



Santa Clara Valley Water District

File No.: 16-0581

Agenda Date: 9/27/2016

Item No.: 5.2.

BOARD AGENDA MEMORANDUM

SUBJECT:

State Water Project Tax Discussion.

RECOMMENDATION:

Consider information provided by staff and provide policy direction as necessary.

SUMMARY:

The purpose of this discussion is to review the District's usage of the State Water Project (SWP) tax, including forecast assumptions for the upcoming water rate setting cycle. This review will include much of the same information presented to the Board during several discussions on this topic in calendar years 2014 and 2015. Those discussions included an overview session on July 8, 2014, a workstudy session on November 18, 2014, a follow-up session on December 16, 2014, and a review on October 27, 2015. Staff is seeking direction that can be incorporated into the FY 2017-18 water rate setting process.

This review is divided into two topics of discussion:

1. An overview of the SWP tax
2. A review of policy issues and alternatives

SWP Tax

Background

The SWP is a conveyance system that includes a series of 21 dams and reservoirs, 5 power plants, and 16 pumping plants from Lake Oroville in Northern California to Lake Perris in Southern California. The South Bay Aqueduct is a 40 mile branch that conveys water to three agencies from the Sacramento-San Joaquin Delta including Zone 7 Water Agency, Alameda County Water District, and the Santa Clara Valley Water District. It is managed by the California Department of Water Resources (DWR).

The District entered into a contract with DWR in 1961 to import water into Santa Clara County through the SWP and is one of 29 SWP contractors. Article 34 of the District's SWP contract obligates the District to levy a tax upon all property in the District not exempt from taxation if other funding sources are insufficient. This decision rests within the discretion of the Board. In addition, section 11652 of the Water Code provides that districts with water contracts "shall whenever necessary, levy upon all property in the state agency not exempt from taxation, a tax or assessment sufficient to provide for all payments under the contract..."

State voters approved the Burns-Porter Act in 1960, which included financing the SWP facilities in part with state bonds. The District implemented the SWP tax in FY 1979-80 after passage of Proposition 13 reduced the District's "5 cent" property tax revenues by 58%. The SWP tax is an "override tax", which means that it is a tax in excess of the one-percent cap imposed by Proposition 13, for purposes of paying for voter-approved indebtedness.

In a Fourth Appellate case, the Court of Appeal held that the SWP tax levies were permissible, and fell within the Proposition 13 voter-approved indebtedness exemption, stating that "...when the Voters approved the Burns-Porter Act in 1960 to provide funds for the State Water Resources Development System they approved an indebtedness in the amount necessary for building, operating, maintaining and replacing the project, and that they intended that the costs were to be met by payments from local agencies with water contracts." (Goodman v. County of Riverside (1983) 140 Cal.App.3d 900).

The SWP tax is restricted to paying for SWP contractual obligations and cannot be used for any other purpose. The District collects the SWP tax countywide, which makes up about 14% of its water utility revenue for FY 2016-17. For many years the Board has adopted resolutions affirming its intent to rely on the SWP tax to pay for 100% of the District's SWP contract costs. The Board adopted resolution 16-33 (See Attachment 2) on May 10, 2016 to collect the SWP tax in the amount of \$33 million for FY 2016-17, which equates to roughly \$55.00 per year on the property tax bill for the average single family residence in Santa Clara County. As reported to the Board during the last budget cycle, if the tax were not levied the impact of lost revenue equates to \$197/AF (18.4% increase) in terms of the North County M&I groundwater production charge, \$45/AF (11.4% increase) in terms of the South County M&I groundwater production charge, and \$962,000 in terms of the Open Space Credit.

History

In 1961, the 5-cent tax was established to help fund the District's water importation program. In 1963, as part of a compromise which enabled the passage of a \$42M bond measure in Zone W-1 (now obsolete) to begin construction of the in-county distribution system including the first water treatment plant (Rinconada), the Board established a policy to provide an "in-county credit" to those agencies that received Hetch Hetchy water in recognition of the benefits provided by the imported Hetch Hetchy water. The County tax office provided the credit to the appropriate agencies based on information provided by the District. With the passage of Proposition 13 in 1978, the District no longer received ad valorem taxes as originally established, but instead received a portion of the 1% ad valorem tax, which resulted in a roughly 58% decrease in tax revenue in FY 1978-79. With the passage of Proposition 13, it was no longer possible to determine the "in-county credit" based on the historical formula. Consequently, the Board developed an alternative method to continue providing the in-county credit directly from the District to the following agencies: Milpitas, Mountain View, Palo Alto, Purissima Hills Water District, San Jose, Santa Clara, Stanford University, and Sunnyvale. The alternative methodology was a unit rebate rate of \$7.50/AF of Hetch Hetchy water imported into the County.

In July 1979, in response to the impact of the passage of Proposition 13, the Board initiated the SWP tax to pay for SWP imported water contractual obligations. In 1981, the Board adopted resolution 81-44 which declared that the in-county credit would be phased out. The rationale was that since SFPUC water and the District's treated water were roughly the same price, the Board could no longer justify providing a credit for water that those agencies had an economic incentive to take anyway. By 1984 the in-county credit was eliminated.

In July 2000, a portion of the Water Utility ad valorem taxes (the former 5-cent tax) was reprogrammed to flood protection and became the key revenue source for the Watershed Stream Stewardship Fund.

Other Agency Reliance on the SWP Tax

SWP contractors' reliance on the SWP tax collected within their respective jurisdiction varies from 0% to 100%. The following SWP contractors rely on the SWP tax to pay for 100% of their SWP contractual obligations:

- Antelope Valley East Kern Water Agency
- Coachella Valley Water District
- San Bernardino Valley Municipal Water District

- Castaic Lake Water Agency

SWP contractors that rely on the SWP tax to pay for less than 100% of their SWP contractual obligations include:

- Metropolitan Water District (8-10%) - based on legislative cap
- Kern County Water Agency (10-14%) - Remainder, or 86% to 90% of SWP costs are billed directly to member units
- Mojave Water Agency (84%) - current practice is that variable SWP costs are paid by water rates, and fixed SWP costs are paid by the SWP tax
- Zone 7 (50%) - current practice is that variable SWP costs are paid by water rates, and fixed SWP costs are paid by the SWP tax

SWP contractors that do not utilize the SWP tax for paying their contractual obligations include:

- Tulare Lake Basin Water Storage District
- Central Coast Water Authority
- Ventura County Watershed Protection District
- County of Kings

SWP Tax by Zone of Benefit

The North County Zone W-2 was originally established in 1963. The South County Zone W-5 began in 1987 with the merger of the Gavilan Water District, which occurred about 7 years after the SWP tax was initiated. The South County financial model was established that year to include a revenue credit to the South County Zone W-5, which reduces the groundwater production charge by the amount of the SWP tax collected in or near South County Zone W-5. This is the same accounting treatment that is applied to the North County Zone W-2, in which the SWP tax collected in or near the North County Zone W-2 is credited to that zone by reducing the groundwater production charge that

otherwise would be charged in that zone. This accounting treatment continues today and is reflected in the cost of service analysis for both the North and South County. Roughly 94% of SWP tax revenue is collected in or near North County Zone W-2 and 6% is collected in or near South County Zone W-5. From a cost perspective, the cost of SWP imported water is allocated 100% to the North County Zone W-2 and 0% to the South County Zone W-5 because 100% of SWP water flows into North County.

Palo Alto and Purissima Hills

The importation of SWP water provides several benefits to Santa Clara County (County) including:

- Provides additional water supply.
- Prevents subsidence due to groundwater overdraft.
- Prevents saltwater intrusion due to groundwater overdraft.
- Supports economic growth in the county due to the availability of SWP water.

There are two retail customers (the City of Palo Alto and Purissima Hills Water District) in the County that do not pump groundwater or receive District treated water, but instead rely 100% on imported Hetch Hetchy water for primary water supply. However, in addition to the benefits mentioned above, the City of Palo Alto receives the benefit of the availability of an emergency water supply source as a result of SWP water availability. In addition to the 8 wells used by the City of Palo Alto for emergency back-up, there are over 250 wells within the City of Palo Alto used by private property owners as a source of supply. While the Purissima Hills Water District itself does not have any wells that fall within North County Zone W-2, there are approximately 65 wells within the Purissima Hills Water District service area used by private property owners as a source of supply. Both agencies benefit from the District/SFPUC intertie.

The elected bodies of both agencies have expressed concern over District reliance on the SWP tax, including the current planning assumption that the SWP tax would pay for the State Water Project portion of the California Water Fix, should the Board decide to participate.

California Water Fix and the SWP Tax

The FY 2016-17 Budget includes \$1.7M for continued planning of the California Water Fix (CWF). Should the Board decide to participate, CWF estimated costs to the District are currently projected to

total \$121 million between FY 2016-17 and FY 2025-26. This projection may change as the planning process continues. Staff financial modeling assumes that CWF costs associated with conveyance of SWP supply (approximately \$43 million out of the \$121 million ten year total) would be paid for by the SWP tax. Consequently, the SWP tax for the average single family residence would increase by \$14.61/yr by FY 2025-26 relative to the current average annual tax of \$54.72/yr today.

Policy Questions and Alternatives for Board Consideration

There are broad Board policies that address the need for adequate financial planning, but no specific policy regarding the degree of reliance on the SWP tax. The Board considers staff reports and presentations, including projected groundwater production charges, to determine to what extent the SWP tax should cover the District's SWP contractual obligations. The Board's Pricing Policy (attachment 3) recognizes the need to keep SWP Tax funding separate, and that SWP tax monies "are not available to the common fund."

Staff would like Board feedback on the following policy question:

Should the District continue reliance on SWP tax to pay 100% of SWP contractual obligations including the SWP portion of the California Water Fix? Or assume a reduced reliance?

Pros of reduced reliance on SWP tax:

- Would reduce property tax bill for county residents

Cons of reduced reliance on SWP tax:

- Would increase Groundwater Production Charge to recoup lost revenue
- Would reduce a "fixed" revenue source and add a degree of financial volatility

Alternatives:

- 1) Rely on SWP tax to pay 100% of SWP costs including CWF (Current Assumption)
- 2) Rely on SWP tax to pay 100% of SWP costs excluding CWF
- 3) Rely on SWP tax to pay fixed (~85%) SWP costs only excluding CWF
- 4) Rely on SWP tax to pay <85% of SWP costs excluding CWF

Financial Impact versus Current Assumption:

- 2) Relying on SWP tax to pay 100% of SWP costs excluding CWF:
 - Would reduce average annual tax bill by \$1.36 in FY 18
 - Would reduce average annual tax bill by \$14.61 in FY 26
 - Would cause incremental \$5/AF in FY 18, and \$47/AF by FY 26 for North County M&I groundwater production charge
 - Would cause incremental \$1/AF in FY 18, and \$12/AF by FY 26 for South County M&I groundwater production charge
 - Open Space Credit higher by \$271K in FY 26
- 3) Relying on SWP tax to pay fixed (~85%) SWP costs only excluding CWF:
 - Would reduce average annual tax bill by \$9 in FY 18
 - Would cause incremental \$36/AF in FY 18, and \$99/AF by FY 26 for North County M&I groundwater production charge
 - Would cause incremental \$8/AF in FY 18, and \$24/AF by FY 26 for South County M&I groundwater production charge
 - Open Space Credit higher by \$563K in FY 26
- 4) Relying on SWP tax to pay <85% of SWP costs (excluding CWF)
 - Depends on % reliance

FINANCIAL IMPACT:

Depending on direction provided by the Board, there could be a future financial impact to the District, rate payers and tax payers.

CEQA:

This is not a project under CEQA because it does not have a potential for resulting in direct or reasonably foreseeable indirect change in the physical environment.

ATTACHMENTS:

Attachment 1: Power Point

Attachment 2: Resolution 16-33

Attachment 3: Resolution 99-21

UNCLASSIFIED MANAGER:

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