



**DATE:** February 12, 2019

**CATEGORY:** New Business

**DEPT.:** Public Works

**TITLE:** **Approve Water Supply Agreement Amendments**

### **RECOMMENDATION**

Adopt a Resolution Approving Amendments to the Water Supply Agreement Between the City and County of San Francisco and Wholesale Customers in Alameda County, San Mateo County, and Santa Clara County, to be read in title only, further reading waived (Attachment 1 to the Council report).

### **BACKGROUND**

The City of Mountain View purchases approximately 87 percent of its drinking water supply from the San Francisco Public Utilities Commission (SFPUC) Regional Water System under the terms of the Water Supply Agreement between the City and County of San Francisco and Wholesale Customers in Alameda County, San Mateo County, and Santa Clara County (Agreement). The Agreement was signed in 2009, expires in 2034, and delineates the terms under which the City purchases water from SFPUC, including aspects of water supply, water quality, and SFPUC's rate-setting process. The current agreement was modeled after the original 1984 Settlement Agreement and Master Sales Contract between the City and County of San Francisco and Suburban Purchasers (1984 Agreement).

The City is a member of the Bay Area Water Supply and Conservation Agency (BAWSCA), a special district that represents the interests of the 26 water agencies that purchase water wholesale from SFPUC. A primary responsibility of BAWSCA is to represent its members in discussions and negotiations with SFPUC. On September 11, 2018, the Mountain View City Council authorized BAWSCA to negotiate amendments to the Agreement with SFPUC on its behalf. Negotiations concluded in late 2018 and the Amended and Restated Water Supply Agreement between the City and County of San Francisco and Wholesale Customers in Alameda County, San Mateo County, and Santa Clara County (Amended Agreement) was approved by SFPUC on December 11, 2018 ([Attachment 2](#)).

Pursuant to the Agreement, amendments must be adopted by San Francisco and at least two-thirds of BAWSCA member agencies representing 75 percent of SFPUC's wholesale water deliveries. BAWSCA is requesting that all member agencies adopt the Amended Agreement by March 31, 2019. As of the drafting of this report, five member agencies have approved the Amended Agreement. The remaining BAWSCA agencies are scheduled to present the item to their governing bodies before the end of March.

## **ANALYSIS**

The Amended Agreement addresses several issues that have arisen since the Agreement was approved in 2009, listed below.

1. BAWSCA's role in overseeing SFPUC capital projects;
2. Drought allocations between SFPUC and the BAWSCA agencies;
3. Extend timeline to consider permanent customer status of the cities of San Jose and Santa Clara;
4. Classification of certain system assets;
5. The review process for SFPUC's Wholesale Capital Fund;
6. The Water System Improvement Program completion schedule; and
7. Language related to the Regional Groundwater Storage and Recovery Project.

In addition to the substantive amendments listed above, the Amended Agreement includes several nonsubstantive updates and "cleanup" revisions. A description of all major and minor amendments is provided below.

## **Major Amendments**

### **Amendment 1 – Oversight of SFPUC Capital Projects**

Amendment 1 adds a new section to the Agreement obligating SFPUC to formally engage with BAWSCA on development of its 10-year water system Capital Improvement Program (CIP). Over the past 15 years, BAWSCA has participated in oversight of capital projects performed under the \$5 billion Water System Improvement Program (WSIP), which specifies oversight responsibilities for BAWSCA and its

member agencies. The WSIP consists of 87 projects spread over seven counties from the Sierra foothills to San Francisco, all aimed at rehabilitating the Regional Water System originally constructed approximately 100 years ago. As of August 2018, the WSIP was 96 percent complete. As the WSIP nears completion, BAWSCA would like to continue being involved in the development of SFPUC's water system CIP to ensure projects are managed to the benefit of its member agencies. This amendment gives BAWSCA official oversight responsibility.

#### Amendment 2 – Tier 1 Drought Allocation Plan

The 1984 Agreement required development of a Water Shortage Allocation Plan (Shortage Plan) to allocate water during supply shortages of up to 20 percent. The current Shortage Plan (included as an attachment to the Agreement) was developed in 2000 and includes two levels of allocation:

- Tier 1 – Allocation between SFPUC and the collective BAWSCA agencies; and
- Tier 2 – Allocation between the individual BAWSCA agencies.

The Amended Agreement modifies the Tier 1 formula to address imbalances caused by the current formula, specifically related to the relative change in water use by SFPUC and the collective BAWSCA agencies over the past 18 years. Because of these changes in water use patterns, the original Tier 1 allocation formula, if implemented today, would result in SFPUC being allocated more water in drought years than they use in normal years. Recognizing the inequity in this formula, the Amended Agreement ensures that SFPUC will not receive more water in drought years than they use in normal years, and assigns them a minimum drought reduction of 5 percent. A portion of the water saved due to this formula change will be redistributed to the BAWSCA agencies and a portion will be held in storage for allocation in future successive dry years.

#### Amendment 3 – Extend Timeline to Consider Permanent Customer Status of San Jose and Santa Clara

The Agreement includes permanent supply guarantees for most of the BAWSCA member agencies. Two agencies, the cities of San Jose and Santa Clara, do not have permanent guarantees but are provided water on a temporary basis pursuant to their individual contracts with SFPUC. The Agreement required SFPUC to decide whether to make San Jose and Santa Clara permanent customers by the end of 2018 and to identify the new water supplies needed to support them by this same deadline. Supply

increases requested by other member agencies were also considered along this same timeline.

To date, no new viable water supply projects have been identified, and SFPUC has not made a decision regarding the status of San Jose or Santa Clara. However, as system usage is currently well below capacity, it was premature to complete these decisions on the original timeline. The Amended Agreement extends the 2018 deadline out to 2028 and changes the termination notice period from 5 to 10 years. SFPUC will be required to provide annual updates regarding the development of permanent new water supplies for San Jose, Santa Clara, and other agencies.

#### Amendment 4 – Asset Classification

In addition to providing water for customers of SFPUC and the BAWSCA member agencies, the Regional Water System also provides power to the City and County of San Francisco. One key principle of the 1984 Agreement involved classifying which assets were used for the water system versus those used to generate and deliver power. This classification is critical to ensuring the BAWSCA member agencies do not bear costs related to SFPUC's power system, from which they receive no benefit.

The 1984 Agreement included a list of system assets classified as "Water," "Power," or "Joint." Water assets are supported by the Water Enterprise; Power assets are supported by the Power Enterprise; and Joint assets are split 55 percent to the Power Enterprise and 45 percent to the Water Enterprise. These 1984 asset classifications were incorporated into the 2009 Agreement without change. However, during Fiscal Year 2010-11, SFPUC unilaterally changed the classification (and therefore the water/power cost allocation) of a small number of assets located in the upper reaches of the watershed (referred to as "upcountry" assets). The result of this change increased costs for the Water Enterprise, two-thirds of which is paid for by the BAWSCA member agencies based on their proportional use of water from the Regional Water System. This unilateral action would have added \$50.4 million in obligations to the BAWSCA member agencies. BAWSCA disputed this decision and, rather than submit the dispute to arbitration, the parties negotiated this contract amendment.

The Amended Agreement documents and classifies all significant upcountry system assets, incorporating negotiated changes for seven projects on five assets, including tunnel improvements, aqueduct repairs and flood response projects. This amendment immediately removes the \$50.4 million imposed by SFPUC's previous unilateral action. The amendment also facilitates efficient contract administration and limits and mitigates member agency exposure to financial risk on certain projects.

#### Amendment 5 – Wholesale Capital Fund

Under the Agreement, BAWSCA agency funds for capital projects are placed into a Wholesale Capital Fund managed by SFPUC. The balance of this fund is reviewed in five-year intervals and excess funds are credited to a balancing account for the BAWSCA agencies. The intent of this process was to ensure that SFPUC did not hold funds from the member agencies unnecessarily.

In implementing this requirement, however, SFPUC discovered that the five-year review periods are incompatible with spending and operation needs, resulting in project funding being returned to the BAWSCA agencies mid-project, only to require reappropriation the following year. This problem occurs particularly when a project is funded during the final year of a five-year review period.

The Amended Agreement eliminates this problem by providing annual cost reconciliation, rather than set five-year review periods. This change will provide SFPUC with the necessary resources for capital improvements, while still ensuring excess BAWSCA agency funds are not held unnecessarily.

#### Amendment 6 – WSIP Completion Date

The Agreement specified that completion of the \$5 billion WSIP would occur by December 2015. Presently, 96 percent of the WSIP is completed and SFPUC anticipates full completion by December 30, 2021. The Amended Agreement extends the WSIP completion date to this later date.

#### Amendment 7 – Regional Groundwater Storage and Recover Project

Through the Regional Groundwater Storage and Recover Project (RGSRP), groundwater pumpers in northern San Mateo County reduce groundwater production in exchange for additional SFPUC water during wet years, thus increasing storage in the groundwater basin. SFPUC may then recover the stored groundwater during dry years for the benefit of all system users.

This amendment updates the RGSRP contract provisions to better reflect how the RGSRP will be operated and to outline the cost-allocation responsibilities shared by the RGSRP's partner agencies. Mountain View is not an RGSRP partner agency and is not directly impacted by the provisions of this amendment, though the City does benefit from implementation of the program in general.

### **Benefits of Approving the Amendments**

Many of the benefits gained by approving these amendments provide operational and accounting efficiencies. Amendment 4, classification of system assets, will have a positive impact on Mountain View's share of the SFPUC asset-cost burden. Although projections by SFPUC and BAWSCA differ, the asset classifications are expected to reduce the collective BAWSCA agency obligations by \$50.4 million immediately and mitigate BAWSCA agency costs for future scheduled projects. Amendment 2, though not quantified monetarily, will provide Mountain View and the other BAWSCA agencies with more water during drought years.

A summary of each amendment and the key benefits provided is included in Table 1.

**Table 1: Summary of Water Supply Agreement Amendments and Key Benefits**

<b>Amended Item</b>	<b>Description</b>	<b>Benefits</b>
1. BAWSCA's role in overseeing SFPUC capital projects	Gives BAWSCA and its member agencies the ability to oversee and scrutinize SFPUC's capital program.	Ensures projects serve the interests of BAWSCA member agencies.
2. Drought allocations between SFPUC and the BAWSCA agencies	Adjusts the Tier 1 drought allocation formula so SFPUC receives a minimum drought reduction of 5 percent.	Allocates more water for the BAWSCA member agencies during droughts and saves water for use in subsequent dry years.
3. Extend timeline to consider permanent customer status of San Jose and Santa Clara	Postpones decision regarding development of additional water to make San Jose and Santa Clara permanent customers.	By purchasing water from the Regional Water System, San Jose and Santa Clara share in system costs, thereby lowering rates for other users. This amendment cleans up timeline language related to possible future changes to their status (and increased supply for other BAWSCA agencies).

**Table 1: Summary of Water Supply Agreement Amendments and Key Benefits**

Amended Item	Description	Benefits
4. Classification of certain system assets	Documents the classification of system assets as water, power, or joint. Modifies classification of seven projects on five upcountry assets.	Limits and mitigates BAWSCA agency exposure to financial risk. Reduces BAWSCA agency obligations by \$50.4 million immediately, and ensures BAWSCA agencies pay only their share of upcoming capital work (currently estimated at \$2 billion over 10 years). BAWSCA agency obligations during Fiscal Year 2018-19 are \$260 million. Mountain View pays approximately 6 percent of these obligations based on our proportional use of water.
5. The review process for SFPUC's Wholesale Capital Fund	Modifies capital fund "true-up" to an annual basis.	BAWSCA member agencies will continue to fund their share of capital projects, but the account balancing will be simpler.
6. The WSIP completion schedule	Updates an outdated deadline.	Provides consistency with adopted project schedules.
7. Language related to the Regional Groundwater Storage and Recovery Project	Clarifies partner responsibilities.	Better reflects how the RGSRP will be implemented.

**Minor Amendments**

Below is a list of the nonsubstantive updates and "cleanup" revisions included in the Amended Agreement reflecting the following items:

1. New and revised definitions;
2. Recent Individual Supply Guarantee transfers (including the 1 million gallons per day (MGD) transfer from Mountain View to the City of East Palo Alto and a 0.5 MGD transfer between the cities of Palo Alto and East Palo Alto);
3. Updated Wholesale Customers' share of Net Book Value of Existing Assets and share of Revenue-Funded Capital Expenditures;

4. An Amendment approved in 2013 in response to efforts from outside groups to drain Hetch Hetchy Reservoir;
5. Authority previously delegated to BAWSCA by its member agencies in 2014 to initiate, defend, and settle arbitration for matters subject to arbitration under the Agreement;
6. Cal Water's acquisition of Skyline County Water District; and
7. Revised mailing addresses for both BAWSCA and SFPUC.

### **Minimum Purchase Requirement**

Staff has had numerous conversations with BAWSCA over the past two years seeking to address the City's minimum purchase requirement, which obliges the City to pay for a specified amount of water even if the water is not used. Although the original intent of the minimum purchase requirement was to prevent agencies from shifting to alternative imported supplies, recent years of drought, long-term conservation, and increased recycled water use has caused the City's total water use to drop below its SFPUC minimum—a scenario that did not seem plausible when the Agreement was approved in 2009 because most agencies were well above their minimum purchase requirements and demand was projected to increase over time. SFPUC waived penalties during the drought, but now staff estimates the City will be charged approximately \$10 million for unused water during the five years immediately following the recent drought, due to SFPUC's minimum purchase requirement. The charge for Fiscal Year 2017-18 was \$2.96 million. The anticipated charge for Fiscal Year 2018-19 is \$2.86 million.

Though sensitive to the City's situation, BAWSCA declined to include this topic in the current amendments because the City's minimum purchase liability is not in the mutual financial interest of all member agencies. Any charges not paid by Mountain View would be borne, at least in part, by the other BAWSCA members. BAWSCA believes the current amendments are in the collective interest of all member agencies and wanted to keep the package noncontroversial. Consequently, staff secured an agreement from BAWSCA during the 2018 negotiations to actively explore options for a minimum purchase amendment separately and add wording to the resolution to that effect (included in Attachment 1).

Following completion of negotiations for the current amendments, BAWSCA has begun working toward a minimum purchase solution. Discussions to date have focused primarily on creating a mechanism for transferring minimum purchase requirements



from one BAWSCA agency to another in tandem with a supply guarantee transfer. The SFPUC is particularly interested in incentivizing intrasystem water transfers as a means of reducing the need for additional future water supplies (e.g., such as those required to make San Jose and Santa Clara permanent customers or to increase supplies for other BAWSCA agencies). Staff concurs that an amendment defining minimum purchase transfers could benefit the City, in particular if recognition for the 1 MGD water transfer to East Palo Alto, completed in 2017, were considered. Another amendment reducing minimum purchase requirements in the years immediately following a drought (e.g., to allow usage to return to normal) has been discussed but is not well supported. Staff will continue to work for changes to the minimum purchase requirement through a collaborative approach. Any amendment related to the minimum purchase would require approval from all parties signatory to the Agreement, and thus requires compromises to consider all parties' interests.

### **FISCAL IMPACT**

If adopted, the Amended Agreement is expected to have a positive impact on the City's water costs, offsetting future rate increases. Amendment 4, related to asset classification, is expected to have the largest impact, such that if the negotiated classifications were in place for Fiscal Year 2017-18, a financial obligation of \$50.4 million would have been eliminated for the BAWSCA agencies (out of an estimated \$2 billion of upcoming capital work expected over the next 10 years).

### **CONCLUSION**

On behalf of its 26 member agencies, BAWSCA has negotiated several amendments to the City's water supply agreement with San Francisco. These amendments affect several aspects of the Regional Water System, including capital project oversight, drought allocations, supply provisions for two agencies, asset classifications, account management, and the timeline and responsibilities for two specific projects. Based on an analysis of benefits provided by the amendments, staff recommends approving the Amended Agreement.

### **ALTERNATIVES**

1. Do not approve the amendments to the water supply agreement.
2. Provide other direction.

**PUBLIC NOTICING** – Agenda posting.

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- Attachments: 1. Resolution  
2. [Amended and Restated Water Supply Agreement](#) between the City and County of San Francisco and Wholesale Customers in Alameda County, San Mateo County, and Santa Clara County (November 2018)

cc: Bay Area Water Supply and Conservation Agency