



# Santa Clara Valley Water District

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**File No.:** 17-0697

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**Item No.:** 5.1.

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## BOARD AGENDA MEMORANDUM

### **SUBJECT:**

Planning for FY 2018-19 Groundwater Production Charges.

### **RECOMMENDATION:**

Discuss planning for Fiscal Year 2018-19 Groundwater Production Charges and provide direction to staff.

### **SUMMARY:**

This agenda item presents the Fiscal Year (FY) 2018-19 groundwater production charge setting process and provides an update on key issues that pertain to setting the charges that would take effect July 1, 2018 (Attachment 1).

Each year, the Board establishes groundwater production charges for two zones of benefit (Zone W-2 in the North County and Zone W-5 in the South County) in accordance with section 26 of the District Act. Although not specified under the District Act, the Board also sets surface water charges, recycled water charges, treated water surcharges, and the amount of the State Water Project (SWP) cost to be recouped through the SWP tax, within the framework of the groundwater charge setting process.

The Water Utility taxing and pricing policy, Resolution 99-21 (Attachment 2) and legal requirements, guide staff in the development of the overall structure for these charges. The FY 2018-19 groundwater production charge setting process and surface water charge setting process will be conducted consistent with Proposition 218's requirements for property-related fees for water services as detailed in Board Resolutions 12-10 (Attachment 3) and 12-11 (Attachment 4).

Under the District Act, Section 26.5, an annual report referred to as the "Report on Protection and Augmentation of Water Supplies (PAWS)" is to be filed with the Clerk of the Board on or before the first Tuesday in April. A public hearing must be held on or before the fourth Tuesday in April and it must be noticed to the public in a newspaper of general circulation at least 10 days in advance. In addition, all well owners and well operators on record are notified of proposed groundwater production increases in writing, and of the public hearing at least 45 days in advance. Groundwater production charges must be determined for the ensuing fiscal year prior to July 1 of the ensuing fiscal year. For each zone of benefit, groundwater production charges must be fixed and uniform per acre-foot for agricultural water and fixed and uniform per acre-foot for all water other than agricultural

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water. The Sustainable Groundwater Management Act passed by the legislature may also grant additional authority to establish fixed fees in addition to fees charged on a volumetric basis. Further discussion on staff's evaluation of a fixed fee is provided later.

Under the District Act, Section 26.3, groundwater production charges are to 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; and
4. Pay for debt incurred for purposes 1, 2 and 3.

The Board may establish zones of benefit in accordance with the District Act. The objective of establishing various groundwater charge zones is to recover costs for the benefits resulting from District activities within that zone. The benefits and costs which are apportioned to zones by customer class are presented in the annual PAWS report.

The groundwater production charge reflects the benefit of District activities to protect and augment groundwater supplies and is applied to water extracted from the groundwater basin in Zones W-2 and W-5. Zone W-2 encompasses the Santa Clara groundwater subbasin north of Metcalf Road or the North County. Zone W-5 includes both the Coyote Valley and Llagas subbasin from Metcalf Road south to the Pajaro River or South County.

The District protects and augments water supplies for the health, welfare, and safety of the community. County-wide, groundwater replenished by the District makes up, on average, two-thirds of the groundwater used by residents, retailers, and businesses. The District replenishes the groundwater basins with local water and purchased water imported from the Sierra Nevada mountains and conveyed thru the San Francisco Bay Delta Estuary. The activities undertaken by the District to acquire, monitor, recharge, and protect the water supply are funded, in part, through groundwater production charges.

### **Water Usage Trend**

District managed water use for FY 2016-17 is estimated to be approximately 207,000 acre-feet (AF), which is roughly 2,000 AF higher than budgeted that year and is roughly a 28% reduction versus calendar year 2013. For the current year, FY 2017-18, actual water usage is trending to meet the budget of 217,000 AF. The FY 2017-18 budgeted water use is a roughly 24% reduction versus calendar year 2013. The current projection for FY 2018-2019 is 226,000 AF, which is a 4% increase compared to the FY 2017-2018 budget, and is in line with the rebound in water use after the previous drought.

Staff will carefully monitor monthly water use actuals and work closely with the water retailers during the upcoming rate setting process to modify the water usage forecast as necessary.

### **State Water Project Tax**

The SWP is a system of reservoirs, aqueducts, power plants, and pumping plants. Its main purpose is to store water and distribute it to urban and agricultural water suppliers in Northern California, the San Francisco Bay Area, the San Joaquin Valley, and Southern California.

The SWP tax is a tax that was implemented by the District in FY 1979-80 after passage of Proposition 13 reduced the District's "5 cent" property tax revenues by 58%.

The tax is collected county-wide and is used to pay for 100% of the District's SWP contractual obligations. It is an "override tax", a tax imposed to pay voter-approved indebtedness.

For many years the Board has adopted resolutions affirming its intent to rely on the SWP tax to pay for 100% of SWP contractual obligations. There is a broad range of reliance on the SWP tax among the other 28 State Water contractors. The City of Palo Alto and Purissima Hills Water District have voiced concerns over the District's reliance on the SWP tax.

#### Guiding Principle #5

At the October 17, 2017, Board meeting, the Board presented guiding principles related to the California WaterFix project. Guiding principle #5 would establish grants to water agencies that serve communities in which 85% of the water supply is not District-managed up to the amount of SWP tax paid.

In addition, guiding principle #5 includes the following:

- Water agencies are required to contribute 20% match toward eligible water supply or environmental enhancement programs/projects, and
- Unused grant funds return to the Water Utility Fund in fiscal year 2025-2026.

Since the agreements associated with California WaterFix are not in place yet, staff recommends bringing the topic of implementing Guiding Principle #5 back to the Board at a future date.

#### State Water Project Tax Alternatives

Below are several alternatives for Board consideration regarding the District's reliance on the SWP tax at this time:

- Option 1: Rely on SWP tax to pay 100% of SWP costs
- Option 2: Rely on SWP tax to pay fixed portion (~85%) of SWP costs only
- Option 3: Rely on SWP tax to pay <85% of SWP costs only

Pros of reduced reliance on SWP tax:

- Reduced property tax bill for county residents

**Cons of reduced reliance on SWP tax:**

- Would increase Groundwater Production Charge to recoup lost revenue
- Reduces “fixed” revenue source and adds financial volatility

An alternative for discussion at such time when California WaterFix agreements are in place would be to rely on the SWP tax to pay 100% of SWP costs, plus 100% of the SWP portion of California WaterFix costs, plus apply Guiding Principle #5. If this alternative is chosen, a further decision would be required as to whether or not to implement the SWP tax for the SWP portion of the California WaterFix prior to or after completion of the validation action filed by the Department of Water Resources (DWR). The validation action filed in July 2017 seeks judicial determination of DWR’s statutory authority to issue revenue bonds for the California WaterFix, which could bring into question whether California WaterFix is part of the State Water Project, and whether override taxes may be levied.

**Open Space Credit**

The Board has historically recognized that agriculture brings value to all residents of Santa Clara County in the form of open space. In an effort to preserve this value, the Board adopted a policy in 1999 that limits the charge that agricultural customers pay for groundwater to no more than 10 percent of the municipal and industrial charge. This has become known as the “Open Space Credit.”

The District Act limits the South County agricultural groundwater charge to 25% of the municipal and industrial (M&I) groundwater production charge. Current Board Open Space Credit Policy sets the maximum charge at 10% of the M&I charge.

For several years, the Board has set the South County agricultural groundwater production charge lower than the Board policy maximum, at 6% of the M&I groundwater production charge.

To offset lost revenue between the adopted agricultural groundwater production charge and the agricultural charge that would have resulted at the full cost of service, the District redirects 1% ad valorem property taxes generated in the Water Utility, General, and Watershed Stream Stewardship Funds.

On September 18, 2017, the Board’s Capital Improvement Program Committee directed staff to analyze scenarios to decrease the Open Space Credit and therefore provide more funding for flood protection projects.

**Alternatives to Minimize Open Space Credit**

1. M&I users pay for open space credit - Not feasible now, but could be in future depending on outcome of City of San Buenaventura v. United Water Conservation District, which is currently pending before the California Supreme Court.
2. Increase agricultural charge to 10% of M&I over 10-year time frame
  - \$5.5M savings by FY 30 (\$3.9M to flood protection)

- Ag GW charge in FY 30 would be \$79.10/AF vs \$47.50/AF
3. Increase agricultural charge to 10% of M&I over 5-year time frame
    - \$7.1M savings by FY 30 (\$5.0M to flood protection)
    - Ag GW charge in FY 30 would be \$79.10/AF vs \$47.50/AF
  4. Increase agricultural charge to 25% of M&I over 10-year timeframe
    - \$26.2M savings by FY 30 (\$18.4M to flood protection)
    - Ag GW charge in FY 30 would be \$197.80/AF vs \$47.50/AF

Minimizing the Open Space Credit could cause fallowing of agricultural lands in the County. According to the 2013 economic study prepared by ERA Economics LLC, increasing the agricultural groundwater production charge to 10% of the M&I charge in South County over a 10-year phase-in period would result in the permanent fallow of 17 acres of agricultural lands out of a baseline of 15,668 acres. Increasing the agricultural groundwater production charge to 25% of the M&I charge would result in the permanent fallow of 549 acres or 3.5% of the 15,668 baseline acres.

### **Fixed Charges**

At the June 15, 2017, Water Conservation and Demand Management Committee (WCDM Committee) meeting, staff presented a plan to evaluate a fixed groundwater production charge concept, which if implemented, would help reduce revenue volatility associated with swings in water usage. Revenue volatility was a serious issue during the recent historic drought.

A preliminary framework for establishment of a fixed charge was presented to the WCDM Committee on August 28, 2017. The WCDM Committee encouraged continued discussion with stakeholders including obtaining feedback from the Water Retailers on whether or not to implement a fixed charge, and if so how to implement.

As requested, the preliminary fixed charge framework was presented at the October 18, 2017, Quarterly Water Retailers Meeting. The retailers expressed interest in collaborating closely with the District if the District were to move forward with a fixed charge implementation.

Assuming Board approval, the next steps would be:

- Engage a rate consultant to work with the retailers and prepare a fixed charge proposal
- Board review and approval of fixed charge proposal in Fall 2018
- Fixed charge implemented for FY 20 rate setting cycle if approved

These steps are consistent with the steps taken by Zone 7 Water Agency, which implemented a fixed charge component for its calendar year 2017 rates.

### **FY 19 Planning Scenario Ideas**

Staff anticipates the need to provide several groundwater charge projection scenarios for Board consideration during this rate setting cycle. Staff would appreciate Board feedback on the following assumptions and scenario ideas:

**Baseline Case Assumptions:**

- California WaterFix: Conservative cost scenario based on 2.5% SWP, 5.0% Central Valley Project participation
  - To be updated as more information becomes available
- Include District Water Supply Master Plan's "No Regrets" investments
- Include latest Expedited Purified Water Public-Private Partnership (P3) cost projection

**Scenarios:**

- Pacheco, Sites, Los Vaqueros
- Other District Water Supply Master Plan investments
- "Cut" Scenario

Based on Board feedback, various groundwater charge projection scenarios will be provided for the Board's consideration.

**Planned Groundwater Charge Setting Schedule**

Below are the key dates for the groundwater charge setting process as tentatively scheduled. The schedule calls for adopting the budget and groundwater production charges on May 8, 2018.

Jan 9: Board Meeting (Preliminary Groundwater Production Charge Analysis), Capital Improvement Plan (CIP) Work Study

Jan 17: Water Retailers Meeting (Preliminary Groundwater Production Charge Analysis)

Jan 24: Water Commission Meeting (Preliminary Groundwater Production Charge Analysis)

Feb 13: Board Meeting - Review draft CIP & Budget development update

Feb 23: File "Report on Protection & Augmentation of Water Supplies (PAWS)" with District Clerk of the Board & mail well owners and surface water users notice

Mar 21: Water Retailers Meeting (Groundwater Production Charge recommendation) tentative date

Mar 27: Board Meeting - Budget development update (2nd Pass)

Apr 02: Agricultural Advisory Committee Meeting (Groundwater Production Charge recommendation)

Apr 03: Landscape Committee Meeting (Groundwater Production Charge recommendation)

Apr 10: Board Meeting (Open Public Hearing on Groundwater Production Charges)

Apr 11: Water Commission Meeting (Groundwater Production Charge recommendation)

Apr TBD: Board Meeting (Continue Public Hearing on Groundwater Production Charges to South County)

Apr 24: Board Meeting (Continue and Conclude Public Hearing)

Apr 25-27: Board Meetings - Budget Work Study Sessions

May 8: Board Meeting (Adopt Groundwater Production Charges, Budget & CIP)

**FINANCIAL IMPACT:**

Depending on the direction provided by the Board, there could be a future financial impact to the Water Utility.

**CEQA:**

CEQA Guidelines Section 15273: CEQA does not apply to establishment or modification of water rates.

**ATTACHMENTS:**

Attachment 1.	PowerPoint
Attachment 2.	Resolution 99-21 (Pricing Policy)
Attachment 3.	Resolution 12-10
Attachment 4.	Resolution 12-11

**UNCLASSIFIED MANAGER:**

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