



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 28, 2012

Dr. Gerald Meral
Deputy Secretary
California Natural Resources Agency
1416 Ninth Street, Suite 1311
Sacramento, CA 95814

Dear Jerry:

Thank you for visiting with us on Wednesday. We enjoyed our discussion, and appreciate the information you shared on the progress of the Bay-Delta Conservation Plan. We very much appreciate the efforts by you, Secretary Laird, Governor Brown, Secretary Salazar and all of the state and federal agencies in bringing the BDCP to this point.

We promised to send you the Water Authority's comments on BDCP Chapter 8. We understand that work is under way to produce a new draft of Chapter 8. It is our hope that the issues outlined below will be considered and addressed.

Introduction

The San Diego County Water Authority is a wholesale water agency providing a safe and reliable water supply to 24 public agencies in San Diego County, supporting our region's \$186 billion economy and the quality of life of 3.1 million Californians. Highly dependent on imported water supplies, the Water Authority has historically and consistently been a strong advocate for the Delta and for the co-equal goals of providing a more reliable water supply for California, while protecting, restoring and enhancing the Delta ecosystem. The Water Authority's board of directors reaffirmed this longstanding support at its February 2012 board meeting. The board also adopted an updated set of policy principles relating to the Bay-Delta outlining the critical issues that must be resolved in the BDCP process; a copy of these Policy Principles is enclosed.

Chief among the Water Authority's concerns is the need to define the various components of the financing plan for the BDCP and the recently announced decision-tree concept in a manner that allows potential participants to evaluate the cost-benefit (or feasibility) of participating in the project. We believe the financing plan must include enforceable agreements to pay for the project, not only from state water contractors directly, but from the member agencies or units

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivewood Municipal Water District
- Olney Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Rancho Municipal Water District
- Rincon del Diablo Municipal Water District
- San Diego Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuma Municipal Water District

OTHER REPRESENTATIVE

- County of San Diego

A public agency providing a safe and reliable water supply to the San Diego region

that provide their revenues. The costs are simply too great to rely on the hope that there will be enough water purchasers over the long-term to pay the project's costs.

As the largest customer of the largest state water contractor – the Metropolitan Water District of Southern California (MWD) – the Water Authority's ratepayers have a great deal at stake in the BDCP process and its financing plan. The Water Authority must be able to assess not only that the project will provide sufficient benefits to be affordable by our ratepayers, but also that they are not at risk of paying BDCP costs associated with the water supplies of other MWD member agencies or state contractors. The Water Authority is already in litigation with MWD over how it allocates its current State Water Project costs.

The Water Authority is concerned that all of the progress that has been made in bringing the BDCP to this point will be stymied, and that the BDCP will fail if participants are not able to evaluate the cost-benefit of the project or reasonably limit the risk their ratepayers are being asked to assume. It is in this light that we offer the following brief comments on the administrative draft of Chapter 8 – *Implementation Costs and Funding Sources*.

Comments

As the largest state water contractor, MWD is the foundation for financing the project. And yet, MWD itself has been struggling over the past several years to pay its current fixed costs – let alone a substantially larger cost associated with the BDCP. The reason is simple: more than 80 percent of MWD's costs are fixed while less than 20 percent of its revenues are paid from fixed charges. More than 80 percent of MWD's revenues come from water sales. Yet, MWD's member agencies are not required to purchase *any* water from MWD. With its member agencies unwilling to sign take-or-pay contracts or make any other firm financial commitments to MWD to cover its fixed obligations, the agency remains heavily dependent on revenues from variable water sales. MWD's water sales have declined approximately 30 percent since 2008, with its firm sales declining to less than 1.3 million acre-feet in fiscal year 2012. MWD's member agencies – including the Water Authority – have also experienced significant reductions in sales. A direct consequence of these declining sales is sharply higher imported water rates that have made additional local water supply investments economically competitive. As a consequence, MWD's member agencies – and their sub-agencies – are doing what they have been asked to do over the past 20 years: reducing reliance on water supplies imported from the Delta.

We are concerned that the BDCP will become the kind of “big ticket project” that MWD board members vocally and enthusiastically support – at the same time their agencies are unwilling to make enforceable commitments to pay for the project.

A final note on the subject of risk: because the project is anticipated to be financed through project revenues, we are informed that bond underwriters are expected to require a “step up” provision by which each BDCP participant in BDCP-related bonds pledges to assume the obligations of defaulting participants.¹ The current draft of Chapter 8 is silent on this issue, yet it is conceivable that some of the BDCP participants may default, which would cause remaining participants, including MWD, to assume a greater portion of the debt. It is important that Chapter 8 analyze the possible effects of the “step up” provisions on MWD and the other participants in the BDCP.

Some have suggested that property taxes may provide the ultimate security for BDCP payment obligations of individual contractors. Putting aside the question whether property taxes levied under the authorization of the Burns-Porter Act may be used to pay for new projects contemplated by the BDCP, it is important to remember that MWD's taxing authority is further limited by the provisions of the MWD Act.² Although the Act contains override ability in the event of a fiscal crisis as determined by the MWD board (one year at a time³), it effectively limits MWD's ability to levy taxes to pay its SWP obligations. It is also unclear whether changes to this limit would require voter approval. Thus, a careful legal analysis of MWD taxing authority should be included in the BDCP due diligence process if taxes are contemplated as additional back-up security for project debt.

To effectively evaluate the finances available for the BDCP, the drafters of Chapter 8 need to conduct comprehensive due diligence on all of the facts and

¹ Under Section 50(h) of MWD's current State Water Project contract, non-defaulting contractors can be assessed to cover payments not made by defaulting contractors, up to 25 percent of the payment not made. Under Section 49(i) of its East Branch Extension of the State Water Project contract, MWD is obligated to cover a default by any and all other participants.

² Section 124.5 of the Metropolitan Water District Act limits MWD's property tax levy to “*the composite amount required to pay (1) the principal and interest on general obligation bonded indebtedness of the district and (2) that portion of the district's payment obligation under [the SWP contract] which is reasonably allocable, as determined by the district, to the repayment by the state of principal and interest on [SWP bonds] as of [January 1, 1985] and used to finance construction of facilities for the benefit of the district.*”

³ In such an event, the State of California would be relying upon an annual vote of MWD's Board of Directors in which it “*...finds that a tax in excess of these restrictions is essential to the fiscal integrity of the district....*”

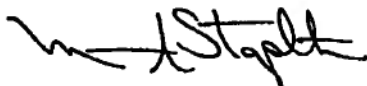
Dr. Gerald Meral
August 28, 2012
Page 4

circumstances described in this letter. Without such due diligence, the BDCP faces a potential cascading collapse of funding. At a minimum, state water contractors that are wholesale water agencies must demonstrate that their customers – the member agencies or units that buy their water and provide their revenues – have take-or-pay contracts or other enforceable commitments to pay the fixed costs of the project commensurate with the term of the BDCP obligation. The Water Authority continues to stand ready to make such a commitment to MWD that provides benefits commensurate with its payments.

Ultimately, the full faith and credit of the State of California will back up the bonds issued to build the conveyance project. Failure to secure enforceable financial commitments from the member agencies or units of water wholesale contractors could place all of California at significant risk of having tens of billions of dollars of new outstanding debt without sufficient water contractor payments to cover the debt service. This is why all California taxpayers have a stake in ensuring that there is a solid foundation and financing plan for the BDCP going forward.

Thank you again for providing the opportunity to comment on the administrative draft of Chapter 8 of the BDCP. We are committed to working with you and all parties to address and resolve these issues.

Sincerely,

A handwritten signature in black ink, appearing to read 'Maureen A. Stapleton', written in a cursive style.

Maureen A. Stapleton
General Manager

Enclosure: Water Authority Bay-Delta Policy Principles