

Staff Report

In accordance with the District Act, District staff has prepared an annual report on the Protection and Augmentation of Water Supplies, which was filed with the Clerk of the Board on February 26, 2021.

The Report is the 50th annual report on the Santa Clara Valley Water District's (Valley Water) activities in the protection and augmentation of the water supplies. This Report is prepared in accordance with the requirements of the District Act, section 26.5. The Report provides information on water requirements and water supply availability, and financial analysis of Valley Water's water utility system. The financial analysis includes future capital improvement and maintenance requirements, operating requirements, financing methods and staff's recommended groundwater production and other water charges by zone for fiscal year 2021-22.

The Rate Setting Process

According to Section 26.3 of the District Act, proceeds from groundwater production charges can be used for the following purposes:

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.

This year, as in past years, staff has carefully evaluated the activities that can be paid for by groundwater production charges. The work of Valley Water is divided into projects. Every project has a detailed description including objectives, milestones, and an estimate of resources needed to deliver the project. To ensure compliance with the District Act, each project manager must justify whether or not groundwater production charges can be used to pay for the activities associated with their project. The financial analysis presented in the annual report is based on the financial forecasts for these vetted projects.

Resolution 99-21 guides staff in the development of the overall pricing structure based on principles established in 1971. The general approach is to charge the recipients of the various benefits for the benefits received. More specifically, pricing is structured to manage surface water, groundwater supplies and recycled water conjunctively to prevent the over use or under use of the groundwater basin. Consequently, staff is very careful to recommend pricing for groundwater production charges, treated water charges, surface water charges and recycled water charges that work in concert to achieve the effective use of available resources.

This year's rate setting process is being conducted consistent with Board Resolutions 99-21 and 12-10. In light of the Supreme Court finding that Proposition 218 is inapplicable to groundwater production charges, only the surface water charge setting process will mirror the process described in Proposition 218 for property-related fees for water services. The rate setting process for both groundwater and surface water is consistent with Proposition 26 requirements that the groundwater production and surface water charges are no more than necessary to cover reasonable costs and bear a fair or reasonable relationship to the rate payor's burdens on or benefits received from the groundwater and surface water programs.

As in the past, the Board will continue to hold public hearings and seek input from its advisory committees and the public before rendering a final decision on groundwater production and other water charges for FY 2021–22.

Staff Recommendations

Exhibit 1 shows the recommended groundwater production charges and other charges for FY 2021–22.

Exhibit 1
Summary of Charges
(Dollars Per Acre Foot, \$/AF)

	Dollars Per Acre Foot		
	FY 2019–20	FY 2020–21	Proposed Maximum FY 2021-22
Zone W-2 (North County)			
Basic User/Groundwater Production Charge			
Municipal & Industrial	1,374.00	1,374.00	1,506.00
Agricultural	28.86	28.86	85.38
Surface Water Charge			
Surface Water Master Charge	37.50	37.50	41.10
Total Surface Water, Municipal & Industrial*	1,411.50	1,411.50	1,547.10
Total Surface Water, Agricultural*	66.36	66.36	126.48
Treated Water Charges			
Contract Surcharge	100.00	100.00	115.00
Total Treated Water Contract Charge**	1,474.00	1,474.00	1,621.00
Non-Contract Surcharge	200.00	200.00	200.00
Total Treated Water Non-Contract Charge***	1,574.00	1,574.00	1,706.00
Zone W-5 (Llagas Subbasin)			
Basic User/Groundwater Production Charge			
Municipal & Industrial	481.00	467.00	488.50
Agricultural	28.86	28.86	85.38
Surface Water Charge			
Surface Water Master Charge	37.50	37.50	41.10
Total Surface Water, Municipal & Industrial*	518.50	504.50	529.60
Total Surface Water, Agricultural*	66.36	66.36	126.48
Recycled Water Charges			
Municipal & Industrial	461.00	447.00	468.50
Agricultural	56.26	56.26	112.78
Zone W-7 (Coyote Valley)			
Basic User/Groundwater Production Charge			
Municipal & Industrial	481.00	481.00	530.50
Agricultural	28.86	28.86	85.38

	Dollars Per Acre Foot		
	FY 2019–20	FY 2020–21	Proposed Maximum FY 2021-22
Zone W-7 (Coyote Valley)			
Surface Water Charge			
Surface Water Master Charge	37.50	37.50	41.10
Total Surface Water, Municipal & Industrial*	518.50	518.50	571.60
Total Surface Water, Agricultural*	66.36	66.36	126.48
Zone W-8 (Uvas/Chesbro)			
Basic User/Groundwater Production Charge			
Municipal & Industrial	481.00	327.00	341.50
Agricultural	28.86	28.86	85.38
Surface Water Charge			
Surface Water Master Charge	37.50	37.50	41.10
Total Surface Water, Municipal & Industrial*	518.50	364.50	382.60
Total Surface Water, Agricultural*	66.36	66.36	126.48

Staff proposes a maximum 9.6% increase in the North County Zone W-2 Municipal and Industrial groundwater production charge from \$1,374 per acre foot (AF) to \$1,506/AF. Staff recommends increasing the treated water surcharge on treated water delivered under the contracts with retail agencies to \$115/AF, and maintaining the non-contract treated water surcharge at \$200/AF. The proposal equates to a monthly bill increase for the average household of \$4.55 to \$5.06 or about 15 to 17 cents a day.

In the South County Zone W-5, staff proposes a maximum 4.6% increase in the M&I groundwater production charge from \$467/AF to \$488.50/AF. The proposal equates to a monthly bill increase for the average household of \$0.74 or about 2 cents per day.

In the South County Zone W-7, staff proposes a maximum 10.3% increase in the M&I groundwater production charge from \$481/AF to \$530.50/AF. The proposal equates to a monthly bill increase for the average household of \$1.70 or about 6 cents per day.

In the South County Zone W-8, staff proposes a maximum 4.4% increase in the M&I groundwater production charge from \$327/AF to \$341.50/AF. The proposal equates to a monthly bill increase for the average household of \$0.50 or about 2 cents per day.

Customers in both areas of North and South County may also experience additional charge increases enacted by their retail water providers.

Based on Board direction, the proposed maximum agricultural groundwater production charge is 25% of M&I for Zone W-8, which would mean an increase from \$28.86/AF (6% of Zone W-7) to \$85.38/AF. The proposed maximum groundwater production charge for agricultural rates would translate to an increase of up to \$9.41 per month per acre, assuming 2 (two) acre-feet of water usage per acre per year. As discussed at the January 12, 2021 Board meeting, staff offers an alternative scenario for Board consideration due to the passage of Measure S in November of 2020, which has relieved some financial pressure for Valley Water in the future. Under this alternative, the agricultural groundwater charge would be set at 10% of the Zone W-8 M&I groundwater charge, or \$34.15/AF in FY 2021-22.

Staff recommends a maximum 9.6% increase to the surface water master charge from \$37.50/AF to \$41.10/AF to align revenues with the costs related to managing, operating and billing for surface water diversions. This increase results in an increase up to 9.6% in the overall North County municipal and industrial surface water charge. For South County, the overall increases in the basic user charge and surface water master charge result in a total surface water charge for M&I water as follows: \$529.60/AF, or an up to 5 percent increase for Zone W-5; \$571.60/AF, or an up to 10.2 percent increase for Zone W-7; and \$382.60/AF, or an up to 5 percent increase for Zone W-8. The total agricultural surface water charge in any zone represents up to a 90.6 percent increase at \$126.48/AF.

For recycled water, staff recommends increasing the M&I charge up to 4.8 percent to \$468.50/AF. For agricultural recycled water, the proposed maximum is a 100.5 percent increase to \$112.78/AF. The increase maximizes cost recovery while concurrently providing an economic incentive to use recycled water. This pricing is consistent with the provisions of the "Wholesale-Retailer Agreement for Supply of Recycled Water Between Santa Clara Valley Water District and City of Gilroy." The proposed rate changes maximize cost recovery while concurrently providing an economic incentive to use recycled water.

The proposed maximum groundwater production charges for FY 2021-22 are necessary to pay for supplemental water purchases in preparation for drought, investments in water supply infrastructure rehabilitation and upgrades, and new water supply reliability investments. The need to purchase supplemental water is driven by the fact that the next drought appears to be on our doorstep, coupled with the recent lowering of water levels at Anderson Reservoir.

A key infrastructure rehabilitation investment is the Anderson Dam Seismic Retrofit, which is a \$650 million project that will help ensure public safety and restore operational capacity. A key water supply reliability investment is the Pacheco Reservoir Expansion project, estimated to cost roughly \$2.5 billion, would provide an additional 80,000 acre-feet of water storage capacity.

Given the size of the Pacheco Reservoir Expansion project investment, staff has also prepared an alternative rate projection scenario that shows the impact to the water rate projection if the Pacheco Reservoir Expansion Project were excluded. Under that scenario, the increase to the North County Zone W-2 Municipal and Industrial groundwater production charge would be 8.5% instead of 9.6% for FY 2021-22 and the next 7 years into the future. Also, under this alternative rate scenario, for FY 2021-22 and the next 7 years into the future, the increase to the South County Zone W-5 Municipal and Industrial groundwater production charge would be 3.8% instead of 4.6%; in Zone W-7 it would be 8.1% instead of 10.3%; and in Zone W-8 it would remain 4.4% since Zone W-8 does receive a direct benefit from the Pacheco Reservoir Expansion project.

Staff recommends setting the State Water Project Tax at \$26 million for FY 2021–22. This translates to a property tax bill for the average single-family residence of roughly \$40.00 per year. Valley Water incurs an annual indebtedness to the State of California pursuant to its Water Supply Contract dated November 20, 1961. Such indebtedness is proportional to Valley Water's allocation of water from the State Water Project and pays for construction, maintenance and operation of state water project infrastructure and facilities. Staff anticipates that Valley Water's contractual indebtedness to the State under the State Water Supply Contract for FY 2021–22 will be at least \$28 million. Staff's recommendation regarding the State Water Project tax is consistent with Valley Water's past practice and with the approach of other water districts and agencies that maintain State water supply contracts.

Projections

Exhibit 2 shows actual and projected District-managed water use. FY 2019–20 water usage came in at 231,000 AF, slightly higher than the projected usage. For the current year, FY 2020–21, staff estimates that water usage will be approximately 230,000 AF or higher, and roughly a 20% reduction versus calendar year 2013. For FY 2021–22, total District-managed water use is projected at 232,000 AF, which is about a 1% increase relative to the FY 2020-21 estimated actual. The FY 2021-22 water usage estimate represents a 19% reduction relative to calendar year 2013. Water use is projected to ramp up to 236,000 AF by FY 2025-26.

Exhibit 2
District-managed Water Use Projection (1,000's AF)

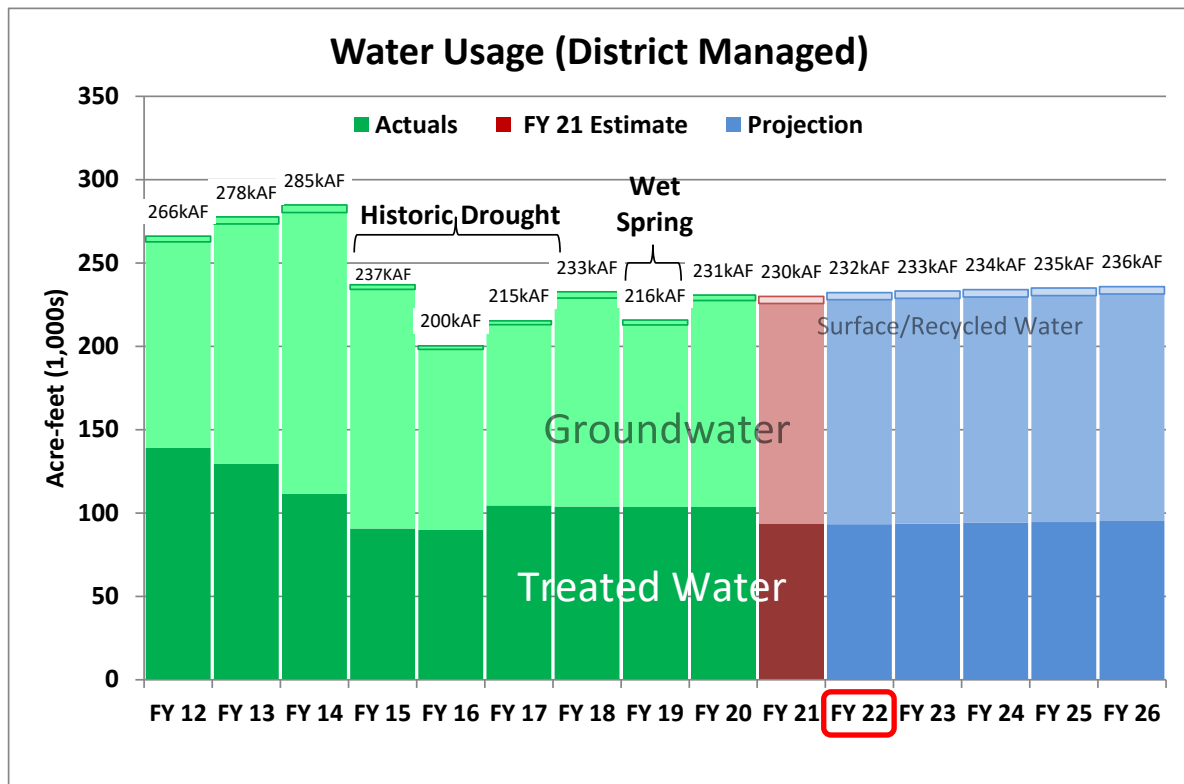


Exhibit 3 shows key financial indicators with staff's recommendation projected to FY 2026-27. The debt service coverage ratio, which is a ratio of revenue less operations expenses divided by annual debt service, is targeted at 2.0 or better which helps to ensure financial stability and continued high credit ratings keeping cost to borrow low.

Exhibit 3

5-Year Water Charge and Financial Indicator Projection

	Adjusted Budget						
Base Case	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27
No. County (W-2) M&I GWP charge (\$/AF)	\$1,374	\$1,506.00	\$1,651	\$1,809	\$1,983	\$2,173	\$2,382
Y-Y Growth %	0.0%	9.6%	9.6%	9.6%	9.6%	9.6%	9.6%
So. County (W-5) M&I GWP charge (\$/AF)	\$467	\$488.50	\$511	\$534	\$559	\$585	\$612
Y-Y Growth %	-2.9%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%
So. County (W-7) M&I GWP charge (\$/AF)	\$481	\$530.50	\$585	\$645	\$712	\$785	\$866
Y-Y Growth %	0.0%	10.3%	10.3%	10.3%	10.3%	10.3%	10.3%
So. County (W-8) M&I GWP charge (\$/AF)	\$327	\$341.50	\$357	\$372	\$389	\$406	\$424
Y-Y Growth %	-32.0%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%
Operating & Capital Reserve	\$92,217	\$45,020	\$51,639	\$55,726	\$61,028	\$57,652	\$57,491
Supplemental Water Supply Reserve (\$K)	\$15,477	\$15,877	\$16,277	\$16,677	\$17,077	\$17,477	\$17,877
Drought Contingency Reserve (\$K)	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
Sr. Lien Debt Svc Cov Ratio (1.25 min)	2.54	2.08	2.14	2.12	2.52	2.66	2.62
South County (Deficit)/Reserves (\$K)	\$18,356	\$15,677	\$14,995	\$14,143	\$13,816	\$15,942	\$18,498

A significant portion of the projected increases in the groundwater production charge are driven by the capital improvement program as shown in Exhibit 4. Over \$4.8 billion in capital investments are planned for the next 10 years. Approximately \$2.2 billion is projected to be spent on the Pacheco Reservoir Expansion Project that would provide an additional 80,000 acre-feet of water storage capacity. Approximately \$549 million is projected to be spent on the Anderson Dam Seismic Retrofit, which would help ensure public safety and restore operational capacity. The remaining portion of the capital program is primarily dedicated to asset management of Water Utility Enterprise facilities throughout the county.

Over the next 10 years, operating outlays are projected to increase an average of 4.7% per year driven by: 1) the ramp up of payments associated with the Delta Conveyance Project; and 2) the beginning of operations of the Expedited Purified Water Project in FY 2027-28, which would produce 9,000 to 12,000 AF of new water supply; and 3) inflation. Debt service is projected to rise from \$52.6 million in FY 2021–22 to \$194.4 million in FY 2030–31 as a result of periodic debt issuances to fund the capital program.

Exhibit 4
Cost Projection by Cost Center (\$M)

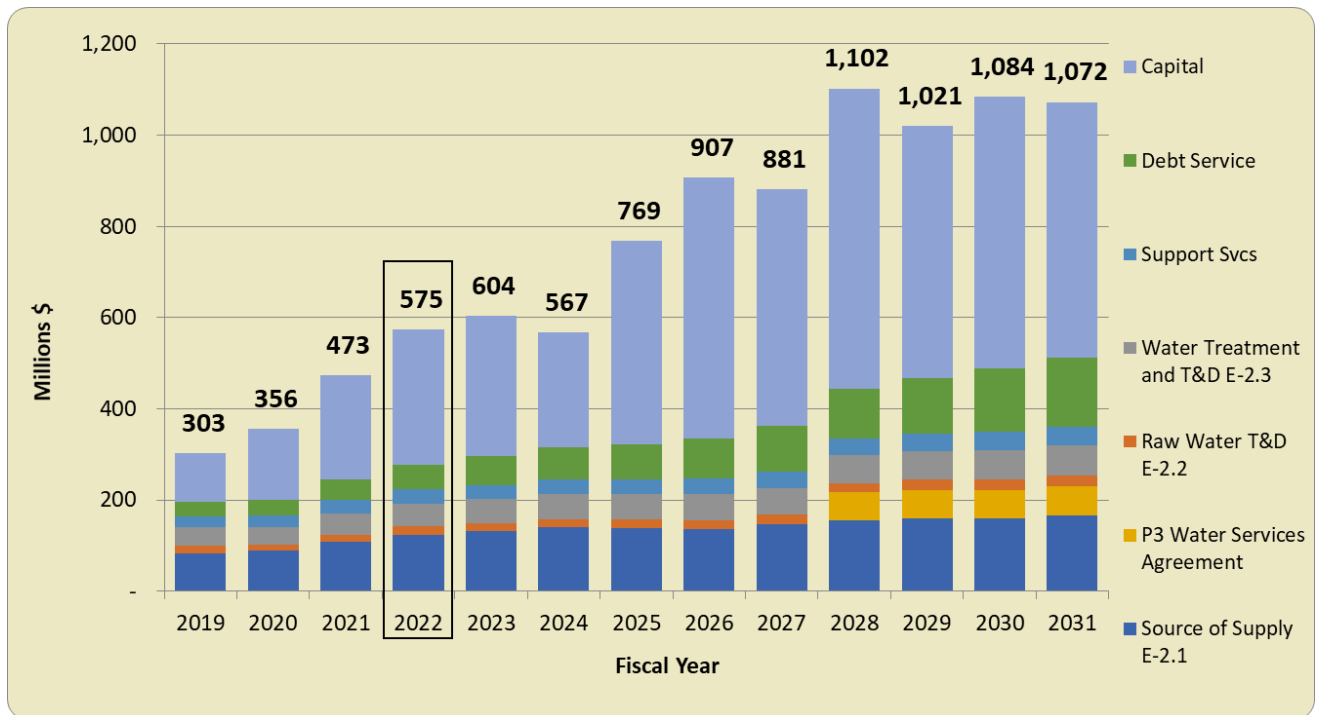


Exhibit 5 shows the groundwater production charge projection for the next 10 years and assumes a continuation of the level of service provided in FY 2020–21 and funding of the preliminary FY 2021-22 Capital Improvement Program (CIP). Note that there are initiatives and potential uncertainties that could result in the identification of additional capital or operations projects that are not reflected in projection.

Exhibit 5 10-Year Groundwater Charge Projection

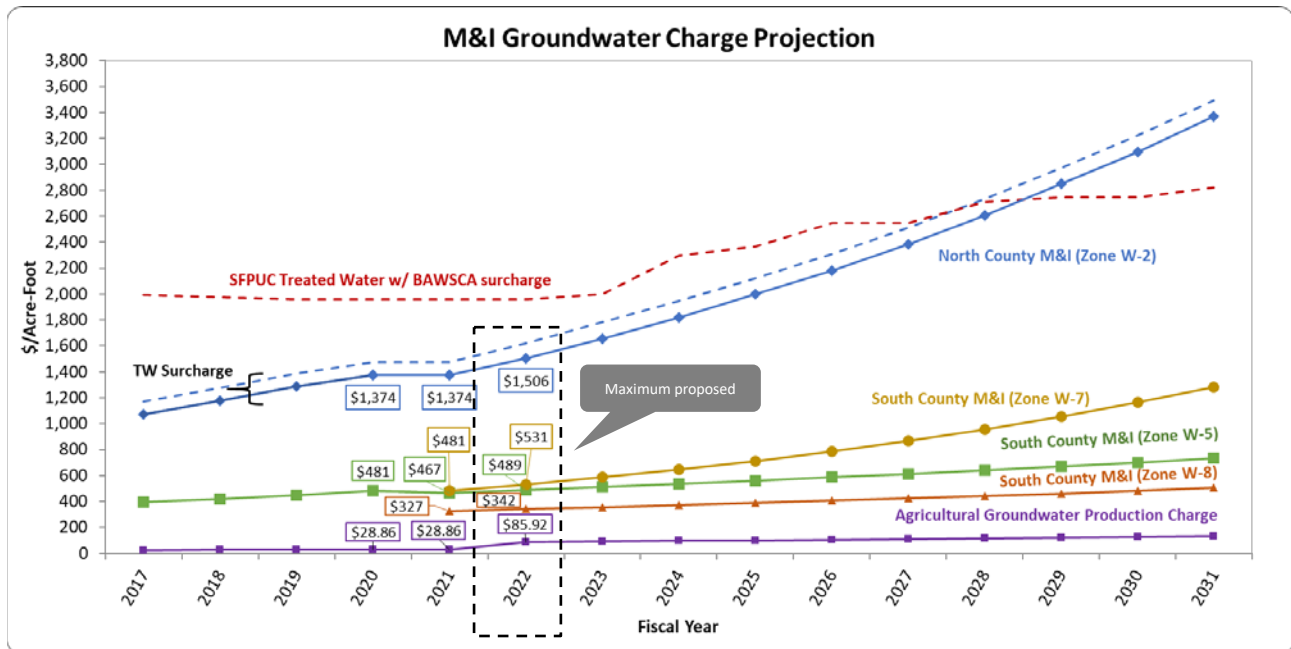


Exhibit 6 shows a comparison of the adjusted proposed groundwater production and treated water charges relative to the anticipated increases for the following similar agencies: Metropolitan Water District, Orange County Water District, San Diego County Water Authority, San Francisco PUC (Hetch Hetchy), and Zone 7.

Exhibit 6 Anticipated FY 2021–22 Water Charge Increases for Similar Agencies

	FY 19	% inc. '19 to '20	FY 20	% inc. '20 to '21	FY 21	Projection FY 22 ³
SCVWD North W-2 (Groundwater prdctn per AF)	\$1,289	6.6%	\$1,374	0.0%	\$1,374	9.6%
SCVWD North W-2 (Treated Water per AF)	\$1,389	6.1%	\$1,474	0.0%	\$1,474	10.0%
SCVWD South W-5 (Groundwater prdctn per AF)	\$450	6.9%	\$481	-2.9%	\$467	4.6%
SCVWD South W-7 (Groundwater prdctn per AF)	\$450	6.9%	\$481	0.0%	\$481	10.3%
SCVWD South W-8 (Groundwater prdctn per AF)	\$450	6.9%	\$481	-32.0%	\$327	4.4%
Metropolitan WD (Untreated Water per AF) ¹	\$846	3.1%	\$873	3.5%	\$904	3.8%
Metropolitan WD (Treated Water per AF) ¹	\$1,165	2.6%	\$1,196	2.6%	\$1,227	2.8%
Orange County WD (Groundwater per AF)	\$462	5.4%	\$487	0.2%	\$488	TBD
San Diego County WA (Treated Water per AF) ¹	\$1,619	2.9%	\$1,666	2.7%	\$1,710	TBD
San Francisco PUC (Treated Water per AF) ²	\$1,786	0.0%	\$1,786	0.0%	\$1,786	0.0%
Zone 7 (Treated Water per AF) ¹	\$1,401	8.8%	\$1,525	2.4%	\$1,561	0.0%

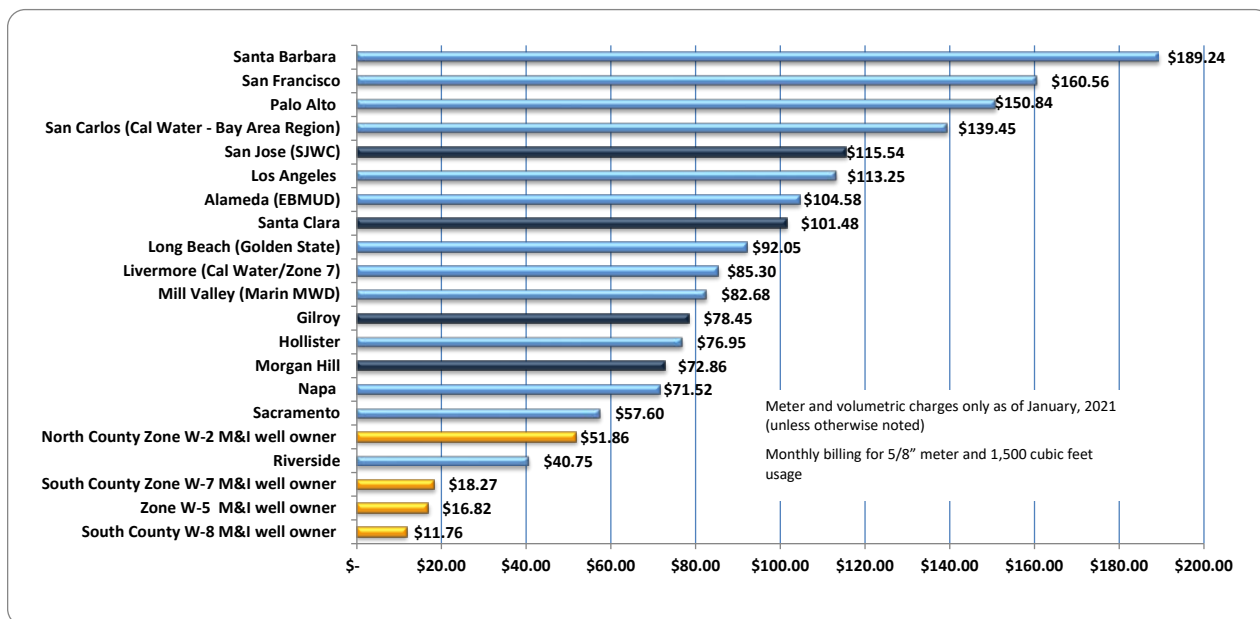
1) MWD, SDCWA and Zone 7 rates based on calendar year (i.e. 2021 rate would be effective on 1/1/2021)

2) SFPUC rate excludes BAWSCA bond surcharge

3) SCVWD FY 22 projection includes staff proposed adjustments to proposed maximum

Exhibit 7 shows a comparison of the average monthly bill for several of Valley Water’s retail customers (e.g. SJWC, City of Santa Clara, City of Morgan Hill, and City of Gilroy) relative to Valley Water’s perennial list of retail agency comparators across the state. SCVWD retailer rates shown include the staff recommended increase for FY 2021-22. North County and South County well owner rates are also shown, which exclude pumping costs (e.g. electricity) and well maintenance costs.

Exhibit 7 Retail Agency Benchmarks



Cost of Service

The cost of service analyses for FY 2021–22 are shown in Exhibit 8 for North County and Exhibit 9 for South County. The exhibits are laid out in a format that follows six industry standard rate making steps.

1. Identify utility pricing objectives and constraints
2. Identify revenue requirements
3. Allocate costs to customer classes
4. Reduce costs by revenue offsets or non-rate related funding sources
5. Develop unit costs by customer class or net revenue requirements by customer class
6. Develop unit rates by customer class

Step 2 includes identifying and segregating Water Utility Fund costs from Watershed and Administrative Funds and allocating Water Utility costs between zones W-2 (North County) and W-5, W-7, and W-8 (South County) according to benefits provided in each zone. Step 3 involves allocating costs by customer class either directly or based on water usage. Steps 4 and 5 result in unit costs by customer class after applying non-rate related offsets.

Step 6 includes two adjustments. The first adjustment is the application of 1% ad valorem property taxes, to offset the costs of agricultural water in accordance with Board Resolution 99-21, also known as the “Open Space Credit.” For FY 2021-22, staff is not proposing a transfer of 1% ad valorem property taxes from the General Fund and the Watershed Stream Stewardship

Fund into the Water Utility Fund due to true up adjustments related to FY 2018-19, which have reduced the amount of Open Space Credit needed in FY 2021-22.

The second adjustment involves reallocating a portion of the cost of treated water (or recycled water in the case of South County) to groundwater and surface water users. Treated and recycled water offsets the need to pump groundwater and therefore increases the volume of stored groundwater and improves reliability. The reallocation of a portion of the treated water cost for example represents the value of treated water to groundwater and surface water users and facilitates a pricing structure that prevents the over use of the groundwater basin. Preventing over use not only preserves groundwater for use in times of drought, but also prevents land subsidence or sinking of the land, which can cause serious infrastructure issues.

Another aspect of the second adjustment is related to setting the basic user charge for surface water equal to the groundwater production charge. Surface water use is effectively in-lieu groundwater use permitted by Valley Water to help preserve the groundwater basin. As such, the costs related to preserving the groundwater basin provide value to surface water users because it makes available District surface water, which otherwise would only be used for groundwater recharge. Similarly, the costs related to providing surface water benefit groundwater users because surface water usage helps preserve the groundwater basin.

The second adjustment reallocates costs between surface water and groundwater customers in order to set the basic user charge for surface water equal to the groundwater production charge in recognition of this conjunctive use relationship, and in accordance with board policy. A 2015 study was conducted by Raffetis Financial Consultants, Inc (RFC) that confirms the reasonableness of such an adjustment. The report titled "Report Documenting the Reasonableness of the Conjunctive Use Benefit of Surface Water and Recycled Water to Groundwater Customers" documents the support and justification for the water district's cost of service methodology and can be found on Valley Water's website.

Exhibit 8
Cost of Service North County Zone W-2 (\$K)

FY '22 Projection (\$ in Thousands)		Zone W-2					Total W-2
		GW		TW	SW		
		M&I	AG	M&I	M&I	Ag	
1	Operating Outlays						
2	Operations/Operating Projects	53,950	400	116,648	1,470	41	172,509
3	SWP Imported Water Costs	6,710	50	20,509	331	9	27,609
4	Debt Service	12,766	95	39,535	161	4	52,561
5	Total Operating Outlays	73,426	545	176,691	1,962	55	252,679
6							
7	Capital & Transfers						
8	Operating Transfers Out	1,550	12	1,808	27	1	3,397
9	Capital Outlays excl. carryforward	101,778	757	164,934	1,725	48	269,242
10	Total Capital & Transfers	103,328	769	166,742	1,752	49	272,639
11	Total Annual Program Costs	176,754	1,314	343,433	3,714	103	525,318
12		Step 3 - Allocate costs to customer classes					
13	Revenue Requirement Offsets						
14	Capital Cost Recovery	(2,886)	(21)	(3,365)	(50)	(1)	(6,323)
15	Debt Proceeds	(65,884)	(490)	(106,766)	(1,117)	(31)	(174,288)
16	Inter-governmental Services	(536)	(4)	(625)	(9)	(0)	(1,174)
17	SWP Property Tax	(5,940)	(44)	(18,155)	(293)	(8)	(24,440)
18	South County Deficit/Reserve	447	3	521	8	0	979
19	Interest Earnings	(653)	(5)	(761)	(11)	(0)	(1,430)
20	Inter-zone Interest	79	1	92	1	0	173
21	Capital Contributions	(207)	(2)	(241)	(4)	(0)	(453)
22	Other	(808)	(6)	(867)	(14)	(0)	(1,695)
23	Reserve Requirements	2,362	(128)	6,649	40	(8)	8,915
24	Adjusted Revenue Requirement (FY 22)	102,730	618	219,915	2,266	54	325,582
25	Adjusted Revenue Requirement (FY 19 adj)	(21,532)	(212)	(30,448)	684	(29)	(51,537)
26							
27	Total Adjusted Revenue Requirement	81,198	405	189,466	2,950	25	274,045
28	Volume (KAF)	79.9	0.6	93.2	1.4	0.0	175.2
29							
30	Revenue Requirement (\$ per AF)	\$ 1,016	\$ 682	\$ 2,033	\$ 2,150	\$ 647	
31		Step 5 - Develop unit costs by customer class					
32	Adjustments for Agricultural Preservation						
33	Allocate WU 1% Ad Valorem Prop Tax	-	(355)	-	-	(20)	(375)
34	Transfer GF 1% Ad valorem Prop Tax	-	-	-	-	-	-
35	Transfer WS 1% Ad Valorem Prop Tax	-	-	-	-	-	-
36	Revenue Requirement (\$ per AF)	\$ 1,015.7	\$ 85.4	\$ 2,033	\$ 2,150	\$ 126.5	
37							
38	Adjustments to Facilitate Conjunctive Use						
39	Reallocate TW/SW/RW costs	39,191	-	(38,364)	(827)	-	0
40	Water Charge (\$ per AF)	\$ 1,506	\$ 85.38	\$ 1,621	\$ 1,547.10	\$ 126.48	\$ -
41	Total Revenue (\$K)	\$120,389	\$51	\$151,102	\$2,123	\$5	\$273,670

Exhibit 9
Cost of Service South County Zone W-5 (\$K)

FY '22 Projection (\$ in Thousands)		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	7,102	7,880	167	431	219	188	15,988
3	SWP Imported Water Costs	-	-	-	-	-	-	-
4	Debt Service	-	-	-	-	-	-	-
5	Total Operating Outlays	7,102	7,880	167	431	219	188	15,988
6								
7	Capital & Transfers							
8	Operating Transfers Out	-	-	-	-	-	-	-
9	Capital Outlays excl. carryforward	-	-	-	-	-	-	-
10	Total Capital & Transfers	-	-	-	-	-	-	-
11	Total Annual Program Costs	7,102	7,880	167	431	219	188	15,988
12		Step 3 - Allocate costs to customer classes						
13	Revenue Requirement Offsets							
14	Capital Cost Recovery	1,388	1,561	23	60	838	718	4,587
15	Debt Proceeds	-	-	-	-	-	-	-
16	Inter-governmental Services	(37)	(41)	(1)	(2)	-	-	(80)
17	SWP Property Tax	(528)	(594)	(9)	(23)	(17)	(15)	(1,186)
18	South County Deficit/Reserve	1,491	(580)	(34)	(22)	(252)	(15)	587
19	Interest Earnings	-	-	-	-	-	-	-
20	Inter-zone Interest	(59)	(66)	(1)	(3)	(2)	(2)	(132)
21	Capital Contributions	-	-	-	-	-	-	-
22	Other	(65)	(73)	(1)	(1)	(1)	(1)	(142)
23	Reserve Requirements	-	-	-	-	-	-	-
24	Adjusted Revenue Requirement (FY 22)	9,292	8,087	145	440	784	874	19,623
25	Adjusted Revenue Requirement (FY 19 adj)	(544)	(1,552)	26	(115)	235	(320)	(2,269)
26								
27	Total Adjusted Revenue Requirement	8,749	6,535	171	326	1,019	554	17,353
28	Volume (KAF)	19.4	21.8	0.3	0.8	0.6	0.5	43.5
29								
30	Revenue Requirement (\$ per AF)	\$ 451	\$ 300	\$ 534	\$ 391	\$ 1,592	\$ 1,009	
31		Step 5 - Develop unit costs by customer class						
32	Adjustments for Agricultural Preservation							
33	Allocate WU 1% Ad Valorem Prop Tax	-	(4,673)	-	(221)	-	(492)	(5,386)
34	Transfer GF 1% Ad valorem Prop Tax	-	-	-	-	-	-	-
35	Transfer WS 1% Ad Valorem Prop Tax	-	-	-	-	-	-	-
36	Revenue Requirement (\$ per AF)	\$ 451	\$ 85.4	\$ 534	\$ 126.5	\$ 1,592	\$ 112.8	
37								
38	Adjustments to Facilitate Conjunctive Use							
39	Reallocate TW/SW/RW costs	721	-	(1)	-	(719)	-	-
40	Water Charge (\$ per AF)	\$ 488.50	\$ 85.38	\$ 529.60	\$ 126.48	\$ 468.50	\$ 112.78	
41	Total Revenue (\$K)	\$9,469	\$1,862	\$170	\$105	\$300	\$62	\$11,968

Exhibit 9, continued
Cost of Service South County Zone W-7 (\$K)

FY '22 Projection (\$ in Thousands)		Zone W-7				Total W-7
		GW		SW		
		M&I	AG	M&I	AG	
1	Operating Outlays					
2	Operations/Operating Projects	5,722	1,783	119	308	7,932
3	SWP Imported Water Costs	-	-	-	-	-
4	Debt Service	-	-	-	-	-
5	Total Operating Outlays	5,722	1,783	119	308	7,932
6						
7	Capital & Transfers					
8	Operating Transfers Out	-	-	-	-	-
9	Capital Outlays excl. carryforward	-	-	-	-	-
10	Total Capital & Transfers	-	-	-	-	-
11	Total Annual Program Costs	5,722	1,783	119	308	7,932
12		Step 3 - Allocate costs to customer				
13	Revenue Requirement Offsets					
14	Capital Cost Recovery	1,272	400	12	32	1,716
15	Debt Proceeds	-	-	-	-	-
16	Inter-governmental Services	(46)	(15)	(0)	(1)	(62)
17	SWP Property Tax	(254)	(80)	(2)	(6)	(343)
18	South County Deficit/Reserve	(1,474)	(78)	(10)	(6)	(1,568)
19	Interest Earnings	-	-	-	-	-
20	Inter-zone Interest	(28)	(9)	(0)	(1)	(38)
21	Capital Contributions	-	-	-	-	-
22	Other	(24)	(7)	(0)	(0)	(31)
23	Reserve Requirements	-	-	-	-	-
24	Adjusted Revenue Requirement (FY 22)	5,167	1,994	118	326	7,605
25	Adjusted Revenue Requirement (FY 19 adj)	(263)	(210)	7	(33)	(498)
26						-
27	Total Adjusted Revenue Requirement	4,904	1,784	126	293	7,107
28	Volume (KAF)	9.4	2.9	0.1	0.2	12.7
29						
30	Revenue Requirement (\$ per AF)	\$ 523	\$ 605	\$ 1,374	\$ 1,232	
31		Step 5 - Develop unit costs by customer class				
32	Adjustments for Agricultural Preservation					
33	Allocate WU 1% Ad Valorem Prop Tax	-	(1,532)	-	(263)	(1,795)
34	Transfer GF 1% Ad valorem Prop Tax	-	-	-	-	-
35	Transfer WS 1% Ad Valorem Prop Tax	-	-	-	-	-
36	Revenue Requirement (\$ per AF)	\$ 523	\$ 85.3	\$ 1,374	\$ 126.4	
37	Step 6 - Rate Design					
38	Adjustments to Facilitate Conjunctive Use					
39	Reallocate TW/SW/RW costs	73	-	(73)	-	-
40	Water Charge (\$ per AF)	\$ 530.50	\$ 85.38	\$ 571.60	\$ 126.48	
41	Total Revenue (\$K)	\$4,978	\$252	\$52	\$30	\$5,312

Exhibit 9, continued
Cost of Service South County Zone W-8 (\$K)

FY '22 Projection (\$ in Thousands)		Zone W-8				Total W-8	Total South County
		GW		SW			
		M&I	AG	M&I	AG		
1	Operating Outlays						
2	Operations/Operating Projects	126	144	14	35	318	24,239
3	SWP Imported Water Costs	-	-	-	-	-	-
4	Debt Service	-	-	-	-	-	-
5	Total Operating Outlays	126	144	14	35	318	24,239
6							
7	Capital & Transfers						
8	Operating Transfers Out	-	-	-	-	-	-
9	Capital Outlays excl. carryforward	-	-	-	-	-	-
10	Total Capital & Transfers	-	-	-	-	-	-
11	Total Annual Program Costs	126	144	14	35	318	24,239
12		Step 3 - Allocate costs to customer					
13	Revenue Requirement Offsets						
14	Capital Cost Recovery	8	9	1	3	20	6,323
15	Debt Proceeds	-	-	-	-	-	-
16	Inter-governmental Services	(0)	(0)	(0)	(0)	(1)	(143)
17	SWP Property Tax	(12)	(14)	(1)	(4)	(31)	(1,560)
18	South County Deficit/Reserve	22	(11)	(5)	(3)	2	(979)
19	Interest Earnings	-	-	-	-	-	-
20	Inter-zone Interest	(1)	(1)	(0)	(0)	(3)	(173)
21	Capital Contributions	-	-	-	-	-	-
22	Other	(1)	(1)	(0)	(0)	(3)	(176)
23	Reserve Requirements	-	-	-	-	-	-
24	Adjusted Revenue Requirement (FY 22)	141	124	8	30	303	27,531
25	Adjusted Revenue Requirement (FY 19 adj)	(10)	(30)	4	(16)	(53)	(2,821)
26							
27	Total Adjusted Revenue Requirement	131	94	12	13	250	24,710
28	Volume (KAF)	0.4	0.4	0.0	0.1	1.0	57.1
29							
30	Revenue Requirement (\$ per AF)	\$ 357	\$ 224	\$ 255	\$ 113		
31		Step 5 - Develop unit costs by customer class					
32	Adjustments for Agricultural Preservation						
33	Allocate WU 1% Ad Valorem Prop Tax	-	(58)	-	2	(57)	(7,237)
34	Transfer GF 1% Ad valorem Prop Tax	-	-	-	-	-	-
35	Transfer WS 1% Ad Valorem Prop Tax	-	-	-	-	-	-
36	Revenue Requirement (\$ per AF)	\$ 357	\$ 85.4	\$ 255	\$ 126.5		
37							
38	Adjustments to Facilitate Conjunctive Use						
39	Reallocate TW/SW/RW costs	(6)	-	6	-	-	-
40	Water Charge (\$ per AF)	\$ 341.50	\$ 85.38	\$ 382.60	\$ 126.48		
41	Total Revenue (\$K)	\$125	\$36	\$18	\$15	\$193	\$17,473

Open Space Credit

The District Act limits agricultural groundwater production charges to a maximum of 25 percent of the M&I groundwater production charges. Current board policy adds an “open space” credit to agricultural revenues. The purpose of the credit is to preserve the open space benefits provided by agricultural lands by keeping agricultural groundwater production charges low. While the Supreme Court found Proposition 218 inapplicable to groundwater production charges, the Court determined that Proposition 26 does apply, which means that in order for the groundwater production charge to qualify as a nontax fee, costs to end users must be proportional such that one class of users is not subsidizing another.

The agricultural community currently benefits from low groundwater charges that are 2% of M&I charges in North County Zone W-2 and 6% of M&I charges in South County Zone W-7. The current FY 2020-21 agricultural groundwater production charge is \$28.86/AF, or 6% of the Zone W-7 M&I charge of \$481.00/AF.

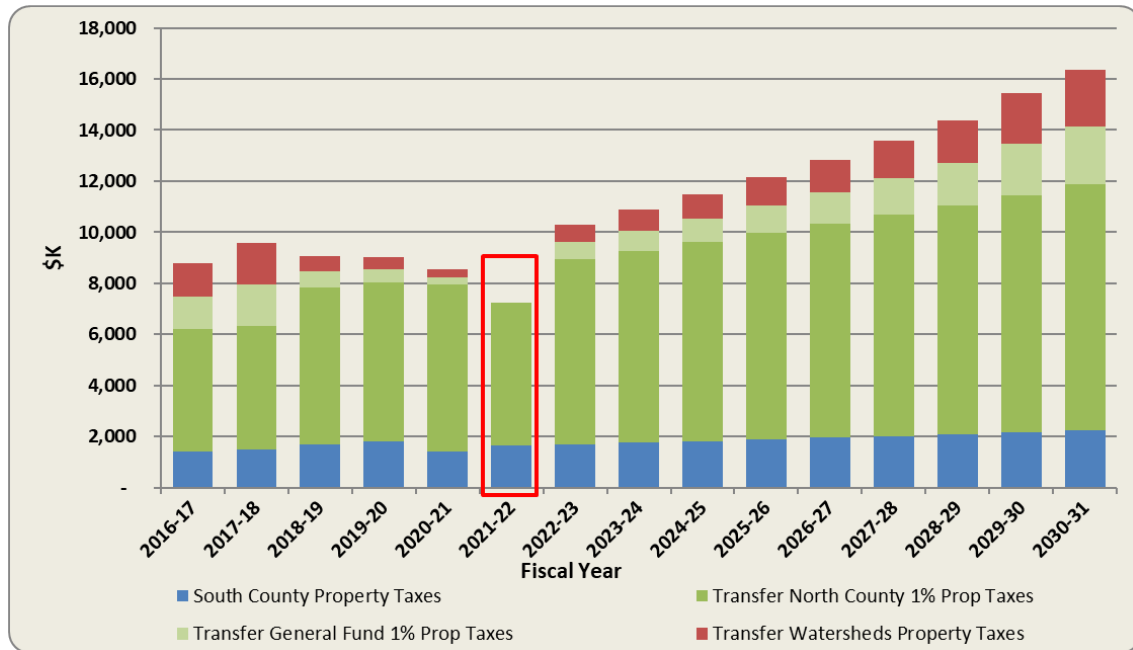
The credit to agricultural water users has become known as an “Open Space Credit.” It is paid for by fungible, non-rate related revenue. To offset lost revenue that results from the difference between the adopted agricultural groundwater production charge and the agricultural charge that would have resulted at the full cost of service, Valley Water redirects a portion of the 1% ad valorem property taxes generated in the Water Utility, General and Watershed Stream Stewardship Funds.

In April 2019, the Board directed staff to eliminate the discretionary portion of the Open Space Credit starting in FY 2021-22, after a two-year period in which a coalition of agricultural industry and other stakeholders would work to pursue an alternative revenue source to replace the discretionary portion of the Open Space Credit. As such the agricultural groundwater charge would increase to the maximum allowed by the District Act at 25% of the M&I charge for FY 2021-22. Doing so would require an update to the Board’s Pricing Policy which currently limits the agricultural groundwater production charge to 10% of the M&I Charge.

Based on Board direction, the proposed maximum agricultural groundwater production charge is 25% of M&I for Zone W-8, which would mean an increase from \$28.86/AF in FY 2020–21 to \$85.38/AF in FY 2021–22. The proposed maximum agricultural groundwater production charge for FY 2021–22 would translate to an increase of up to \$9.41 per month per acre, assuming 2 (two) acre-feet of water usage per acre per year. As discussed at the January 12, 2021 Board meeting, staff offers an alternative scenario for Board consideration due to the passage of Measure S in November of 2020, which has relieved some financial pressure for Valley Water in the future. Under this alternative, the agricultural groundwater charge would be set at 10% of the Zone W-8 M&I groundwater charge, or \$34.15/AF in FY 2021-22.

To comply with the current agricultural groundwater production charge setting policy, staff recommends the open space credit received by South County be \$7.2 million in FY 2021-22 (funded by 1 percent ad valorem property taxes). This includes an adjustment that reconciles FY 2018–19 actuals against what was projected. The \$7.2 million is comprised of a \$6.9 million transfer from North County Water Utility 1% ad valorem property taxes, and a \$0.3 million contribution from South County Water Utility 1% ad valorem property taxes. No transfer of 1% ad valorem property taxes from the General Fund or the Watershed Stream Stewardship Fund is required. As shown in Exhibit 10, the Open Space Credit is projected to grow to \$16.4 million by FY 2030-31.

Exhibit 10 Open Space Credit Trend



Hearings and Meetings Schedule

Exhibit 11 presents the schedule for the annual groundwater production charge setting process.

Exhibit 11 Hearings and Meetings Schedule – 2021

Date	Hearing/Meeting
January 4	Agricultural Water Advisory Committee Meeting
January 12	Board Meeting: Preliminary Groundwater Charge Analysis
January 20	Water Retailers Meeting: Preliminary Groundwater Charge Analysis
January 20	Water Commission Meeting: Prelim Groundwater Charge Analysis
February 9	Board Meeting: Budget devlp. update & Set time & place of Public Hearing
February 26	Mail notice of public hearing and file PAWS report
March 17	Water Retailers Meeting: FY 22 Groundwater Charge Recommendation
March 23	Board Meeting: Budget development update
April 5	Agricultural Water Advisory Committee Meeting
April 6	Landscape Committee Meeting
April 13	Open Public Hearing
April 14	Water Commission Meeting
April 15	Continue Public Hearing in Morgan Hill (Informational Open House)
April 19	Environmental & Water Resources Committee
April 27	Conclude Public Hearing
April 28-29	Board Meeting: Budget work study session
May 11	Adopt Budget & Groundwater Production and Other Water Charges