



DATE: January 14, 2019

TO: Council Sustainability Committee

FROM: Director of Utilities & Environmental Services

SUBJECT: Proposed Amendments to the 2009 Water Supply Agreement with the City and County of San Francisco

RECOMMENDATION

That the Committee reviews this report and recommends to the Council approval of proposed amendments to the 2009 Water Supply Agreement with the City and County of San Francisco.

SUMMARY

Hayward receives its water supply from the San Francisco Public Utilities Commission (SFPUC) under the terms of an individual water sales agreement, as well as the 2009 Water Supply Agreement (WSA) between San Francisco and wholesale water customers. There are seven provisions within the WSA that have been identified by the Bay Area Water Supply and Conservation Agency (BAWSCA), which represents the interests of the twenty-six entities that purchase water from San Francisco, and SFPUC as requiring amendment. On September 25, 2018, the Hayward City Council approved a resolution authorizing BAWSCA to represent Hayward in negotiations with San Francisco on the proposed amendments to the WSA. City staff closely monitored the progress of negotiations. The negotiations are now complete, and the proposed amendments to the WSA were approved by SFPUC on December 11, 2018. This report provides information on the proposed amendments that the wholesale water customers, including Hayward, will need to consider approving by March 2019.

BACKGROUND

The City of Hayward purchases one hundred percent of its water supply from the SFPUC's Regional Water System. This water supply is governed by two agreements: 1) the 1962 water sales agreement between the City of Hayward and the San Francisco Water Department; and 2) the Water Supply Agreement (WSA) between San Francisco and all wholesale customers, including Hayward, and subsequent amendments. The 1962 agreement primarily addresses the quantity of water to be delivered to Hayward and is the document under which Hayward is assured of receiving sufficient quantities to meet its demand as long as adequate water supplies are available. The WSA focuses on issues of common interest to all wholesale customers, such as the calculation of wholesale rates and allocation of system costs.

Hayward is a member agency of BAWSCA, which represents the interests of the twenty-six entities that purchase water from San Francisco. In 2006, Hayward delegated authority to BAWSCA to negotiate the WSA, with the condition that Hayward staff be present at the negotiation meetings. Wholesale customers, including Hayward, also approved Amendment No. 1 in 2013, to prohibit changes to the Hetch Hetchy Reservoir unless there is an amendment to the WSA. In 2014, Hayward also delegated authority to BAWSCA to initiate, defend and settle arbitration related to the WSA.

BAWSCA administers the WSA on behalf of its members. Several sections of the WSA have been identified as requiring amendment to address substantive issues that have arisen during implementation of the WSA. On September 25, 2018, the City Council approved a resolution authorizing BAWSCA to represent Hayward in negotiations with San Francisco on eight specific and discrete WSA provisions.

DISCUSSION

BAWSCA and San Francisco originally identified four items each to be included in the negotiations. One of San Francisco's proposed items related to increasing the debt coverage ratio to be consistent with the SFPUC's current policy. During negotiations, BAWSCA and San Francisco determined that the WSA already includes the necessary provisions to implement the revised debt coverage ratio and, therefore, no amendment is needed. The remaining seven proposed amendments are largely administrative and would not change the structure of the WSA or the fundamental rights of any of the member agencies to receive water under the WSA. They would not have an adverse impact on Hayward.

Proposed Amendments

The following table briefly describes the issues and proposed amendments. The first four are issues of concern to BAWSCA and the last three are issues raised by SFPUC.

WSA Provision Requiring Amendment	Issue	Outcome
1. Tier 1 Drought Allocation	The WSA includes a procedure for calculating how available water supplies are divided between San Francisco and wholesale customers during droughts (Tier 1 Drought Allocation). The Tier 1 formula, which was adopted in 2000, requires higher cutbacks by the wholesale customers based on the assumption that the wholesale customers have the ability to cut back more in a drought than San Francisco. Various factors that affect this formula have changed, notably lower water use by wholesale customers. If the Tier 1 allocation formula had been applied during the 2014-2017 drought, San Francisco retail customers would have received a positive allocation of water while wholesale customers would have been required to significantly cutback water use.	Change to existing formula to require a minimum 5% cutback by SFPUC's retail customers. Water saved as a result of the 5% reduction would be allocated to wholesale customers, while additional water conserved by retail customers would remain in storage for allocation in future successive dry years.
2. SFPUC 2018 Decisions Regarding San Jose and Santa Clara and Increase in Water Supply for Permanent Customers	Unlike other BAWSCA member agencies, the cities of San Jose and Santa Clara currently have interruptible contracts for water from SFPUC. The WSA requires that SFPUC decide by December 31, 2018 on whether to make San Jose and Santa Clara permanent customers of the SFPUC and whether to increase the supply assurance for permanent customers. Events since 2009 have made it difficult for the SFPUC to conduct the necessary supply analyses and environmental assessment to make these decisions. It is in the parties' interest to extend the decision deadline.	Extension of SFPUC's decisions to December 31, 2028 in order to evaluate water supplies and impacts on other wholesale customers. The amendment also extends the notification for potential termination of deliveries to San Jose and Santa Clara from 5 years to 10 years, to reflect a more reasonable timeline for developing alternative water supplies.

WSA Provision Requiring Amendment	Issue	Outcome
3. Oversight of SFPUC's Capital Improvement Program	BAWSCA has no contractual right to review and provide input on SFPUC's Capital Improvement Program (CIP).	Establishment of a process to allow BAWSCA and wholesale customers to provide input into CIP development and changes in Level of Service Goals, and requirement for quarterly reports on CIP implementation.
4. Asset Classification	Resolution of disputed SFPUC Regional Water System asset classifications is needed, which affect how costs are divided between San Francisco and the wholesale customers.	Final classification of certain SFPUC assets that have been part of ongoing negotiations since 2013. The proposed adjustments would ensure that wholesale customers pay only for the water supply benefits provided by the assets.
5. Wholesale Capital Fund	The WSA has language to reconcile planned versus actual allocation of revenue funded capital expenditures in five-year intervals. This interval does not address unintended consequences that occur during implementation.	Shortened process intervals to provide greater stability in the annual determination of the Wholesale Revenue Requirement.
6. Water System Improvement Program (WSIP) Completion Date	The WSA states that WSIP will be completed by December 31, 2015.	Revised WSIP competition date to December 30, 2021 (as adopted by the SFPUC's Commission in March 2018).
7. Regional Groundwater Storage and Recovery Project (RGSRP)	The WSA has outdated language regarding operational and cost-allocation responsibilities for the RGSRP.	Updated WSA language to provide additional detail regarding operation and allocation of capital and operating costs for the RGSRP.

BAWSCA and San Francisco completed negotiations on the seven proposed amendments in November 2018. The parties have also prepared an Amended and Restated WSA that includes the proposed amendments and a number of non-substantive updates and “clean-up” revisions to the WSA. SFPUC approved the proposed amendments and the Amended and Restated WSA on December 11, 2018. The proposed amendments must also be approved by the wholesale customers to take effect. According to the provisions of the WSA, since the proposed amendments would not change the structure or affect the fundamental rights of wholesale customers, they can be executed with the approval of two-thirds of the wholesale customers or the number of wholesale customers representing seventy-five percent of the quantity of water delivered by San Francisco.

BAWSCA has prepared information and a draft resolution for approving the proposed amendments and Amended and Restated WSA to be used by agencies for consideration by their governing bodies. Approval of the proposed amendments does not require review under the California Environmental Quality Act (CEQA) because the amendments are not considered a “project” for the purposes of compliance with CEQA. The amendments at issue involve an administrative activity that does not result in a direct change to the environment (see 14 CCR Section 15378(b)(5)) and would not result in a direct or reasonably foreseeable indirect physical change in the environment (see 14 CCR Section 15060(c)(2)).

Staff received regular briefings from BAWSCA during the negotiations with San Francisco. Staff has reviewed and recommends approval of the seven proposed amendments. If the Committee concurs, staff will bring a resolution to the City Council adopting the seven proposed WSA amendments and Amended and Restated WSA in February or early March.

Minimum Purchase Requirements (A separate issue)

As requested by BAWSCA, the resolution Council adopted in September authorizes BAWSCA to negotiate amendments related only to the provisions described in the previous section. As mentioned above, staff received regular briefings on the negotiations and is supportive of the proposed WSA amendments. However, an issue that is not directly related to the proposed amendments surfaced during the negotiations and has raised concerns.

Four of the twenty-six wholesale agencies have a contractual obligation in their individual water sales contracts to purchase a minimum quantity of water from SFPUC. If an agency decides to purchase less than their minimum requirement, they are billed by SFPUC for the difference. These agencies expressed interest in reducing or eliminating the minimum purchase requirements as part of the recently completed WSA amendment negotiations. BAWSCA was clear that addressing the minimum purchase requirements could not be included in these negotiations. However, BAWSCA and SFPUC agreed to put language in the findings for the proposed WSA amendments to reflect a mutual intent to address the minimum purchase requirements in a timely way as part of a future potential amendment. This language was intended to assure the four affected agencies that BAWSCA and SFPUC are committed to addressing the minimum purchase issue and alert governing boards of a possible subsequent amendment.

Amending the WSA to reduce or eliminate minimum purchase requirements has the potential to financially impact other wholesale customers, including Hayward, if, as a result, less water is purchased and paid for by the four agencies. This results in a reduction in revenue for SFPUC that must be made up by shifting costs to other customers. These potential impacts were clearly demonstrated during the recent drought, when minimum purchase requirements were temporarily waived due to water supply shortages. Based on information provided by BAWSCA, the four agencies saw an estimated \$20 million in cost savings over the four-year period that were shifted to other wholesale customers and San Francisco retail customers. For Hayward, this shift resulted in \$1.7 million of additional costs that needed to be recovered in customer water rates.

The WSA provides for temporary waivers of the minimum purchase requirement during water supply shortages. Hayward also recognizes the need for and supported the temporary waivers that were issued during the recent drought as part of the short-term drought response and water supply strategy to leave more water in storage for the benefit of all SFPUC customers. However, Hayward's interest in a commitment to working on a future amendment to permanently change the minimum purchase requirements would depend on the structure of the amendment and impacts on Hayward. In the absence of this information, staff believes that it is premature to include a related finding in the forthcoming resolution. Further, it is not in keeping with the City Council's delegation of authority to BAWSCA, which was limited specifically to the issues outlined earlier in this report.

Staff's preference was that BAWSCA and SFPUC not include language on the minimum purchase requirements in the draft materials for approving the proposed amendments. However, the language related to the minimum purchase requirements was included in SFPUC's findings that were adopted on December 11 and is included in the draft resolution that BAWSCA distributed to the wholesale customers for approving the proposed WSA amendments. Staff recommends that the findings related to the minimum purchase requirements not be included in the draft resolution that is provided to the City Council. In this way, Hayward would not be on record as agreeing with the intent to negotiate a future solution to the minimum purchase requirements without information about the structure and impacts. Staff's recommendation would have no effect on Council's ability to approve the proposed WSA amendments.

ECONOMIC IMPACT

Approval of the proposed WSA amendments are not expected to impact Hayward's water rates.

FISCAL IMPACT

No fiscal impacts to the City Water Enterprise Fund are anticipated as a result of approving the proposed WSA amendments. Likewise, there are no General Fund impacts.

In the absence of information regarding future potential amendments related to the minimum purchase requirements, the fiscal impacts of those future actions cannot be assessed at this time. However, staff will continue to actively participate in discussions to ensure that any proposal to address the concerns of the agencies with minimum purchase requirements would not result in a financial impact to Hayward.

STRATEGIC INITIATIVES

This agenda item does not directly relate to one of Council's Strategic Initiatives.

SUSTAINABILITY FEATURES

The WSA provides for reliable and sustainable water supplies.

PUBLIC CONTACT

No public contact was undertaken, as it is not anticipated that the proposed WSA amendments will fundamentally impact water consumers in Hayward.

NEXT STEPS

If the Committee concurs with staff's recommendations, staff will work with BAWSCA to prepare the necessary materials to bring a resolution to the City Council adopting the proposed WSA amendments and Amended and Restated WSA in February or early March 2019.

Prepared by: Jan Lee, Water Resources Manager

Recommended by: Alex Ameri, Director of Utilities & Environmental Services

Approved by:

A handwritten signature in dark ink, appearing to read 'K. McAdoo', is written over a horizontal line.

Kelly McAdoo, City Manager