

# Department of Water Resources

## Water Supply Contract Extension

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**State Water Project  
Water Supply Contract Extension**

**Executive Summary  
Legislative Informational Hearing**

**Introduction:**

In the 1960's, the Department of Water Resources (DWR) entered into water supply contracts with public water agencies located in northern California, the Bay Area, San Joaquin Valley, Central Coast and Southern California to provide water service to the State Water Project (SWP) Water Contractors in exchange for payments that recover the water supply cost of providing the service. Contract extension involves extending the 29 water supply contracts, which all have the same general provisions, have initial terms of 75 years and have expiration dates that currently range from 2035 to 2042.

**Need for Contract Extension:**

A significant part of the original capital costs to build the SWP was financed through State General Obligation Bonds (\$1.75 billion), but following this initial period, SWP capital costs have been financed primarily through the issuance of SWP revenue bonds. Today, with only 17 years left until the first contracts expire in 2035, DWR is limited to selling bonds with maturity dates that extend only 17 years rather than the customary practice of selling at least 30-year bonds. This shorter repayment period increases annual repayment costs to the contractors with the potential for significant financial impacts, which impacts will increase as the time passes without a contract extension.

Some SWP facilities are over 50 years old, and there are many needed capital upgrades and repairs. Some anticipated capital projects include reinforcing Perris Dam and Sisk Dam against seismic failure, reconstructing the Thermalito Powerplant in the aftermath of a damaging fire, reconstructing the spillways at Oroville Dam, implementing the Oroville Hydroelectric License Project, obtaining a new license for the SWP's southern hydroelectric plants and completing other repairs to, among other things, the aqueduct, pumping plants and hydroelectric pump-generating equipment. All of these projects could benefit from funding from 30 year or longer bonds.

**The Agreement in Principle (AIP):**

To begin the contract extension process, DWR and the 29 water contractors held 23 public negotiation sessions over a one year period (May 2013 – June 2014) and arrived at an

agreement in principle for the contract extension. Among other things, the AIP provided for the extension of the expiration dates for all contracts to December 31, 2085 and for other changes to the financial provisions in the contracts. The goal of the AIP was to place the SWP and contractors on a sounder financial footing going forward. In this regard, the AIP provided for, among other things, increasing the financial operating reserves of the SWP and moving to a more comprehensive pay-as-you-go billing methodology to provide a better match between revenues and costs incurred. (Twenty-five contractors have signed the AIP).

### **Contract Extension Amendment**

A model of the contract extension amendment based on the principles in the AIP has now been completed. The primary components of the model amendment are described below.

#### **A. Term**

The current Water Supply Contracts each have an initial term of 75 years, but since they were signed at various times, they also have varying initial expiration dates that range from 2035 to 2042. This amendment would set the next expiration date for each extended contract to December 31, 2085.

#### **B. Major Billing Change**

In the early years of the Contracts (in the 1960's), the Contractors were billed for costs while the initial facilities were being built and before water was able to be delivered. To address this situation, the original contract billing provisions have provided for amortizing capital costs (other than certain costs financed by revenue bonds) and conservation facility operations costs over a relatively long repayment period ending in the 2035, and all such amortized costs are repaid with interest at the project interest rate, a defined term in the contracts.

The Extension Amendment establishes a date (referred to as the Billing Transition Date (BTD)) and provides for the original contract billing methodology (which includes amortization of costs and the Water System Revenue Bond Surcharge) to continue to apply to all costs incurred prior to the BTD and for a new pay-as-you-go billing methodology to apply to all costs incurred on and after the BTD. The actual BTD will depend on when the contract amendment is able to take effect. This effective date will in turn depend on whether a specified number of Contractors sign the amendment and whether there is any litigation challenging the amendment.

Moving to a pay-as-you-go billing system will result in a better real time match of revenues and expenditures and will ultimately make administration of the billing process less complicated. The Extension Amendment contains a number of items addressing the manner in which the new pay-as-you-go methodology will be implemented and administered.

C. Reserves – General Operating Account

A 1995 Amendment to the Water Supply Contracts, referred to as the Monterey Amendment established the General Operating Account and set a cap that is currently approximately \$32 million. The Extension Amendment would increase the cap to at least \$150 million with a provision to provide for cap adjustments in the future based on a business case analysis presented to the Director. The purpose of the GOA is to provide a fund to be used for (1) cash flow deficiencies relating to water supply activities for which DWR can charge the Contractors and (2) a State Water Resources Development System (SWRDS) emergency for any SWRDS purpose (whether or not the activity is chargeable to the Contractors).

D. SWRDS Reinvestment Account (SRA)

The Extension Amendment creates a new account, the SWRDS Reinvestment Account (SRA), to provide funds to finance all or a portion of the capital costs of individual SWP projects that are chargeable to the Contractors and for which neither general obligation bonds nor revenue bonds are issued. This funding could be used for any SWP capital projects, similar to categories of capital projects that would be financed with revenue bonds, to the extent of funds in the account. After initial funding with available SWP funds, the primary source of replenishment of the account would be from reimbursements with interest. The reimbursement will then be available to provide a source of funds for the SWRDS Support Account (discussed below), for the SRA for additional investment purposes, and for additional deposits to the General Operating Account.

E. SWRDS Support Account (SSA)

The Extension Amendment creates the SWRDS Support Account, the primary purpose of which is to provide a source of funds to pay for non-chargeable expenditures where there are no funds or revenue sources available to pay for such costs. (An example would include funding of the San Joaquin Valley Drainage Program).

F. Facilities to Be Funded by Water System Facility Revenue Bonds

The Extension Amendment would allow DWR to issue SWP water system facility revenue bonds and to charge the contractors for the associated financing costs to: (1) finance repairs, additions, and betterments to most facilities of the SWP without regard to whether the facilities were in existence prior to January 1, 1987, which is the current Contract requirement and (2) finance other capital projects (not already listed in the contract for which water system facility revenue bonds could be sold) when mutually agreed to by DWR and at least 80 percent of the affected Contractors, provided the approving affected Contractors' Table A amounts also exceed 80 percent of all affected Contractors Table A amounts.

G. Flow of Funds

The Extension Amendment adjusts the rate restructuring provision in Article 51, which provides for the reduction of rates on an annual basis after revenues are determined to be available to meet then-current SWP needs and requirements. The projected annual rate reductions of \$40.5 million under the existing contract will be increased to a maximum of \$48 million, but only if available revenues permit such reductions. The Contractors would agree to forgo any additional rate management reductions, including additional rate reductions to make up for past deficiencies. The Article 51 rate restructuring provision will expire as of December 31, 2035.

H. Davis-Dolwig Act

The Extension Amendment recognizes DWR's contract administration regarding the development of public recreation as including both capital and O&M costs in accordance with the Davis-Dolwig Act (Water Code Section 11910 et seq.) requirement that the costs of the development of public recreation not be included in the prices, rates, and charges for water and power. In addition, certain language from the Davis-Dolwig Act would be set out in the Contracts.

I. Enhanced Coordination Regarding SWP Finances

The Extension Amendment provides for the establishment of a SWRDS Finance Committee comprised of DWR and Contractor representatives to provide recommendations to the Director concerning financial policies of the SWP and certain other specified matters. The Extension Amendment also provide for DWR's preparation of specific reports regarding SWP finances and provision of those reports to the SWRDS Finance Committee. In addition, during the public negotiations, a charter for the SWRDS Finance Committee was developed.

Environmental Review

DWR has prepared a Draft EIR in accordance with the California Environmental Quality Act to address possible environmental impacts associated with the proposed contract amendments. The Draft EIR, which was released on August 17, 2016, determined that the Extension Amendment would not result in any physical environmental impacts since the Extension Amendment addresses only the financial provisions of the contract. The Extension Amendment does not address any changes to the water management provisions of the contract or the water allocations among the contractors. The final EIR will be completed after the Legislative hearing required by Water Code Section 147.5 takes place and will serve as the basis for DWR and the individual contractors to determine whether to approve the Extension Amendment.

Legislative Informational Hearing

Water Code Section 147.5 requires DWR to make a presentation to the Legislature at an informational hearing at least 60 days prior to final approval of a Water Supply Contract Extension Section 147.5 also requires DWR to present the details of the terms and conditions of the contract and how they serve as a template for the remaining long-term water supply contracts and submit a copy of one long-term contract to the Joint Legislative Budget Committee no less than 30 days prior to the scheduled hearing.