City of Santa Barbara
Public Works Department

Memorandum

DATE: May 16, 2019

TO: Water Commission

FROM: Joshua Haggmark, Water Resources Manager

SUBJECT: Review of Council-Approved Term Sheet for Water Sales Agreement with Montecito Water District

RECOMMENDATION:

That Water Commission receive a presentation on the Council-approved Term Sheet for a Water Sales Agreement with Montecito Water District.

DISCUSSION:

From time to time, there are highly sensitive or high-profile matters that the City Council has asked to receive in advance of the Water Commission. The subject agreement was identified as one such item. So that the Water Commission may continue to advise Council when the Water Sales Agreement (WSA) is completed and brought back to Council for consideration, the Commission requested, as time permitted, that staff return and provide the same information and presentation made to Council in January 2019. Below is a brief summary followed by a copy of the staff report and presentation that went to Council on January 29, 2019.

In June 2016, the Montecito Water District (MWD) sent a letter to the City requesting that the Charles E. Meyer Desalination Plant (Desal Plant) operate as a regional water supply. At the direction of Council, City staff began negotiations with MWD, which continued through December 2018 and culminated in the drafting of a Term Sheet that outlines the governing principles, water pricing, and key concepts to be included in a WSA.

The Term Sheet contemplates a 50-year agreement that provides 1,430 acre feet (AF) of water annually to MWD. There are several governing principles that guided the negotiations and drafting of the Term Sheet:

- The WSA will not grant any ownership interest in the Desal Plant or Conveyance Pipeline;
- MWD is purchasing a wholesale supply of water and will pay the full annual contract amount even if the water is surplus to MWD’s needs (commonly referred to as a “take or pay” commitment);
- The City is committing to reasonably manage its potable water supplies in order to provide MWD a reliable water supply, subject to specified uncontrollable events;
- The City’s historical contributions to permitting and maintenance will be recognized in the WSA;
• The City may be excused from performance and MWD’s obligation to make payments may be reduced in the event of a water shortage emergency; and
• The expansion of the Desal Plant and construction of the Conveyance Pipeline are necessary, in the long term, to sell water to MWD.

The water price will be calculated by allocating costs in proportion to each agency’s share of the plant capacity, or in the case of variable operating costs, in proportion to actual water produced. In addition to the 1,430 AF, the City may offer, at its discretion, up to 445 AF of additional volume in any given contract year, with the price being determined in a similar proportionate manner as the 1,430 AF. Staff’s presentation to the Water Commission will discuss in more detail the governing principles and water pricing terms.

Due to the significant technical and legal costs associated with negotiating a complex agreement, the City and MWD entered into a funding agreement that provides for a sharing of costs for technical and legal services, and the costs for preliminary design of the Conveyance Pipeline that is necessary to deliver water to MWD.

City staff presented the draft Term Sheet to Council on January 29, 2019. Council approved the Term Sheet and directed staff to draft a WSA in accordance with the Term Sheet and prepare an Ordinance for Council’s consideration.
AGENDA DATE: January 29, 2019

TO: Mayor and Councilmembers

FROM: Water Resources Division, Public Works Department

SUBJECT: Montecito Water District Desalination Water Sales Agreement Status Update And Term Sheet Approval

RECOMMENDATION: That Council:

A. Receive an update on the status of negotiations with the Montecito Water District regarding a Water Sales Agreement in relation to the City’s Charles E. Meyer Desalination Plant as a potential regional water supply;

B. Approve the negotiated Term Sheet outlining the governing principles, water pricing, and key concepts to be included in a Water Sales Agreement; and

C. Direct staff to negotiate a draft Water Supply Agreement in accordance with the Term Sheet, and upon completion of negotiations, prepare an appropriate ordinance approving the Water Supply Agreement for Council consideration and adoption.

EXECUTIVE SUMMARY:

In June 2015, the City entered into a contract to reactivate the Charles E. Meyer Desalination Plant (Desal Plant). Around the same time, the Montecito Water District (MWD) approached the City with an interest in partnering in the reactivation of the Desal Plant to improve the reliability of MWD’s water supply. Negotiations with MWD have persisted and evolved over the years, and the staff of both agencies have recently reached consensus on a Term Sheet. The Term Sheet identifies the major deal points for a 50-year Water Sales Agreement, whereby the City will develop a new supply of 1,430 acre feet of water and sell it to MWD. If the Term Sheet is supported by both agencies, staff will draft a Water Sales Agreement to be brought back for consideration and potential approval.
DISCUSSION:

Background

The Desal Plant was constructed by the City as an emergency facility to supply water to the City, MWD, and the Goleta Water District (GWD) during the last drought (1987-1991). The Desal Plant was planned and Coastal Zone-permitted for a maximum capacity of 10,000 acre feet per year (AFY); however, only 7,500 AFY of water treatment capacity was constructed. Abundant rainfall in March 1992 ended the drought, and the Desal Plant was placed in standby mode. At that time, GWD and MWD indicated that they did not wish to continue to use the Desal Plant as an emergency water supply.

In June 2015, the City entered into a design/build/operate contract with IDE Americas, Inc., to reconstruct the Desal Plant. On June 16, 2015, MWD sent a letter to the City requesting that the Desal Plant operate as a regional water supply. On September 15, 2015, Council directed staff to initiate formal discussions with MWD regarding a potential Water Sales Agreement (WSA) involving the Desal Plant as a regional water supply. The parties began negotiations by entering into a Memorandum of Understanding (MOU), which set the parameters within which the parties agreed to negotiate. The MOU anticipated that negotiations would be concluded by January 1, 2016; however, negotiations resulted in no significant progress toward an agreement.

In February 2016, the City was again approached by MWD with a desire to continue discussions. Recognizing the significant technical and legal costs associated with negotiating a complex agreement, the City and MWD entered into a Funding Agreement. The Funding Agreement provided for a sharing of costs for technical and legal services, and the costs for preliminary design of a Conveyance Pipeline that is necessary to deliver water to MWD.

From August 2016 through January 2017, the City and MWD participated in negotiations that resulted in a Term Sheet. MWD presented the Term Sheet to its Board in February and March 2017 and received direction to explore other options for water supply resiliency. In March 2018, MWD revisited the potential for a WSA with the City, and the Board voted in support of restarting negotiations. On May 1, 2018, Council authorized staff to execute a new Funding Agreement with MWD and resume negotiations.

Negotiations Status Update

City and MWD staff have been actively meeting since April 2018 in an effort to develop a Term Sheet that could be used to draft a WSA. At this time, the City and MWD staff have reached consensus on the terms of an agreement and have agreed to bring the Term Sheet to their respective governing bodies for approval before proceeding further with development of a WSA. In summary, the Term Sheet contemplates a 50-year agreement whereby MWD would receive 1,430 AFY of water (Contract Water) from the
City. Currently, the Desal Plant has a production capacity of 3,125 AFY. This amount of water is needed for the City’s own purposes. In order to develop the Contract Water to sell to MWD, the production capacity of the Desal Plant must be increased. To accomplish this, the City plans to increase the production capacity to 5,000 AFY. In addition, a Conveyance Pipeline must be constructed from the Desal Plant to the Cater Water Treatment Plant Clearwell to deliver water to MWD. MWD would pay 64.6 percent of the costs of a new pipeline, which is approximately the cost of construction of a stand-alone facility from the Desal Plant to MWD’s delivery system.

The Term Sheet includes several governing principles that have guided the negotiations. They include the following:

- The City will own and operate the Desal Plant and the Conveyance Pipeline. The WSA will not grant any ownership interest in either the Desal Plant or the Conveyance Pipeline to MWD.

- MWD is purchasing a wholesale supply of water to be developed and made available by the City. In exchange for a reliable water supply, MWD will pay the full annual contract amount even if hydrological conditions make the Contract Water surplus to MWD’s needs (commonly referred to as a “take or pay” commitment). The price for the water includes a portion of the Desal Plant’s fixed and variable costs, as well as additional payments in consideration of the City’s investments and risks. In addition, MWD will pay a ratable portion of potential increases in Desal Plant costs that may result from future capital modifications or operating cost increases required in response to uncontrollable circumstances.

- The City is committing to provide MWD with a reliable water supply. Thus, the City will reasonably manage its potable water supplies, including the Desal Plant, such that the Contract Water fully exceeds the quantity of water needed to provide service to customers of the City’s water system within the City’s water service territory, and wholesale delivery of surplus water to future buyers outside of the City’s water service territory, if any. The City’s obligation to provide Contract Water to MWD will be subject to specified uncontrollable events and a shortage sharing provision.

- The Term Sheet recognizes the City’s unique contribution to the WSA as owner of the Desal Plant, including City expenditures and risks, such as the permitting and maintenance costs of the Plant dating back as early as 1995.

- The expansion of the Desal Plant and construction of the Conveyance Pipeline are necessary for the City to sell Contract Water to MWD. In addition, while these components are needed as a water supply, for operational convenience of the City’s potable water system, the City shall have the right to supply MWD water from the City potable water supply system as a whole.
These general principles and the specific deal points are described in further detail in the Term Sheet.

The Contract Water price will be calculated by allocating costs in proportion to the 1,430 AF and the Desal Plant capacity, or in the case of variable operating costs, in proportion to actual water produced. MWD will participate at a proportional level in the administrative costs associated with managing the operations of the Desal Plant, including the WSA and the contract for operations of the Plant. For the first 20 years of the agreement, an index-linked Water Supply Development Fee of $237,500 would be paid by MWD annually. MWD will also be responsible for contributing to a debt service coverage deposit and debt service reserve account. Lastly, the City may offer, at its discretion, up to 445 AF of additional volume in any given contract year, with the water price being determined in a similar proportionate manner as the 1,430 AF, except that it would not include additional costs for administration, capital reserve funding, and the water supply development fee, which are proportionately shared based on 1,430 AF.

Water non-delivery events and excuses from performance have been a key focus of the negotiations, especially since MWD has requested a 50-year term for the WSA. The Term Sheet describes uncontrollable circumstances in which the City’s obligation to deliver Contract Water may be excused and MWD’s obligation to make payments is reduced. It also contains a provision for shortage sharing in the event that the Desal Plant is fully operational, but there is a water shortage emergency resulting from a catastrophic event or extended drought that causes a reduction of the City’s other water supplies. Under the Term Sheet, a water shortage emergency would allow the City to reduce Contract Water deliveries if the Desal Plant has been expanded to 7,500 AFY and the City’s other water supplies are reduced to the point that the City has insufficient water to meet minimum customer service needs. In this extreme scenario, the City would be excused from performance to the extent that a portion of the 1,430 AFY is required, along with available supplies, to meet the City’s basic needs for human consumption, sanitation, and other critical services such as fire protection, hospitals, clinical care, schools, or industry needs for employment of workers within the City, as determined by Council.

If there is a regional drought or other water shortage emergency affecting both the City and MWD (as declared by the governing bodies of the City and MWD, or by the Governor), an assessment of available water necessary to meet basic needs for human consumption, sanitation, and other critical services will be conducted for both agencies. Available water will be distributed between both agencies in such a way that the respective residential customers of each agency receive the same health and safety basic needs based on gallons per capita per day; other critical service needs will be apportioned equitably. In such shared allocation circumstance, the amount of water provided to MWD may be less than, but shall not exceed, the 1,430 AFY.

Staff has been meeting on an as-needed basis with the Council-appointed ad hoc Desal Negotiations Advisory Committee. The Committee last met on January 16, 2019 and
recommended that the Term Sheet be brought back to Council for approval before staff proceeds with drafting of the WSA.

Staff recommends approval of the negotiated Term Sheet outlining the governing principles, water pricing, and key concepts to be included in a Water Sales Agreement. Drafting of the WSA will likely take several months, given the complexity and financial commitment it will represent for MWD. A final WSA for consideration by Council is not anticipated until late spring 2019.

A copy of the Term Sheet is available for public review in the City Clerk’s Office.

Professional Service Contracts

An important element for finalizing negotiations of the WSA is negotiating a scope of work and a final cost for expansion of the Desal Plant from 3,125 AFY to 5,000 AFY. The contract with the design/build/operate contractor, IDE Americas, Inc., contemplated this capital modification. Staff requires technical support from Carollo Engineers to assist with the scoping, cost estimating, and loan support. Carollo has provided technical support to the City throughout construction, and its unique skills and knowledge make it the most qualified contractor to continue to provide support. If Council approves the negotiated Term Sheet, staff will return to Council next month with a recommendation for extra services with Carollo, which would be added to its existing contract by amendment. Additionally, staff will propose to amend the existing contract for on-call support with Mimimaga Engineering Group (MEG) to provide project management support for Desal Plant expansion. MEG is familiar with the Desal Plant project, and the extra services would be added to its existing contract by amendment.

Funding

Funding for the professional services above would be shared with the MWD under a previously approved Funding Agreement (Agreement 25,665) for the development of the WSA. Should the City move forward with Desal Plant expansion, the MWD would participate in costs consistent with the terms in the WSA.

Environmental Review

The Term Sheet is not a project as defined in the California Environmental Quality Act.

PREPARED BY: Joshua Haggmark, Water Resources Manager/MBH/js
SUBMITTED BY: Rebecca J. Bjork, Public Works Director
APPROVED BY: City Administrator’s Office
Objectives

• Provide an update on the status of negotiations with the Montecito Water District;
• Review key concepts and discuss the Term Sheet
• Receive Council approval of Term Sheet as basis for drafting and returning to Council for further action on a Water Sales Agreement
Negotiating Team

- Rebecca Bjork, Public Works Director
- Joshua Haggmark, Water Resources Manager
- Kelley Dyer, Water Supply Manager
- Daniel Hentschke, Assistant City Attorney
- Bob Samario, Finance Director
- Jennifer Tomaszewski, Finance & Treasury Manager
- Malcolm Hamilton, Water Analyst

Outline

- Background
- Principles of Negotiation
- Water Sales Agreement (WSA) Key Terms
- Funding for Plant and Pipeline
- Next Steps
- Recommendations
Background

2014
• City begins reactivation of Desalination plant
• MWD requests to participate

2015
• Staff directed to begin formal negotiations with MWD
• Negotiations end after no substantial progress

2016
• Funding Agreement established to share in costs of development of a Water Sales Agreement (WSA)
• Negotiations resume

Mar ’17
• Negotiations Paused by MWD

Background

Feb ’18
• MWD seeks to restart negotiations
• Authorizes Amendment to Funding Agreement for additional shared costs for development of WSA

May ’18
• Council authorizes staff to execute new Funding Agreement
• Negotiations resume

Jan ’19
• Negotiating teams agree to final draft Term Sheet for presentation to their respective Council and Board
Principles of Negotiations

- The City will own and operate both the Desal Plant and Conveyance Pipeline
  - WSA will not grant ownership interest
- “Take or Pay” terms
- Water pricing reflects costs to finance and operate the plant to produce the water supply
- Recognition of City’s historical expenditures and risks
- Protection of City Water Supplies
- Regional Water Supply Management

Water Sales Agreement Key Terms

1. Term of Agreement
2. Volume of Water
3. Source of Water
4. Excuses from Performance
5. Risk Management
6. Desal Conveyance Pipeline
7. Costs
8. Commencement of Deliveries
Water Sales Agreement Key Terms

• Term of Agreement
  - 50 Years

• Volume of Water
  - Base – 1,430 AFY
  - Take-if-Offered (TIO) – Up to 445 AFY

• Source of Water
  - City’s Discretion
  - With Desal water as the basis of the Contract Water

Water Sales Agreement Key Terms

• Excuses from Performance
  - Uncontrollable Events affecting Plant or Pipeline
    - City excused from delivery
    - District pays fixed costs and for water delivered, if any
  - Uncontrollable Events affecting District ability to take
    - City excused from delivery
    - District pays fixed costs
Water Sales Agreement Key Terms

• Critical Water Emergency
  - Severe Drought
    - After expansion to 7,500 AFY
      • Shortage Sharing based on same Health and Safety standard
      • Gallons per capita per day plus essential services
  - Other shortages affecting City
    - Reduction of deliveries as needed to meet City Health and Safety

Water Shortage Scenario #1
Low Demands (30% Reduction)
Extremely Limited Surface Water & Groundwater
Moderately Increase Desal

Cachuma/Gibraltar/Mission Tunnel
State Water Project
Groundwater
Future Direct Potable Reuse
Desal
Current Potable Demands (30% Conservation)
Water Shortage Scenario #2
Higher (Pre-Drought) Demands
Moderately Limited Surface Water & Groundwater
Moderately Increase Desal

- Cachuma/Gibraltar/Mission Tunnel
- State Water Project
- Groundwater
- Future Direct Potable Reuse
- Desal
- Current Potable Demands (30% Conservation)

Water Sales Agreement Key Terms

- Desal Conveyance Pipeline
  - Scope – Desal Plant to Cater Clearwell
    - New Pipeline (Shown in Purple)
    - Repurposing an Existing Pipeline (Shown in Red)
  - Costs Estimated at $12M-$15M
Water Sales Agreement Key Terms

• Cost Components
  - Capital Charge – Proportional to Capacity
  - Operations and Maintenance
    - Variable - Proportional based on production
    - Fixed – Proportional to Capacity
  - Water Supply Development Fee - $237,500 for 20 years
  - Conveyance Pipeline – MWD share 64.6%
  - Administration Fee – Proportional to Capacity
  - TIO Water – To reflect Capital and Operational costs
  - Grant Funding – Proportional to Plant Capacity

• Commencement of Deliveries
  - Upon completion of Conveyance Pipeline and Expansion of Plant to 5,000 AFY
    - If Plant temporarily remains at 3,125 AFY, commencement would be based on Conveyance Pipeline completion
  - Conveyance Pipeline is currently in design
    - Award of Construction anticipated in Summer 2019
    - Construction estimated to take ~18 months
Funding Overview

- Conveyance Pipeline
  - Funding to come from Water Fund Reserves above Council Policy
    - Largely funded from $10M Prop 1 Desal Grant
- Desal Plant Expansion
  - Seeking State Revolving Fund loan to finance expansion
    - Staff continues to look for additional grant funding to offset costs
- Staff will return to Council February 5, 2019 for authorization to increase consultant support to final Desal Plant Expansion negotiations and ongoing project management support

Benefits

- The Charles E. Meyer Desalination Plant was originally conceived as a regional water supply
- Regional Cooperation
  - Shared water supplies
  - Economies of scale
  - Shared Risk
  - Improved water quality
- Current Terms represent an equitable agreement
WSA Next Steps

• Draft Water Sales Agreement and return for Council approval by July 2019

Recommendations

A. Receive an update on the status of negotiations with the Montecito Water District; ✓

B. Approve the negotiated Term Sheet outlining the governing principles, water pricing, and key concepts to be included in a Water Sales Agreement; and

C. Direct staff to negotiate a draft Water Supply Agreement in accordance with the Term Sheet, and upon completion of negotiations, prepare an appropriate ordinance approving the Water Supply Agreement for Council consideration and adoption.