



CITY OF
**PALO
ALTO**

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VIA FIRST CLASS MAIL AND EMAIL

Santa Clara Valley Water District Board of Directors
Joint Recycled Water Committee – City of Palo Alto/SCVWD
Chief Executive Officer Norma Camacho
5750 Almaden Expressway
San Jose, CA 95118-3686

Dear Members of the Santa Clara Valley Water District Board, Members of the Joint Recycled Water Committee of the City of Palo Alto and SCVWD, and SCVWD Chief Executive Officer Norma Camacho:

At the September 2018 meeting of the Joint Recycled Water Committee, the City of Palo Alto's continuing concern about the unfair collection of the State Water Project (SWP) tax from Palo Alto property owners was briefly discussed. The purpose of this letter is to reassert the City's position that the Santa Clara Valley Water District's longstanding practice of taxing property owners in Palo Alto and other parts of Santa Clara County who do not receive water from the SWP to pay for the entirety of the District's SWP contractual obligations, rather than attempting to fund those costs from rate payers who use SWP water, is clearly inequitable and legally tenuous. For many years, the City has expressed a willingness to work with the District to address these concerns shared by the City and other affected jurisdictions, but the District has taken no concrete action to redress the inequity and has instead continued to fully fund its SWP obligations through taxation without adequate justification. The City urges the District to take immediate steps to eliminate the ad valorem property tax collection in Palo Alto, develop revised rates to address the inequities in assessing Palo Alto taxpayers the full cost of a system they cannot and do not use, or implement another mechanism that provides tangible credit for SWP property taxes collected in Palo Alto. The City is prepared to work with the District to those ends, and requests a meaningful response and action to address the inequities perpetuated by the District's funding practice.

State Water Project

The Burns-Porter Act (Water Code §§12930 *et seq.*), approved by California voters in 1960, authorized the construction and operation of specified state water facilities, including dams, reservoirs, levees and an aqueduct system to convey water from the Sacramento-San Joaquin Delta to other parts of the state and a \$1.75 billion bond for initial construction of

these facilities. The Act directed the State Department of Water Resources (DWR) to enter into contracts to sell water and power, so that revenue from those sales would pay to operate the facilities and repay the bond.

The Santa Clara Valley Water District ("SCVWD" or "District") is one of 29 contractors that purchases SWP water from the State. The SWP is one source of potable water that the District receives and sells to water customers in many areas of Santa Clara County. The District has a long-term contract with the DWR for deliveries from the SWP system. As part of that long-term obligation, the District can collect SWP costs through water rates, though the District has authority to collect funding shortfalls through property taxation where necessary.

District's Reliance and Burden on Taxpayers, Not Water Rate Payers, to Fund the District's SWP Obligations is Inequitable

Some parts of the County, including Palo Alto, do not receive SWP water from the District. Instead, their potable water is supplied by and through contracts with the San Francisco Public Utilities Commission (SFPUC) from the Regional Water System (RWS). Although these property owners do not rely on SWP water, the District for decades has imposed an ad valorem tax (based on the assessed property value) on property owners throughout the County (even those who do not benefit from SWP water) to meet 100% of its SWP contract obligations, instead of recovering those costs through water rates charged to its customers who use and benefit from SWP water. As of July 1, 2018, property owners pay a tax of approximately \$42 per \$1 million in property valuation to fund the District's SWP obligations. A property owner who directly benefits from SWP water pays the same as a property owner who does not receive SWP water. Palo Alto taxpayers collectively pay between \$1 million and \$1.5 million per year in property taxes to fund the SWP, effectively subsidizing the rates of SWP water consumers. These property owners who receive water from the RWS also separately pay for infrastructure and other contract costs associated with their water provider – SFPUC – which SWP water consumers do not pay.

In the past, the District acknowledged the inequity in charging taxpayers for a water system they do not use by providing jurisdictions who receive RWS water with an "in-county credit" to offset the amount paid for the SWP tax, but in 1982 stopped providing that credit to North County jurisdictions including Palo Alto. The District has continued providing the in-county credit in the South County, however.

District's SWP Funding Practice is Inconsistent with State Law; District Has Not Shown That Its Sole Reliance on Taxation to Fully Fund Its SWP Obligations is Necessary

The District has the authority to fund its SWP costs in a variety of ways, including through rates charged to water users. While property taxes may also be utilized, according to the District's contract with the DWR, the Water Code, and the Burns-Porter Act, property taxes are intended to be a secondary collection method that provides assurance to bond holders that

debts will be paid in years when other funding sources are insufficient to meet SWP costs. State law expresses a clear preference that water charges fund SWP obligations before taxation and that property taxes may be increased only if it is infeasible to increase the fees or rates of customers using system water or power or pumping groundwater. This hierarchy of funding sources is reflected in the legislative history of the Burns-Porter Act, as described at some length by the Attorney General:

The Burns-Porter Act expresses a preference for water charges over taxation in that it provides that the state system would be supported primarily by the sale of water and power. It directs the Department of Water Resources to enter into contracts to sell the water and power and it pledges the revenues from those contracts to the operation of the system and the service of the bonded debt. (Wat. Code § 12937.) The Legislature and the voters clearly contemplated an essentially closed, self-supporting system. The Act even provides that revenues from water and power sales would be sufficient to reimburse the California Water Fund for amounts that had been expended for the construction of the State Water Resources Development System. (Wat. Code § 12937(b)(3).) The ballot argument in favor of the Burns-Porter Act echoed this preference:

‘The program will not be a burden on the taxpayer; no new state taxes are involved; the bonds are repaid from project revenues through the sale of water and power. In other words, it will pay for itself.’ (Voters Pamphlet, Nov. 8, 1960, p.3; emphasis in original.)

The Burns-Porter Act and water contracts under that act do contemplate that local taxes may be required to pay the obligation to the state, and authorize such taxation. However, that authority is expressly limited to situations where it is necessary. The Burns-Porter Act incorporates by reference the Central Valley Project Act. ... The Central Valley Project Act authorizes local taxation, but only where necessary:

‘The governing body [of any public agency that has contracted with the State] shall whenever necessary, levy upon all property owners not exempt from taxation, a tax or assessment sufficient to provide for all payments under the contract then due or to become due within the current fiscal year or within the following fiscal year before the time when money will be available from the next general tax levy.’ (Wat. Code § 11652; emphasis added.)

Similarly, the contract with the Metropolitan Water District authorizes taxation only where revenue from the sale of water proves insufficient:

'If in any year the District fails or is unable to raise sufficient funds by other means, the governing body of the District shall levy upon all property in the District not exempt from taxation, a tax or assessment sufficient to provide for all payments under this contract then due or to become due within that year.' (Metropolitan Water District of Southern California contract, article 34(a); emphasis added.)

(61 Ops.Cal.Atty.Gen. 373 (1978).) SCVWD's 1961 contract with DWR uses this same language as in the Metropolitan Water District contract cited by the Attorney General.

Disregarding both state law and the fair treatment of County taxpayers, the District has made no effort to collect SWP from water rates; nor has it demonstrated an inability to raise funds by means other than taxation or, conversely, a necessity to utilize taxation. The District has simply, as a default, resorted to taxation to fund 100% of its SWP costs. The course of action taken by the District is not the norm among local water districts throughout the state. In contrast, other local water districts collect their SWP costs at least partially from retail water sales, not taxes. For example, Metropolitan Water District (MWD) and Alameda County Water District rely on water rates, not taxes, to fund a significant portion of their SWP obligations.

Local water districts that undertake SWP funding in the same manner as the District are susceptible to legal challenge by taxpayers, advocacy groups, and public agencies. The City is aware of at least one citizen-initiated effort in another part of the state to redress such unfair taxation, and the impetus to challenge these practices will become greater if SWP costs increase substantially as anticipated.

Conclusion

The District should take prompt action to correct its practice of relying on property taxpayers to meet 100% of its SWP obligations, rather than waiting until litigation is filed against it. Taking corrective action would be fair to County taxpayers who receive no SWP water and would be consistent with state law and the promises made to voters when the SWP was approved. The City remains open to working with the District collaboratively to achieve a solution to this longstanding problem.

Sincerely,



Molly Stump
City Attorney



Ed Shikada
Assistant City Manager