	\$39,414	\$22,154	\$23,837	\$24,165	\$30,300	\$28,704
Sr. Lien Debt Svc Cov Ratio (1.25 min)	2.51	2.41	2.65	2.86	2.66	2.34
South County Cumulative Deficit	(\$8,481)	(\$6,973)	(\$4,377)	(\$2,039)	\$167	\$2,663

Assumptions:

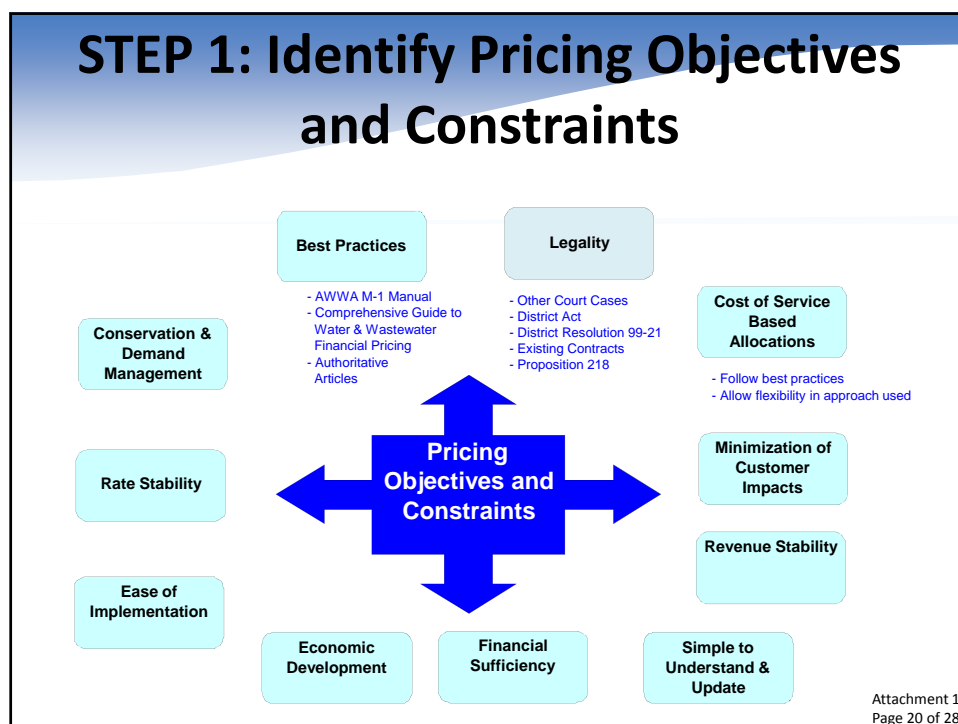
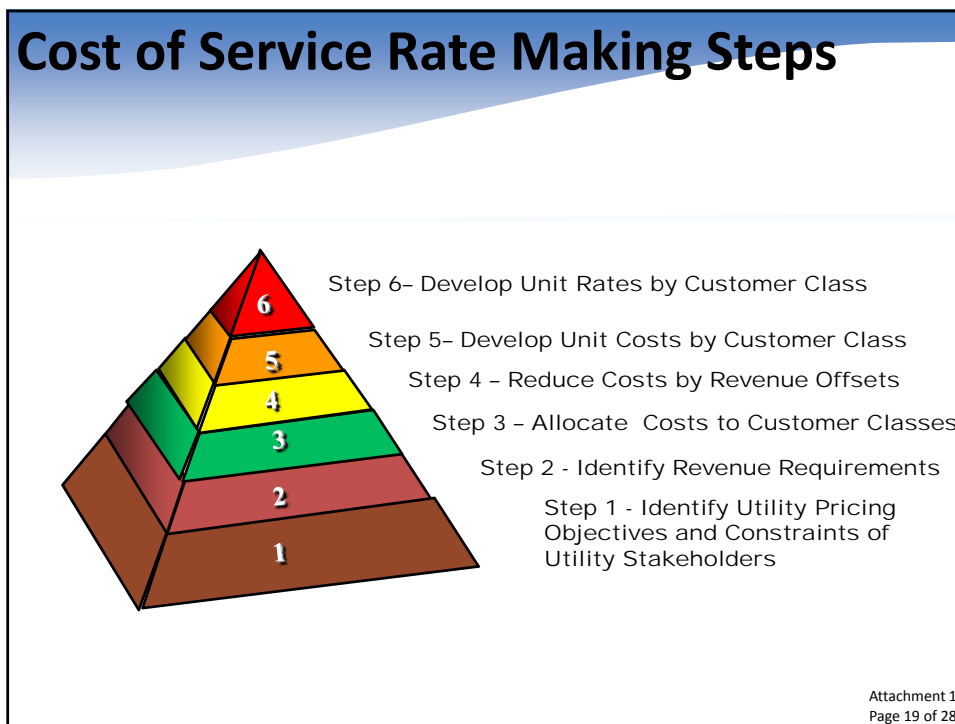
1. Reduced water use consistent with 15% mandatory conservation from FY 10 – FY12 ramping to pre-drought usage by FY 14
2. Reduce proposed FY 11 CIP by ~\$550M over next 10 years
3. Reduce operations cost projection by \$3M/yr (on going)

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- Schedule
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 - State Water Project Tax Clarification
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- ➔ **–Cost of Service Analysis**
- Discussion/Wrap up

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Cost of Service Analysis – North County

Steps 2 & 3

Preliminary -
For Discussion
Purposes

FY '11 Projection (\$K)	Zone W-2					
	GW		TW	SW		Total W-2
	M&I	AG	M&I	M&I	Ag	
1 Operating Outlays						
2 Operations/Operating Projects	36,597	130	80,842	1,286	13	118,868
3 Debt Service	4,347	15	11,914	135	1	16,413
4 Total Operating Outlays	40,944	145	92,756	1,421	15	135,281
5						
6 Capital & Transfers						
7 Operating Transfers Out	24	-	24	1	-	49
8 Capital Outlays excl. carryforward	21,664	77	46,913	658	7	69,318
9 Total Capital & Transfers	21,689	77	46,936	658	7	69,367
10 Total Annual Program Costs	62,633	222	139,692	2,079	22	204,648
11						

Step 2 - Identify revenue reqmnts

Step 3 - Allocate costs to customer classes

Cost of Service Analysis – North County

Steps 4 & 5

Preliminary -
For Discussion
Purposes

FY '11 Projection (\$K)	Zone W-2					
	GW		TW	SW		Total W-2
	M&I	AG	M&I	M&I	Ag	
10 Total Annual Program Costs	62,633	222	139,692	2,079	22	204,648
11						
12 Revenue Requirement Offsets						
13 Capital Cost Recovery	(1,388)	(5)	(1,347)	(43)	(0)	(2,783)
14 Debt Proceeds	(10,493)	(37)	(14,751)	(325)	(3)	(25,610)
15 Inter-governmental Services	(528)	(2)	(512)	(16)	(0)	(1,058)
16 SWP and W-1 Property Taxes	(3,766)	(13)	(13,436)	(244)	(3)	(17,462)
17 Interest	(117)	(0)	(114)	(4)	(0)	(235)
18 Capital Contributions	(4,614)	(16)	(4,479)	(143)	(1)	(9,254)
19 Perchlorate Response	(523)	(2)	(508)	(16)	(0)	(1,050)
20 Other	(1,142)	(4)	(1,109)	(35)	(0)	(2,291)
21 Reserve Requirements	(4,596)	(16)	(10,251)	(153)	(2)	(15,018)
22 Adjusted Revenue Requirement	35,466	126	93,184	1,100	12	129,888
23						
24 Volume (KAF)	112.9	0.4	109.6	3.5	0.0	226.5
25						
26 Revenue Requirement per AF	\$ 314	\$ 315	\$ 850	\$ 314	\$ 315	
27						

Step 4 - Reduce costs by revenue offsets

Step 3 - Allocate costs to customer classes

Step 5 - Develop unit costs by customer class

Cost of Service Analysis – North County

Step 6

Preliminary -
For Discussion
Purposes

FY '11 Projection (\$K)	Zone W-2						Total W-2
	GW		TW	SW			
	M&I	AG	M&I	M&I	Ag		
26 Revenue Requirement per AF	\$ 314	\$ 315	\$ 850	\$ 314	\$ 315		
27	Step 5 - Develop unit costs by customer class						
28 Adjustments for Agricultural Preservation							
29 Allocate WU 1% Ad Valorem Prop Tax	-	(119)	-	-	-	(119)	
30 Allocate Interest Earnings	(602)		(582)	(19)	(0)	(1,203)	
31 Revenue Requirement per AF	\$ 308.7	\$ 16.5	\$ 845	\$ 309	\$ 310		
32							
33 Adjustments to Facilitate Conjunctive Use							
34 Reallocate TW/SW/RW costs	23,861	-	(24,612)	761	(10)	0	
35 Other	Step 6 - Develop unit rates by customer class						-
36 Charge per AF	\$ 520	\$ 16.5	\$ 620	\$ 532	\$ 28.3		
37 Total Revenue (\$K)	\$58,726	\$7	\$67,990	\$1,861	\$1	\$128,584	

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Cost of Service Analysis – South County

Steps 2 & 3

Preliminary -
For Discussion
Purposes

FY '11 Projection (\$K)	Zone W-5						Total W-5	
	GW		SW		RW			
	M&I	AG	M&I	AG	M&I	AG		
1 Operating Outlays								
2 Operations/Operating Projects	5,472	5,066	53	344	122	70	11,127	
3 Debt Service	-	-	-	-	-	-	-	
4 Total Operating Outlays	5,472	5,066	53	344	122	70	11,127	
5 Capital & Transfers	Step 2 - Identify revenue reqmnts							
7 Operating Transfers Out	-	-	-	-	-	-	-	
8 Capital Outlays excl. carryforward	-	-	-	-	-	-	-	
9 Total Capital & Transfers	-	-	-	-	-	-	-	
10 Total Annual Program Costs	5,472	5,066	53	344	122	70	11,127	
11	Step 3 - Allocate costs to customer classes							

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Cost of Service Analysis – South County

Steps 4 & 5

Preliminary -
For Discussion
Purposes

FY '11 Projection (\$K)	Zone W-5							Total W-5
	GW		SW		RW			
	M&I	AG	M&I	AG	M&I	AG		
10	Total Annual Program Costs							11,127
11	Step 3 - Allocate costs to customer classes							
12	Revenue Requirement Offsets							
13	Capital Cost Recovery	991	918	7	48	522	298	2,783
14	Debt Proceeds	-	-	-	-	-	-	-
15	Inter-governmental Services	(55)	(51)	(0)	(3)	-	-	(109)
16	SWP and W-1 Property Taxes	(545)	(505)	(4)	(26)	-	-	(1,080)
17	Interest	114	105	1	5	6	3	235
18	Capital Contributions	-	-	-	-	-	-	-
19	Perchlorate Response	545	505	-	-	-	-	1,050
20	Other	(20)	(19)	(0)	(1)	-	-	(40)
21	Reserve Requirements	-	-	-	-	-	-	-
22	Adjusted Revenue Requirement	6,502	6,020	57	367	650	371	13,966
23								
24	Volume (KAF)	27.0	25.0	0.2	1.3	1.4	0.8	55.7
25								
26	Revenue Requirement per AF	\$ 241	\$ 241	\$ 283	\$ 283	\$ 464	\$ 464	
27	Step 5 - Develop unit costs by customer class							

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Cost of Service Analysis – South County

Step 6

Preliminary -
For Discussion
Purposes

FY '11 Projection (\$K)	Zone W-5							Total W-5
	GW		SW		RW			
	M&I	AG	M&I	AG	M&I	AG		
26	Revenue Requirement per AF	\$ 241	\$ 241	\$ 283	\$ 283	\$ 464	\$ 464	
27	Step 5 - Develop unit costs by customer class							
28	Adjustments for Agricultural Preservation							
29	Allocate WU 1% Ad Valorem Prop Tax	-	(3,907)	-	-	-	-	(3,907)
30	Allocate Interest Earnings	-	(1,701)	-	-	-	-	(1,701)
31	Revenue Requirement per AF	\$ 241	\$ 16.5	\$ 283	\$ 283	\$ 464	\$ 464	
32								
33	Adjustments to Facilitate Conjunctive Use							
34	Reallocate TW/SW/RW costs	933	-	1	(331)	(265)	(338)	-
35	Other	-	-	-	-	-	-	-
36	Charge per AF	\$ 275	\$ 16.5	\$ 287	\$ 28	\$ 275	\$ 41.5	
37	Total Revenue (\$K)	\$7,434	\$413	\$57	\$37	\$385	\$33	\$8,359

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Other Agency Forecasts

- SFPUC (serves North Santa Clara County)
 - Adopted a 15.4% increase in Treated Water for FY 10.
 - Anticipates an 18.2% increase in FY 11
- Zone 7
 - Adopted a 9.2% increase in Treated Water for FY 10.
 - Anticipates an 8.3% increase in FY 11
- MWD
 - Adopted a 20.9% increase in Treated Water for FY 10.
 - Anticipates a ??% increase in FY 11
- OCWD
 - Adopted a 0% increase in groundwater for FY 10
 - Anticipates a ??% increase in FY 11

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Discussion/Wrap Up

Next Steps

Jan 26	Groundwater Production Charge Setting Process Resolution
Feb 9	Set Public Hearing Date
Feb 26	File PAWS Report and mail well owners notice
April 13	Open Public Hearing

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