



CITY OF SANTA BARBARA

COUNCIL AGENDA REPORT

AGENDA DATE: December 11, 2018

TO: Mayor and Councilmembers

FROM: Water Resources Division, Public Works Department

SUBJECT: Montecito Water District Desalination Water Sales Agreement Status Update

RECOMMENDATION: That Council:

- A. Receive an update on the status of discussions with the Montecito Water District regarding a Water Sales Agreement in relation to the City's Charles E. Meyer Desalination Plant as a potential regional water supply;
- B. Adopt, by reading of title only, a Resolution of the Council of the City of Santa Barbara Designating the City Administrator to Execute and Deliver an Application to the State Water Resources Control Board for a Safe Drinking Water State Revolving Fund Loan for the Expansion of the Charles E. Meyer Desalination Plant; and,
- C. Authorize the continuation of the ad hoc negotiations advisory committee of Councilmembers Dominguez and Sneddon, and appointment of a new member to replace outgoing Councilmember Hart.

DISCUSSION

Background

The Charles E. Meyer Desalination Plant (Desal Plant) was constructed by the City as an emergency facility to supply water to the City, the Goleta Water District (GWD), and the Montecito Water District (MWD) during the last drought (1987-1991). The Desal Plant was planned and Coastal Zone-permitted for a maximum capacity of 10,000 acre feet per year (AFY); however, only 7,500 AFY of water treatment capacity was constructed. Abundant rainfall in March 1992 ended the drought, and the Desal Plant was placed in standby mode. At that time, GWD and MWD indicated that they did not wish to continue to use the Desal Plant as an emergency water supply.

In June 2015, the City entered into a design/build/operate contract with IDE Americas, Inc., to reconstruct the Desal Plant. On June 16, 2015, MWD sent a letter to the City requesting that the Desal Plant operate as a regional water supply. On September 15,

2015, Council directed staff to initiate formal discussions with MWD regarding a potential Water Sales Agreement (WSA) involving the Desal Plant as a regional water supply. The parties began negotiations by entering into a Memorandum of Understanding (MOU), which set the parameters within which the parties agreed to negotiate. The MOU anticipated that negotiations would be concluded by January 1, 2016; however, negotiations resulted in no significant progress toward an agreement.

In February 2016, the City was again approached by MWD with a request to continue negotiations. Recognizing the significant technical and legal costs associated with negotiating a complex agreement, the City and MWD entered into a Funding Agreement. The Funding Agreement provided for a sharing of costs for technical and legal services, and the costs for preliminary design of a conveyance pipeline which is necessary to deliver water to MWD.

From August 2016 through January 2017, the City and MWD participated in negotiations that resulted in a draft Term Sheet. MWD presented the draft Term Sheet to its Board in February and March 2017 and received direction to explore other options for water supply resiliency. In March 2018, MWD revisited the potential for a WSA with the City, and the Board voted in support of restarting negotiations. On May 1, 2018, Council authorized staff to execute a new Funding Agreement with MWD and resume negotiations.

Staff has been meeting on an as-needed basis with a Council-appointed ad hoc Desal Negotiations Advisory Committee (Committee). At the last meeting, the Committee discussed the last, major items of the WSA and recommended that this item be brought back to Council for a briefing on the draft terms of the WSA and the status of negotiations to date.

Negotiations Status Update

City and MWD staff have been actively meeting since April 2018 in an effort to develop a Term Sheet that could be used to draft a WSA. At this time, the City and MWD staff are in substantial agreement and have agreed to bring the draft Term Sheet to their respective governing bodies for input before proceeding further with development of a WSA. In summary, the Term Sheet contemplates a 50-year agreement whereby MWD would receive 1,430 AFY of water (Contract Water) from the City. Currently, the Desal Plant has a production capacity of 3,125 AFY. This amount of water is needed for the City's own purposes. In order to develop the Contract Water to sell to MWD, the production capacity of the Desal Plant must be increased. To accomplish this, the City plans to increase the production capacity to 5,000 AFY. In addition, a conveyance pipeline must be constructed from the Desal Plant to the Cater Water Treatment Plant Clearwell to deliver water to MWD. MWD would pay 64.6 percent of the costs of both a new pipeline and costs associated with reuse of an existing City pipeline, which is based on the estimated cost of construction of a stand-alone pipeline for MWD to get water from the Desal Plant to MWD's delivery system.

Several governing principles have guided the negotiations. They include the following:

- The City will own and operate the Desal Plant and the Conveyance Pipeline. The WSA will not grant any ownership interest in either the Desal Plant or the Conveyance Pipeline to MWD.
- MWD is purchasing a wholesale supply of water to be developed and made available by the City. In exchange for a reliable water supply, MWD will pay the full annual contract amount even if hydrological conditions make the Contract Water surplus to MWD's needs (commonly referred to as a "take or pay" commitment). The price for the water includes a portion of the Desal Plant's fixed and variable costs, as well as additional payments in consideration of the City's investments and risks. In addition, MWD will pay a ratable portion of potential increases in Desal Plant costs that may result from future capital modifications or operating cost increases required in response to uncontrollable circumstances.
- The City is committing to provide MWD with a reliable water supply. Thus, the City will reasonably manage its potable water supplies, including the Desal Plant, such that the Contract Water fully exceeds the quantity of water needed to provide service to customers of the City's water system within the City's water service territory, and wholesale delivery of water to future buyers outside of the City's water service territory, if any. The City's obligation to provide Contract Water to MWD will be subject to specified uncontrollable events and a shortage sharing provision.
- The Term Sheet recognizes the City's unique contribution to the WSA as owner of the Desal Plant, including City expenditures and risks, such as the permitting and maintenance costs of the Plant dating back as early as 1995.
- The expansion of the Desal Plant and construction of the Conveyance Pipeline are necessary for the City to sell Contract Water to MWD. In addition, while these components are needed as a water supply, for operational convenience of the City's potable water system, the City shall have the right to supply MWD water from the City potable water supply system as a whole.

The Contract Water unit price would be calculated by allocating costs in proportion to the 1,430 AF and the total Desal Plant capacity, or in the case of variable operating costs, in proportion to actual water produced. Similarly, MWD would participate at a proportional level in the administrative costs associated with managing the operations of the Desal Plant, including the WSA and the contract for operations of the Plant. For the first 20 years of the agreement, an index-linked Water Supply Development Fee of \$237,500 would be paid by MWD. MWD would also be responsible for contributing to a debt service coverage deposit and debt service reserve account. Lastly, the City may offer, at its discretion, up to 445 AF of additional volume in any given contract year, with the water price being determined in the same manner as the 1,430 AF, allocating costs in proportion to total Desal Plant capacity and water production.

Water non-delivery events and excuses from performance have been a key focus of the negotiations, especially since MWD has requested a 50-year term for the WSA. The Term Sheet describes uncontrollable circumstances in which the City's obligation to deliver Contract Water may be excused and MWD's obligation to make payments is reduced. It also contains a provision for shortage sharing in the event that the Desal Plant is fully operational, but there is a water shortage emergency resulting from a catastrophic event or extended drought that causes a reduction of the City's other water supplies. Under the draft Term Sheet, a water shortage emergency would allow the City to reduce Contract Water deliveries if the Desal Plant has been expanded to 7,500 AFY and the City's other water supplies are reduced to the point that the City has insufficient water to meet minimum health and safety needs. In this extreme scenario, the City would be excused from performance to the extent that a portion of the 1,430 AFY is required, along with available supplies, to meet the City's basic needs for human consumption, sanitation, and other critical services such as fire protection, hospitals, clinical care, schools, or industry needs for employment of workers within the City, as determined by Council.

If there is a regional drought or other water shortage emergency affecting both the City and MWD (as declared by the governing bodies of the City and MWD, or by the Governor), an assessment of available water necessary to meet basic needs for human consumption, sanitation, and other critical services will be conducted for both agencies. Available water will be distributed between both agencies in such a way that the respective residential customers of each agency receive the same health and safety needs based on gallons per capita per day; other critical service needs will be apportioned equitably. In such shared allocation circumstance, the amount of water provided to MWD may be less than, but shall not exceed, the 1,430 AFY.

The draft Term Sheet is in the final stage of negotiation. Staff anticipates bringing the final Term Sheet to Council for approval in January. Once the Term Sheet is approved by Council and the MWD Board of Directors, drafting will begin on a WSA based on the Term Sheet. Completion of the WSA will likely take several months.

Funding for Expansion

Additional funding will be required for expansion of the Desal Plant as contemplated by the draft Term Sheet. Staff believes the use of a Drinking Water State Revolving Fund loan (SRF) is appropriate for this project, as it would provide low-cost financing, have minimal impact on debt coverage requirements, and prevent an increase in rates that would otherwise be needed to maintain adequate reserves while simultaneously cash funding the City's share of the expansion. Because the preparation and execution of an SRF installment agreement is a year-long process, staff recommends starting the process now so as to have funding in place for the start of construction, and ultimately to meet the water delivery commencement date in the Term Sheet. Construction costs incurred prior to executing an SRF installment agreement may not be eligible for reimbursement, therefore it is important to submit an SRF application as soon as

possible. Having executed an SRF for the reactivation of the Desal Plant, staff is working with the State to minimize the work effort by identifying documents that may be reused for the new application.

The estimated cost of expanding the Desal Plant is \$24 million, which includes the design, construction, and construction management costs. To provide for a 10 percent contingency, staff is recommending authorization to submit for a total funding amount of \$26.4 million. With Council's approval, staff will complete the loan application process, execute support contracts as necessary, and return to Council with an Ordinance approving the final loan amount and directing execution of an installment agreement.

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SUBMITTED BY: Rebecca J. Bjork, Public Works Director

APPROVED BY: City Administrator's Office