



Santa Clara Valley Water District

File No.: 18-1023

Agenda Date: 1/8/2019

Item No.: 5.3.

BOARD AGENDA MEMORANDUM

SUBJECT:

Work Study Session on Preliminary Fiscal Year (FY) 2019-20 Groundwater Production Charges and the District's Capital Improvement Program, and Board Consideration to Approve the District's Fiscal Years 2020-24 Preliminary Capital Improvement Program (CIP).

RECOMMENDATION:

- A. Review and approve the Fiscal Years (FY) 2020-24 Preliminary CIP; and
- B. Discuss and provide direction on the preliminary FY 2019-20 Groundwater Production Charge analysis prepared by staff.

SUMMARY:

This Work Study Session combines, for Board review, the preliminary FY 2019-20 groundwater production charge analysis and the preliminary FY 2020-24 Capital Improvement Program (CIP).

The groundwater production charge analysis includes a current water use projection, a discussion of key capital project funding, and some scenarios for Board consideration. Staff is seeking Board input on the preliminary analysis to incorporate into the development of the groundwater production charge recommendation.

In concert with the review of the preliminary groundwater production charge analysis, this agenda items presents the 5-year FY 2020-24 Preliminary CIP list of projects with their estimated costs and proposed funding (Attachment 1).

Capital Improvement Program (CIP) Background

Each year, a five-year Capital Improvement Program (CIP) is prepared for Board consideration and approval. The CIP describes the District's capital investment priorities, and provides information on the planned capital projects and the District's intended source(s) of funding. The CIP process works in concert with the annual budget process, wherein funding is appropriated to the projects.

The Board-approved FY 2019-23 CIP contains a brief description of, and cost and schedule information for, each capital project. It also includes general information about the capital program, project prioritization criteria, and information about cost sharing or reimbursements from other

agencies. Projects in the CIP fall under one or more of the below-listed categories, and the number of projects in each category in the FY 2019-23 CIP is provided as well:

- A. Regulatory requirements (6 projects)
- B. Repair or replacement of aging infrastructure (29 projects)
- C. District commitment [Safe Clean Water (SCW); Fish and Aquatic Habitat Collaborative Effort (FAHCE)] (21 projects)
- D. Water Supply Master Plan “No Regrets” Option (0 projects)
- E. Board Policy (9 projects)
- F. Discretionary projects as directed by the Board (7 projects)

History of the CIP Development

The District first began publishing and annually updating its 5-Year CIP in 2002. In 2011, the District added a Capital Project Validation Process (Validation Process) to the CIP annual update. The purpose of this process is to establish a business case—a stronger justification—for adding new capital investments to the CIP. The Validation Process requires staff to prepare a business case to compare alternative solutions for a given problem or failure using lifecycle cost analysis. Validation is not the same as prioritization. Validation evaluates the lifecycle costs of different capital, non-capital (changing maintenance frequency, changing operations), or non-asset-based (demand management, partnerships, outreach, etc.) solutions for addressing a problem. The Validation Process identifies a solution with the lowest likely lifecycle cost. The objective of the Validation Process is to ensure that the District invests in the right solutions or projects at the right time for the right costs and for the right reasons.

The Validation Process was applied to all 132 projects in the District’s 5-year CIP in FY2010-11 and FY 2011-12. This included all projects on the unfunded list. Eighty-two of the 132 projects were deemed exempt from the Validation Process for one of the following reasons:

- Already in construction or in the close-out phase;
- Clean, Safe Creeks project;
- Federally authorized;
- 90% or more grant- or federally-funded;
- Environmental enhancement undertaken at the Board’s direction;
- Required environmental mitigation; or
- Part of a legal settlement or binding agreement.

The Validation Process was applied to the remaining 50 projects. The outcome determined that 19 were no longer needed, and these were removed from the CIP. Two additional projects were removed and changed to a maintenance effort, and three other projects were moved to a future start date beyond the 5-year CIP. The removal or delay of these 24 projects resulted in a reduction of approximately \$250 million (M) from the 5-year CIP at the time; however, it should be noted that \$171 M of this amount was from projects that had been on the “unfunded” list.

The Validation Process and business case are required for all capital projects that are proposed annually for addition to the CIP. Preparing a business case helps staff quickly assess if a capital

infrastructure solution is the best or lowest lifecycle cost solution. Implementation of the Validation Process requires evaluation and documentation that an idea is a good investment; and because staff has learned to also consider non-capital solutions in lieu of capital investments.

Annual Process to Evaluate Newly-Proposed Capital Projects

Most new Water Supply capital projects submitted for CIP inclusion are identified via the District's Asset Management Program. Asset Management Program staff manages a database of all water utility assets and their scheduled rehabilitation/replacement and associated costs. Each year, the Asset Management Program develops a list of all asset rehabilitation and replacement projects required for all water utility assets for the next five years. The list is validated, vetted and prioritized by an internal team of maintenance, operations, engineering, and asset management staff. The final list is compiled into a Five-Year Maintenance Work Plan, a rolling five-year plan that is updated annually, similar to the CIP.

The Validation Process is the gateway for a project to be included the CIP unless one or more of the earlier-described exemption criteria apply. A Deputy Officer's approval is required to initiate preparation of a business case for a new capital project, as it can require significant staff time. The business case includes a written report and lifecycle cost analysis. The business case must be approved by the ultimate project owner (Deputy Officer) and is then submitted to the CIP Coordinator.

Upon submittal of a business case for a new capital project, a capital program engineer reviews the business case and develops a project proposal and initial capital cost estimate. The validated, newly-proposed projects are then placed on the CIP's unfunded list. In late fall of every year, CIP and Finance staff compile the data from existing CIP project plans, collect the operational forecast information, and run the financial models. The Staff CIP Group, composed of Deputy Officers, meets in November of each year to review the financial models and determine which, if any, unfunded projects should be recommended for inclusion in the CIP. Staff considers factors such as an asset's condition; probability and impact of failure; service commitments and regulations; and availability of funding and staff resources when recommending whether a proposed project be moved from the unfunded list to the CIP.

Board's Capital Improvement Program Committee

The Board has established a CIP Committee whose purpose is to review and discuss in greater detail the various processes that are followed and information that is used to prepare an annual update to the District's CIP. In 2018, the CIP Committee was comprised of Directors Nai Hsueh, Tony Estremera, and Linda LeZotte.

The CIP Committee met monthly in 2018 to review and discuss information related to monitoring capital projects, the development of the CIP and to provide input to staff.

CIP Committee-Recommended Changes to the FY 2020-24 CIP

Per the CIP Committee's recommendations, the following new projects are included in the FY 2020-24 Preliminary CIP:

1. **Pacheco Reservoir Expansion Project \$1.345 Billion (B).** The District has been awarded \$485.4 M from the State's Proposition 1 grant funding for this project. This project would provide emergency water storage for the County and would significantly benefit fisheries in Pacheco Creek downstream of the dam.
2. **Water Treatment Plant Electrical Improvement Project \$11 M.** This project would extend the service life of the electrical distribution system at both the Penitencia and Santa Teresa Water Treatment Plants (PWTP, STWTP), and would improve the plants' operational reliability.
3. **Santa Teresa Water Treatment Plant (STWTP) Filter Media Replacement Project \$9.5 M.** The granular activated carbon filter media at the STWTP was installed in 2005 and has performed well despite an expected 10-year service life. This project would replace the filter media and other appurtenances associated with filtration that are failing.
4. **Los Gatos Creek Restoration and Flood Protection Project \$9 M (Safe Clean Water Program D.6).** A potential partnership with Google, Inc. for a flood protection and stream restoration project in the vicinity of its planned downtown San Jose "Google Village". Preliminary discussion indicates that Google, Inc. will provide necessary rights-of-way for the project. Construction cost is estimated to be between \$20M and \$28M and the Safe Clean Water Fund could provide approximately \$9M to support this project. The remaining funding would have to be secured from other sources.
5. **Guadalupe River Freeboard Restoration, Montague Expressway to Airport Parkway (Planning Only).** Based on recent topographic data a preliminary assessment conducted on the Lower Guadalupe River indicates current channel configuration varies from the project as-built drawings such that there may be reduced freeboard in parts of the channel. This project will conduct a thorough hydraulic analysis of the channel capacity and make appropriate recommendations.
6. **Ogier Ponds Separation from Coyote Creek (Planning and Design only) \$3.2 M.** The funding for construction would be contingent on a successful Fish and Aquatic Habitat Collaboration Effort (FAHCE) settlement and a partnership with the County of Santa Clara.
7. **Employee Workspace Optimization Project (Feasibility and Planning only) \$1.5 M.** The District's Almaden Campus buildings are approaching or have already reached full capacity and the Maintenance Office Building was built in 1957 with several additions and requires frequent maintenance. Approximately 75 staff members work in the Maintenance Building. This project will develop a feasible plan to reconfigure the workspace in the available buildings.
8. **Almaden Telephone System Voice Internet Protocol \$1.2 M.** An assessment of the District's current telephone environment by Communication Strategies was completed in September of 2018. While operational, the Avaya PBX system needs frequent maintenance performed by both internal IT staff and a service contractor, Advantel. In addition to the inherent risk of continued reliance on a 25+-year-old PBX and handsets, the assessment outlines several critical risks including multiple single points of failure at several locations.

At its December 10, 2018 meeting, the CIP Committee recommended that the Preliminary FY 2020-24 CIP be presented to the full Board on January 8, 2019. As the CIP and budget process proceeds, the CIP Committee will continue to meet and provide recommendations on refining the CIP in alignment with the Board's priorities.

Attachment 2 contains the Priority Ranking Criteria for the FY 2019-23 CIP.

Review and Approval Process for Fiscal Years 2020-24 CIP

Board review and approval of the preliminary list of projects (Attachment 1) will allow staff to proceed with preparing the Draft FY 2020-24 CIP. The Draft CIP is scheduled to be presented to the Board at its February 27, 2019 meeting, at which time staff will recommend Board review and authorization to release the Draft CIP for a 60-day public review period. After public review and responses to comments are completed, the Final CIP will be presented to the Board in May 2019 for approval in conjunction with the FY 2019-20 budget.

Summary of Groundwater Production Charge Analysis:

Staff has prepared the preliminary FY 2019-20 groundwater production charge analysis, which includes a current water use projection and several scenarios for Board review. Staff has developed two basic scenarios that align with the 90% and 80% level of service goals according to the January 2019 Water Supply Master Plan update, along with several other scenarios for Board consideration. Staff is seeking Board input on the preliminary analysis to incorporate into the development of the groundwater production charge recommendation.

The groundwater production charge recommendation will be detailed in the Annual Report on the Protection and Augmentation of Water Supplies that is planned to be filed with the Clerk of the Board on February 22, 2019. The public hearing on groundwater production charges is scheduled to open on April 9, 2019. It is anticipated that the Board would set the FY 2019-20 groundwater production charges by May 14, 2019, that would become effective on July 1, 2019.

The FY 2019-20 groundwater production charge and surface water charge setting process will be conducted consistent with the District Act, and Board resolutions 99-21 and 12-10. (Attachments 3-4).

Water Use Assumptions

District managed water use for FY 2017-18 is estimated to be approximately 226,000 acre-feet (AF), which is roughly 9,000 AF higher than budgeted that year and is roughly a 21% reduction versus calendar year 2013. (District-managed water use excludes Hetch Hetchy, and San Jose Water Company owned water supplies). For the current year, FY 2018-19, staff estimates that water usage will meet the budgeted water use of 226,000 AF, which is again roughly a 21% reduction versus calendar year 2013. For purposes of the preliminary analysis, staff is assuming a water usage of 239,000 AF for FY 2019-20, which is a 5.7% increase relative to the estimated FY 2018-19 water usage, and a 16% reduction versus calendar year 2013.

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.

Groundwater Production Charge Projections

Staff has prepared several preliminary groundwater production charge projection scenarios for Board review. The increase in the North County Municipal and Industrial (M&I) groundwater production charge ranges from 4.7% to 8.1% for FY 2019-20 depending on the scenario, and from 5.7% to 7.7% in the South County.

The overall impact of the preliminary analysis scenarios for FY 2019-20 to the average household would be an increase ranging from \$2.09 to \$3.60 per month in North County and from \$0.88 to \$1.19 per month in South County.

Staff anticipates no changes to the current contract treated water surcharge and the non-contract treated water surcharge for FY 2019-20.

Scenario 1) Water Supply Master Plan (WSMP) 90% Level of Service

This scenario includes the following projects and assumptions:

- Baseline Projects (according to the WSMP);
- California WaterFix (CWF) (State and Federal side);
- No Regrets Package projects;
- Potable Reuse Phase 1 to produce 24,000 AF (assume operations start in FY 28);
- Pacheco Reservoir Expansion (assumes \$485 M Proposition 1 grant);
- Transfer-Bethany Pipeline;
- South County Recharge (assume facilities built beyond FY 2028-29);
- \$200 M warranty placeholder cost for dams and Rinconada Water Treatment Plant (RWTP);
- The Board's CWF Guiding Principle #5.

Scenario 2) Water Supply Master Plan 80% Level of Service (LOS)

Includes the same projects and assumptions as Scenario 1 except as follows:

- CWF Federal side is excluded;
- Transfer-Bethany Pipeline is excluded;
- Pacheco Reservoir Expansion is paid for by a special tax, not water charges.

Scenario 3) Water Supply Master Plan 80% LOS, Reduce Potable Reuse

Includes the same projects and assumptions as Scenario 2 except as follows:

- Potable Reuse Phase 1 capital costs are reduced by 50%, with the remaining 50% assumed to be spent beyond FY 2028-29; the District "pay as you go" contribution is reduced from 30% to 15%; and the Public-Private Partnership (P3) reserve grows to \$10 M by FY 2027-28 instead of \$20 M;
- Transfer-Bethany Pipeline is included.

Scenario 4) Water Supply Master Plan 80% LOS, Reduce Potable Reuse, No CWF

Includes the same projects and assumptions as Scenario 3 except as follows:

- CWF State side is excluded

Scenario 5) Water Supply Master Plan 80% LOS, Reduce Potable Reuse, Add Los Vaqueros and Sites Reservoirs

Includes the same projects and assumptions as Scenario 4 except as follows:

- CWF State side is included;
- Sites and Los Vaqueros Reservoirs are included.

Staff can model additional scenarios for the Board as needed.

Other Assumptions

All scenarios assume the continued practice of relying on the State Water Project (SWP) Tax to pay for 100% of the SWP contractual obligations. Pursuant to Water Code Section 11652, the District, whenever necessary, is required to levy on all property in its jurisdiction not exempt from taxation, a tax sufficient to provide for all payments under its SWP contract with the California Department of Water Resources (DWR). All scenarios assume no change in the SWP Tax for FY 2019-20, which would remain at \$18 M. The SWP Tax for the average household in Santa Clara would remain at about \$27 per year. Note that the SWP tax projection for FY 2019-20 under all scenarios does not include any costs for the CWF.

All scenarios also assume the continued practice to set the South County agricultural groundwater production charge at 6% of the M&I charge.

A Drought Reserve was established in FY 2015-16, and was budgeted at \$7M for FY 2018-19. No further funding for this reserve is included in the preliminary analysis. The purpose of this reserve would be to help minimize rate impacts and fluctuation during the next drought, and would complement the Supplemental Water Supply Reserve. The preliminary analysis also includes a P3 reserve that ranges between \$4 M and \$8 M in FY 2019-20 depending on the scenario. The purpose of this reserve would be to help minimize the impact of unforeseen events associated with the Purified Water Program. The preliminary analysis does not include unfunded capital projects or additional unfunded operations cost needs identified by staff.

All scenarios assume Water Utility operations cost growth of 5% to \$186.4 M in FY 2019-20 versus the FY 2018-19 adopted budget.

Use of Property Tax and Capital Reimbursement Revenues

The District has many sources of revenue. Some are constrained to specified uses and some can be used for any authorized District purpose based primarily on the District Act. The District Act authorizes the Board to:

- Charge for Groundwater production (Section 26);
- Charge for Services Provided under contractual relationships (Section 5);

- Seek Voter Approval for Special Taxes (Section 13); and
- Collect Ad Valorem Property Taxes (Section 13).

FY 2018-19 Budget revenue sources include:

- Treated Water Charges (\$152.8 M), which are constrained to paying for the cost of providing treated water service per contract.
- 1% Ad Valorem Property Taxes (\$93.9 M), which can be used for any purpose authorized by the District Act. For FY 2018-19, these revenues are allocated \$79.2 M to Watershed Stream Stewardship (WSS) fund, \$7.0 M to Water Utility Fund, and \$7.7 M to the General Fund. Note that \$8.2 M of the \$93.9 M is used for the Open Space Credit.
- Groundwater Charges (\$90.7 M), which are constrained to paying for water supply protection and augmentation purposes specified in the District Act.
- Special Parcel Tax (\$44.0 M), which is constrained to pay for the voter approved activities under the Safe Clean Water measure.
- Capital Reimbursements (\$22.9 M), which are partially constrained depending on the fund where generated. For example, subventions under the Watershed Stream Stewardship fund are flexible because these funds reimburse flexible 1% Ad Valorem property tax monies used initially. However, if the subvention is part of the Safe Clean Water measure approved by voters, then it is constrained to activities of the Safe Clean Water program.
- State Water Project Tax (\$18.0 M), which is constrained to pay for State Water Project imported water contractual obligations.
- Benefit Assessments (\$14.8 M), which are constrained to pay for voter approved purposes within the flood control zone that generated the revenue.
- Other/Interest/Intergovernmental Services (\$8.2 M), which are constrained depending on the fund where generated.
- Surface/Recycled Water revenues (\$2.7 M), which are constrained to paying for the cost of providing water service.

For the Water Utility fund, Board discretion pertains to setting groundwater management policies, charges and project funding levels. For the Safe Clean Water Program, the Board may direct that proposed projects be modified or not implemented depending upon a number of factors, including federal and state funding limitations and the analysis and results of California Environmental Quality Act (CEQA) review. The Board must hold a formal, public hearing on the matter, which will be noticed by publication and notification to interested parties, before adoption of any such decision to modify or not implement a project. The Board can also set the SCW tax rate up to the annual percentage increase of the San Francisco-Oakland-San Jose Consumer Price Index for all Urban Consumers or 3%, whichever is greater.

The primary funding source for the Watershed and Stream Stewardship (WSS) Fund and General Fund is 1% Ad Valorem property taxes. Since this revenue is flexible, the Board may use these revenues for any purpose authorized by the District Act. These funds presently pay for flood protection and environmental programs in the WSS Fund, and administrative activities supporting groundwater management and flood protection in the General Fund. A portion of the 1% Ad Valorem property tax revenue is transferred from the WSS and General Funds to the Water Utility Fund each

year for the Open Space Credit.

Summary of Proposed Changes to the CIP

The proposed changes to the CIP are presented in the Preliminary FY 2020-24 CIP (Attachment 1). Eight (8) projects in the FY 2019-23 CIP are anticipated to be completed and/or closed out by June 2019; this will remove about \$100 M from the CIP.

Staff is recommending seven (7) new projects with a total combined cost of \$1.387 B be included in the FY 2020-24 CIP. With the incorporation of some key capital projects' changes into this CIP, the proposed FY 2020-24 CIP is \$1.4 B higher than the previous 5-year CIP, with a total value of \$5.2 B.

FINANCIAL IMPACT:

While there is no direct financial impact associated with the recommended action to approve the Preliminary CIP, the CIP presents a funding plan that shows the intended source of funds for each project. The District's FY 2019-20 proposed budget will include the approved projects in the first year of the FY 2020-24 CIP.

Furthermore, this preliminary analysis of the groundwater production charges does not have any direct financial impact, however, the adopted groundwater production charges will affect the future finances of the Water Utility Enterprise.

CEQA:

The recommended CIP action does not constitute a project under CEQA because it does not have a potential for resulting in direct or reasonably foreseeable indirect physical change in the environment.

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

ATTACHMENTS:

Attachment 1: Preliminary FY 2020-24 CIP
Attachment 2: FY 2019-23 CIP Priority Criteria
Attachment 3: SCVWD Resolution 99-21
Attachment 4: SCVWD Resolution 12-10
Attachment 5: PowerPoint

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