



City of Santa Barbara
Public Works Department

Memorandum

DATE: May 21, 2020
TO: Water Commission
FROM: Joshua Haggmark, Water Resources Manager
SUBJECT: Montecito Water District Water Supply Agreement Status Update

PURPOSE:

That Water Commission receive an update on the status of the drafting of the Montecito Water District Water Supply Agreement, which has been drafted to implement the conditions of the term sheet unanimously approved by the City Council in January 2019.

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. Extensive negotiations with MWD occurred over a period of years and in January 2019 both City Council and the Montecito Water District Board of Directors approved a Term Sheet. The Term Sheet identifies the major deal points for a 50-year Water Supply Agreement, whereby the City will make available 1,430 acre feet of water annually to the MWD. Staffs have now drafted an agreement consistent with the approved Term Sheet. The Water Supply Agreement is scheduled to be made publicly available on May 22, 2020 for public review.

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 designed, and permitted to provide a maximum capacity of 10,000 acre feet per year (AFY); however, only 7,500 AFY of water treatment membrane capacity was constructed at that time. 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. By 1997 all of the City's temporary permits had all been updated to reflect a permanent facility.

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 Supply 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.

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 shared 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 December 2019, the City and MWD participated in negotiations that resulted in a Term Sheet. In January 2019, the Term Sheet was presented and approved by the MWD Board and City Council. Direction was given by both entities to develop a WSA based on the Term Sheet and to return for approval. At this time, drafting of the WSA has been completed and the document is tentatively set to be made publicly available on May 22, 2020. Given the time that has passed in drafting the WSA, staff are revisiting the terms of the agreement for the benefit of Water Commission and the Community.

WSA Terms Summary

The WSA is a 50-year agreement providing MWD 1,430 AFY of water from the City. Currently, the Desal Plant has a production capacity of 3,125 AFY. This amount of water is anticipated to be needed for the City's own purposes over the life of the agreement. In order to provide sufficient surplus supplies to sell to MWD over the life of the agreement, the treatment production capacity of the Desal Plant is expected to be increased within the permitted capacity of 10,000 AFY. To accomplish this, the City plans to approach incremental increases in treatment production capacity based on forecasted needs consistent with our water supply plan and three year supply look-ahead. In addition, a Conveyance Pipeline Project will be constructed to allow water to be pumped from the Desal Plant to the Cater Water Treatment Plant finished water reservoir, known as the Cater Clearwell, for delivery to MWD. MWD will pay 64.6 percent of the costs of the capital costs associated with the Conveyance Pipeline Project.

Consistent with the approved Term Sheet the WSA includes the following key provisions:

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

- MWD is purchasing a wholesale supply of water 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 water surplus to MWD's needs (commonly referred to as a "take or pay" commitment). The price based on 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 participate 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 manage its water supplies, including the Desal Plant, such that the annual amount of water committed to MWD is surplus to the quantity of water needed to provide service to customers of the City's water system. The City's obligation to provide water to MWD will be subject to specified uncontrollable events and a shortage sharing provision.
- The WSA recognizes the City's unique contribution 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.
- Expansion of the Desal Plant and construction of the Conveyance Pipeline Project are necessary to ensure the City can reliably meet its supply obligations to MWD over the term of the agreement. The City shall have the right to supply MWD water from the City potable water supply system as a whole.

The water price will be calculated by allocating costs in proportion to the 1,430 AFY and the Desal Plant capacity (3,125 AFY), or in the case of variable operating costs, in proportion to actual water produced. MWD will participate at a proportionate 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 term of the agreement, an index-linked Water Supply Development Fee of \$237,500 will be paid by MWD annually; this essentially reimburses the City rate payers for funds previously expended on the Desal plant. MWD will also be responsible for contributing to a debt service coverage deposit.

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 WSA describes uncontrollable circumstances in which the City's obligation to deliver 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 such that water for basic health and safety is needed. Under the Term Sheet, a water shortage emergency would

allow the City to reduce 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 1,430 AFY.

Funding

The WSA has a direct benefit to City customers in that it will help reduce the costs and mitigate risks associated with operating the Desal Plant, which will take pressure off of future water rate increases to City customers. The City's water supplies are currently in a state where water can be provided to MWD without increasing the treatment capacity of our Desal Plant or having to purchase supplemental water over the next three years. Initially, the City will fund the construction of the Conveyance Pipeline Project. Ultimately, the District will be responsible for 64.6 percent of Conveyance Pipeline Project capital costs and 45.7 percent of the Desal Plant capital costs (at the current capacity of 3,125 AFY). Funding to build the conveyance pipeline project will be fronted by the City and repaid by the District in the future. Staff have successfully secured a \$1 million grant from the Department of Water Resources to be used for the construction of the conveyance pipeline. In addition to ensuring the City's ability to meet the WSA obligations, the pipeline will also significantly improve the reliability and water quality in the City's water system, enabling the pumping of Desal water anywhere in the City's service area.

If the WSA is approved, water deliveries will commence on January 1, 2022, the City will receive approximately \$4 million in revenue annually for the delivery of 1,430 AFY to the MWD. Staff believe that the WSA is both an example of good regional cooperation and a fair deal for City water customers that fully reimburses the City for the costs of providing MWD with water.