COUNCIL AGENDA: 11/20/07
ITEM: 7.5

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Nadine N. Nader

SUBJECT: **SEE BELOW**

DATE: November 6, 2007

Approved

Date 11/19/07

SUBJECT: UPDATE ON LONG-TERM OWNERSHIP AND OPERATION OF SOUTH BAY WATER RECYCLING [Transportation and Environment Committee referral 11/05/07 – Item (f)]

On November 5, 2007 staff presented an update on Long-term Ownership and Operation of South Bay Water Recycling to the Transportation and Environment Committee.

Councilmember Liccardo motioned to accept the update and requested that the item be cross-referenced for full Council consideration, Councilmember Cortese seconded the motion. Attached is the report that was presented to the T&E Committee.

NADINE N. NADER
Agenda Services Manager

Attachment

T&E AGENDA: 11-5-07
ITEM: 6

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: TRANSPORTATION AND ENVIRONMENT COMMITTEE

FROM: John Stufflebean

SUBJECT: SEE BELOW

DATE: 10-29-07

Approved Deanna Santana Date 10/29/07

COUNCIL DISTRICT: City-Wide

SUBJECT: UPDATE ON LONG-TERM OWNERSHIP AND OPERATION OF SOUTH BAY WATER RECYCLING

RECOMMENDATION

Accept this update on issues and options for the long-term ownership and operation of South Bay Water Recycling.

OUTCOME

In advance of their respective meetings on November 5 and 20, members of the Transportation & Environment Committee and full City Council will have a framework against which to measure and respond to recent discussions and actions concerning recycled water taken by the Santa Clara Valley Water District Board of Directors. This issue will also be briefly discussed at the November 19 Joint City/District Study Session on Flood Management.

EXECUTIVE SUMMARY

The cities of San Jose and Santa Clara and the Treatment Plant tributary agencies have invested almost $280 million in the South Bay Water Recycling system, which is comprised of pump stations, reservoirs and more than 100 miles of pipeline. More than 500 customers are served by SBWR, which delivers three billion gallons of water per year (almost 20 billion gallons total since 1997). In the summer of 2007, SBWR delivered an average of 14 million gallons of recycled water daily.

Initial investments were driven by the need to protect two endangered species and avoid a state-threatened building moratorium, but even then, the water provided by the system was viewed as a commodity of vital future importance. On this basis, in the early 1990s, the City had pursued a partnership with the District while SBWR was being developed, but the two agencies were unable to agree on terms that were mutually beneficial. Instead, a Joint Powers Authority agreement was developed that involved San Jose, Santa Clara and the six Tributary Agencies that discharge to the San

Jose/Santa Clara Water Pollution Control Plant. Funding assistance was sought through grants from the U.S. Bureau of Reclamation, the State Revolving Loan Fund, and bonds.

In 2002, the District expressed its interest in re-opening partnership discussions. The Council agreed and the two agencies formed the South Bay Water Recycling Collaborative. This began what became a two-year process to explore options for long-term ownership and operations of SBWR. The Collaborative included a broad range of stakeholders and was guided by an independent facilitator. The group identified and studied numerous permutations of ownership and operations ranging from District ownership to privatization and narrowed the choices down to the four believed to provide the greatest benefit to the public, the ratepayers, and the environment.

These options, described more fully in the Analysis section, included District purchase of SBWR, establishment of a Joint Powers Authority involving the District and City/Plant, a long-term partnership agreement between the City and District, and District purchase of recycled water akin to their contracts for imported potable water from the state and federal systems. The Board and Council reviewed the Collaborative's recommendations in a Joint Session in 2003 and agreed to pursue a long-term agreement for operations and maintenance of SBWR. Cost-efficiency and a focus on the future were cited in selecting that option. The Board and Council directed staff to complete a series of water quality studies and then return with a long-term agreement for consideration and approval.

In September 2007, after completing the water quality studies and an advanced water treatment pilot study, staff returned to the Board and Council for approval of the core principles for negotiating the long-term operations and maintenance agreement. Those principals had previously been reviewed and recommended by the Transportation and Environment Committee and Treatment Plant Advisory Committee. However, when they were presented to the Board on September 25, the Board deferred a decision and expressed the need for additional time to re-consider the four options. In particular, the Board wanted to focus its attention on purchase of the SBWR system. In response, the item was dropped from the October 2 Council agenda. The Board subsequently held a special Study Session on October 24.

This memorandum provides an update of the discussions since September 25 and provides further information on the issues under consideration.

BACKGROUND

The cities of San Jose and Santa Clara built the San Jose/Santa Clara Water Pollution Control Plant (Plant) under a Joint Powers Authority agreement. They, together with the six Tributary Agencies serving six additional cities, fund the Plant and direct its overall operations. Each of the participating agencies has rights, responsibilities, and a vote in what happens to the Plant and all of its properties. The City of San Jose administers the Plant on behalf of the partner agencies.

In 1992, the Regional Water Quality Control Board issued an Administrative Order stating that the Plant had to reduce its discharge to south San Francisco Bay to protect two endangered species that were dependent on the salt marshes in the Bay. In order to reduce the discharge, the City/Plant agreed

to develop the South Bay Water Recycling (SBWR) system along with an enhanced water conservation program and other measures. Construction began in 1996 and the first recycled water was delivered in 1997. Since 1992, the Plant has invested over $230 Million in capital and almost $50 Million to operate and maintain SBWR. The system now includes more than 100 miles of pipeline, serves 546 customers, and delivers 3 billion gallons of water per year (almost 20 billion gallons of recycled water to date). In the summer of 2007, SBWR delivered an average of 14 million gallons per day.

When SBWR was first envisioned, the partner agencies and other key stakeholders quickly saw its potential as a future water supply. At that time, there were discussions with the District about partnering in the development of the system to maximize both its diversion and water supply benefits. The agencies were unable to negotiate mutually acceptable terms in the early 1990s, but in 1997 the District agreed to provide an incentive of $115/acre foot of recycled water sold to replace potable water. The District pays this incentive to all three wastewater treatment plants – Palo Alto, Sunnyvale, and San Jose/Santa Clara. Recycled water is a more environmentally friendly and less expensive alternative to importing additional water to fill that demand.

In 2002, the District expressed interest in expanding its role in recycled water delivery relative to SBWR. The Council agreed to discuss the issue and both agencies agreed to form the South Bay Water Recycling Collaborative to explore the options for long-term ownership and operations of SBWR. The Collaborative included representatives from the City, the District, the Tributary Agencies and the three water retailers as well as business, environmental, and community stakeholders. An independent facilitator guided discussions. The group identified and studied numerous permutations of ownership and operations, ranging from District ownership to the status quo to privatization.

The Collaborative narrowed the choices down to the four that provided the greatest benefit to the public, the ratepayers, and the environment. Those options, listed below, were presented to a Joint Session of the Board and Council in 2003:

- Option 1 - District buys the entire SBWR system and thus becomes the owner and recycled water wholesaler;
- Option 2 - District and City/Plant agree to become partners in SBWR under a Joint Powers Authority;
- Option 3 - District and City agree to become partners in the operations and maintenance of SBWR through a long-term partnership agreement;
- Option 4 - District buys recycled water as customer of SBWR and treats and distributes it through their own distribution system (similar to the way that the District buys its imported water).

The Board and Council reviewed the Collaborative's recommendations and decided that the best option was Option 3 – the long-term agreement for operations and maintenance. They particularly liked the cost efficiency and focus on the future in that option. Option 1 was rejected because it was deemed a waste of taxpayer funds to transfer close to $300 million from the District and water ratepayers to the Plant instead of investing the $300 million in new infrastructure and advanced

treatment, Option 2 was rejected because the outcome would be very similar to Option 3 but it would require much more legal infrastructure and cost. Option 3 was preferred by the Board because it gave them more say in the operations and maintenance of the system. The Board and Council directed staff to complete a series of water quality studies and then return with a long-term agreement for consideration and approval.

On September 17, 2007, after completing the water quality studies and an advanced water treatment pilot, staff presented a report, jointly authored by District and City staff, to the T&E Committee on the development of a long-term cooperative agreement with the District for long-term operation and maintenance of the SBWR program (Attachment A). The report presented the next steps for expanding the recycled water collaboration effort with the District. It included seven principles that, if adopted by the City Council and the District Board, would be used as the basis for negotiating a long-term cooperation agreement. T&E Committee and the Treatment Plant Advisory Committee approved staff's recommendation and requested that the item be cross-referenced for full Council consideration on October 2, 2007.

On October 2, 2007, staff reported to Council that District Board, at its meeting on September 25, 2007, had requested that further work on development of a long-term cooperative agreement be deferred until the Board had time to re-review the four options, including potentially offering to purchase the entire SBWR system, purchasing tertiary treated water from the San Jose/Santa Clara Water Pollution Control Plant, or proposing creation of a new Joint Powers Authority to manage the recycled water program. The District Board expressed its concern that a long-term agreement did not provide the Board with sufficient control of SBWR and its preference for the option to purchase the entire system. As a result of the Board's action, this item was dropped from the Council Agenda on October 2, pending further Board action.

Since then, the District Board has met two more times, once as part of their regular meeting on October 9 and once in a special 3.5-hour Study Session on October 24, to focus on their goals for the long-term future of SBWR.

ANALYSIS

San Jose, Santa Clara, and the six tributary agencies have a vested interest in South Bay Water Recycling. Together they own and operate the Plant and have invested almost $280 Million in building and operating the South Bay Water Recycling system. Ownership and operation of SBWR fulfills many City/Plant/Tributary Agency interests including ensuring:

- Cost efficient/effective management of the Plant
    - Ensures ability to meet the Plant's operating permits including the permit to discharge into the Bay.
    - Centralized integration of the Plant and recycled water operations reduces costs and minimizes excess redundancy. The two operations currently share the same staff, filtration and chlorination facilities, and central operations center. Thus, divesting SBWR would not reduce Plant operation costs.

  - Increased operational flexibility in times of emergency (e.g.; flooding).
  - Ensures that Plant, City, and Tributary Agency priorities continue to be a key consideration in the operation and management of SBWR.
  - Ability to increase investment in SBWR to respond to growth needs.
  - Future revenues from recycled water will be available to fund SBWR and Plant *infrastructure needs and may offset some future rate increases.*
  - Ensures long term sustainable water supply for the partner agencies.
  - Continued protection of the salt marsh habitat in the Plant discharge area.
- Vibrant local economy
  - Sufficient supply of local water for city residents/businesses to continue to thrive in the future.
  - Mitigation from harshest effects of global warming (diminishing snowpack, water supply cutbacks, etc.)
  - Protection in case of disruption of water supplies from the Sacramento Delta.
- Healthy environment
  - Expansion of recycled water use – meeting the Green Vision.
  - Sufficient diversion to ensure that discharge stays below 120MGD and to meet permit and habitat requirements.
  - Protection of salt marsh habitat and potential to improve stream habitat.
  - Reduces the environmental impact, greenhouse gas emission, and energy usage from pumping water from around the state.
- Sound fiscal management
  - Efficient effective use of taxpayer dollars.
  - The community already benefits from the $230 million investment in SBWR. Changing the system's nominal owner would neither expand its water resources and distribution pipelines nor increase the community's benefits.
  - Fulfilling all bond, loan, and grant requirements.
  - Appropriate return on the significant investment by the City, Santa Clara, and the tributary agencies.
  - Future revenue streams to the Plant sufficient to maintain and continue investing in the system.
  - Recycled water price/revenue increases with demand and the market value of potable water.
  - Sewer and water rate payers contribute proportionally to the benefits they receive.
- Business-friendly environment

  - Continued support for current customers.
  - Respect for the investment that businesses and developers have made to utilize recycled water.
  - Guaranteed source of water for business expansion.
- Strategic positioning for the future
  - Maintains control of a utility resource that has the potential and high likelihood to increase significantly in value as water becomes scarcer.
  - Maintains long term revenue for Plant and system maintenance and expansion.
  - Maintains a diversified water supply portfolio, including both Hetch-Hetchy and South Bay Water Recycling.
  - Continued control of water rights in case of future need.
  - Continued ability to set recycled water rates and to offer recycled water as incentive to attract new development.

Attachment B provides an analysis of the advantages and disadvantages of each of the three options. Note that Options 2 and 3, the Joint Powers Authority and long-term contract, have been combined into one to be consistent with the way that the District is considering them.

The District Board recognizes the value of recycled water. This recognition has been further strengthened by the cuts in pumping from the Delta, the record low Sierra snowpack, and the likelihood of drought and continued water supply cutbacks. As a result, when considering the proposed long-term agreement on September 25th, the Board decided that, rather than just entering into a cooperation agreement, it would prefer to fully add recycled water to its water supply portfolio.

The Board has had extensive discussions about the importance of adding recycled water to its portfolio albeit without coordination with the City and Tributary Agencies and data on the cost implications. At the October 24th Study Session, the Board discussed unrealistically low potential prices (ranging from a low of $5 Million to a high of $180 Million) for SBWR. All of the scenarios assume that the City, Tributary Agencies, and sewer rate payers would not expect any return on their investment. The prices were discussed based on the following assumptions:

Price Proposed	District Rationale
$5 million	District would reimburse the cost for the City to defease the bonds and the legal expenses involved in the transfer. This scenario assumes that the City and Tributary Agencies, not the District, would pay off the $150 million outstanding debt for the "good of the community".
$90 million	Assumes that the City and Tributary Agencies have already received full value for SBWR over the last ten years and, since half of the value is now water supply, the Plant would give the system to the District for half of the original capital investment in SBWR excluding any grants or other cost sharing by other agencies and all

	subsequent investments. Note that the Plant has invested $280 million to date.
$120 million	Assumes that, if the District paid the outstanding balance on the loans and bonds, the City and Tributary Agencies would give SBWR to the District. Note: the actual outstanding balance is approximately $150 million, not $120 million.
$180 million	Assumes that the maximum price would be the original capital investment of the City and Tributary Agencies excluding any grants or other cost sharing by other agencies and all subsequent investments. Note that the Plant has invested $280 million to date.

The District further discussed ways to reduce that cost by divesting the system of the lateral lines and customer base (potentially to the water retailers) so that it could focus on the main lines and wholesale the water. It did not discuss the combined cost and potential rate impacts of buying the SBWR system, buying water from the Plant to distribute through the system, moving the recycled water into the District distribution system, and advanced treating the water.

After almost eight hours of discussion across three meetings, the majority of the Board agreed that:

a. Its preferred option was Option 1 - purchase of the SBWR system.
b. Water rate payers should pay for the expansion of recycled water as water supply.
c. Chair Estremera and Vice Chair Kamai should meet with the Mayor, present the preferred options, and request a joint sub-committee of Board and Council members to negotiate an agreement.
d. Staff should gather additional information on cost, impact on rates, etc. for presentation and discussion at a future Board meeting.
e. A community task force should be established to begin discussing expanded use of recycled water.
f. A technical panel should be established to advise the deliberations of the Board and community task force on uses of recycled water, groundwater recharge, and streamflow augmentation.

Financial Implications

The $280 million capital investment in SBWR was funded by the Plant partners and tributary agencies and financed with San Jose-Santa Clara Clean Water Financing Authority Revenue Bonds, State Water Resources Control Board Revolving Loans, a State Water Resources Control Board Grant, and Federal grants through the U.S. Bureau of Reclamation. These loans and bonds are being repaid by the sewer ratepayers throughout the tributary area. The expectation is that, by 2020, recycled water rates will exceed expenditures (including loan/bond payments) and SBWR generate revenue that will offset Plant costs and reduce the need for future rate increases.

In the event SBWR is transferred to the District, the bonds, loans, and grants will be impacted as follows:

Revenue Bonds: The revenue bonds would need to be repaid prior to the transfer of the SBWR to a third party. The cost of redeeming the two series of outstanding bonds, series 2005 A and 2005 B is estimated at $79 million.

State Loans: The State loans specify the following regarding disposition of the SBWR project prior to the expiration of its useful life:

The Agency agrees that it will not abandon, substantially discontinue use of, lease or dispose of the Project or any significant part or portion thereof during the useful life of the Project without prior written approval of the Division of Clean Water Programs of the State Water Resources Control Board. Such approval may be conditioned as determined to be appropriate by the Division, including a condition requiring repayment of all or any portion of all remaining loan funds covered by this contract together with accrued interest, and any penalty assessments which may be due.

The outstanding principal to be repaid or assumed by the District is approximately $42 million.

State Grant: A state grant was issued by the State Water Resources Control Board for the Silver Creek pipeline component of the SBWR. The grant agreement includes language similar to the language quoted above in the State loan agreement. The amount of the grant was $3,654,544. The City would need to contact the State Board regarding whether grant repayment would be a condition of their approval of the transfer of the SBWR to another local agency.

Federal Grants: The Plant has received $27,100,300 in Federal grants. Federal grant regulations are similar to the State grant and loan regulations with respect to the transfer of assets. The City would need to contact the Bureau of Reclamation regarding whether grant repayment would be a condition of their for approval of the transfer of the SBWR to another local agency to ensure that such a transfer does not jeopardize the additional grant funding for which the project is eligible, subject to appropriation by Congress (total of $35 Million allocated.)

EVALUATION AND FOLLOW-UP

This memo will be presented to the Treatment Plant Advisory Committee on November 8 and to Council on November 20. The District Board Chair and Vice Chair are planning to meet with the Mayor prior to the Joint Council-Board Study Session on Flood Management currently scheduled for November 19 from 1-3pm. Staff will report briefly on the status of Council and Board deliberations at the end of that meeting.

PUBLIC OUTREACH/INTEREST

There has been considerable public interest in this topic in the past. The 2002-04 South Bay Water Recycling Collaborative, which included representatives from San Jose, Santa Clara, the tributary agencies, the Water District, the three water retailers, and business, environmental, and community organizations, met monthly for almost 2 years and requested continued information as work progressed. Staff notified the Collaborative participants and many of those representatives attended the District Study Session on October 24. This update does not meet the criteria for expanded posting.

However, if the Council decides to move forward with an option other than a long-term agreement for operations and maintenance in the future, additional outreach would be appropriate.

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

COORDINATION

This memo has been coordinated with the Finance Department and the Attorney's Office.

COST SUMMARY/IMPLICATIONS

There are no cost implications from this update. Cost implications from future actions will be analyzed as discussion ensues.

CEQA

Not a project.

JOHN STUFFLEBEAN
Director, Environmental Services

Attachment A

T&E AGENDA: 09-17-07
ITEM: 9b

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: TRANSPORTATION AND ENVIRONMENT COMMITTEE

FROM: John Stufflebean

SUBJECT: SEE BELOW

DATE: 08-31-07

Approved

Date 9/5/07

SUBJECT: DEVELOPMENT OF A LONG-TERM COOPERATIVE AGREEMENT WITH THE SANTA CLARA VALLEY WATER DISTRICT FOR THE SOUTH BAY WATER RECYCLING PROGRAM

RECOMMENDATION

1. Adopt the following principles as the basis for developing a long-term cooperative agreement on the South Bay Water Recycling program with the Santa Clara Valley Water District:
   - Principle 1. The Agreement should reflect the mutual interest of the City and the District in expanding the use of recycled water.
   - Principle 2. The Recycled Water Cooperative Agreement should support and enhance each agency's ability to carry out its mission.
   - Principle 3. In order to fully integrate recycled water into the countywide water supply portfolio, the Agreement should establish a framework for both agencies to meet regularly to discuss and participate in planning for development of new recycled water treatment and major distribution facilities and the future allocation and use of recycled water.
   - Principle 4. The Agreement should provide for equal cost sharing by both agencies in the cost of operating and maintaining the South Bay Water Recycling Program.
   - Principle 5. Cost sharing on future capital expansion will be negotiated on a project by project basis.
   - Principle 6. The Agreement should reflect the City and District interest in a long-term, stable, cooperative relationship.
   - Principle 7. The preferred location for environmental review and engineering design of an advanced water treatment facility should be Treatment Plant lands located near the SBWR Transmission Pumping, and the review and design should be for an advanced water treatment facility that is sized to provide treatment sufficient to meet future water quality goals and to support flexible operation of treatment plant processes.

2. Direct staff to negotiate a draft Recycled Water Cooperative Agreement based on the principles set forth herewith and agendize for approval by Council.

3. Adopt a resolution authorizing the City Manager to negotiate and execute a new "South Bay Water Recycling Reimbursement Agreement for Development and Utilization of Recycled Water Between the Santa Clara Valley Water District and the City of San José.", under which the District pays the City $115 per acre foot of recycled water used, for a term of July 1, 2007 through July 15 2008 or until the Recycled Water Cooperative Agreement is approved by Council and the Board, whichever comes first.

OUTCOME

This memorandum presents the next step in expanding the recycled water collaboration with the Santa Clara Valley Water District (District). The principles discussed in this memorandum, if adopted by the Council and District Board of Directors (Board) will be used as the basis for negotiating a long-term cooperative agreement for operations, maintenance, and expansion of the South Bay Water Recycling program. That agreement will be brought back to the Council and Board for final approval at a future meeting. In the interim, it is proposed that the District continue its recycled water development incentive of $115 per acre foot of recycled water used in the county.

A separate memo is being prepared to provide Council with a status report on South Bay Water Recycling related to funding mechanisms for annual operating costs and pipeline extension costs.

EXECUTIVE SUMMARY

In January 2002, Council and the Santa Clara Valley Water District Board of Directors agreed to engage in a series of collaborative efforts, recognizing that both agencies are responsible for providing services and programs that sometimes overlap. Two of those efforts were the "South Bay Water Recycling Collaborative of 2002" and the "South Bay Water Recycling Reimbursement Agreement for Development and Utilization of Recycled Water between the Santa Clara Valley Water District and the City of San José." The purpose of the Collaborative was to engage all of the relevant stakeholders (including the Treatment Plant tributary agencies and county water retailers) in discussions on ways to participate in the expansion of the South Bay Water Recycling system. The goal of the Reimbursement Agreement was to encourage the expansion of the recycled water system.

Since initiating the Collaborative, the City Council and District Board have met at least annually to review progress made on their collaborative projects and provide direction to staff on issues of mutual interest. In September 2006, the Board and Council met in a joint Study Session to discuss a range of Water Supply issues, including the role of recycled water as a reliable local

water supply and the importance of expanding the use of recycled water in Santa Clara County. This memorandum presents the next step in City/District cooperation on recycled water.

The first step to ensure that both agencies have similar expectations for a long-term agreement is to agree to the underlying principles. These principles will be presented for discussion and approval to the District Board on September 11, 2007, to the Treatment Plant Advisory Committee on September 13th, to the City Transportation and Environment Committee on September 17th, and to the City Council on September 25th. It is envisioned that, in this new agreement, the District will have a more effective and comprehensive role in recycled water operations, management, planning and expansion decisions and will be able to fully integrate recycled water into its overall water supply portfolio. This will better position each agency to meet future challenges. After the principles are adopted, staff from the agencies will negotiate a final cooperative agreement that will be brought to the Council and Board for approval. Adoption of the Cooperative Agreement will supersede the Reimbursement Agreement.

BACKGROUND

South Bay Water Recycling (SBWR) was developed by the City, as the administering agency for the San José/Santa Clara Water Pollution Control Plant (Plant), as a wastewater diversion project, but its value as a reliable local water supply was recognized soon after it became operational. Recycled water has now become a vital component of the county's overall water supply portfolio. As statewide population and competition for imported water increases, recycled water will become essential in keeping the San José / Silicon Valley economic engine thriving and sustainable.

In addition to meeting regularly as part of the Collaborative, the City and District have conducted a number of recycled water projects jointly, individually, and also in cooperation with other agencies and entities. Joint projects include the construction of the Silver Creek Pipeline and the recycled water reimbursement agreement under which the District has paid $115/acre foot to support SBWR operations and to encourage expansion since the system became operational in 1997.

In 2005, the District and City began discussing design and construction of a five million gallon per day (mgd) Advanced Water Treatment (AWT) Plant. On September 26, 2006, the District Board authorized execution of a consultant agreement with Black & Veatch for $2.78 million to provide engineering services to design the facility. Subsequently, the agencies were notified that a State Proposition 50 grant of almost $3 million may be available to reimburse a portion of the construction costs of the proposed facility. In addition, both agencies are also cooperatively pursuing several other state and federal grants for construction funding.

ANALYSIS

As discussions on the advanced water treatment facility progressed, staff from both agencies came to agree that it was time to develop an overarching cooperative agreement that was originally envisioned some time ago by the South Bay Water Recycling Collaborative, rather than continuing to develop a myriad of smaller individual agreements. In order to develop such a cooperative agreement, staffs from both agencies are now requesting policy level adoption of principles that can be used as the basis for developing a new Cooperative Agreement.

Staff from both agencies have worked together to develop a set of principles to recommend as guidance for the development of a recycled water Cooperative agreement. These principles and the reasons they are recommended for adoption are as follows:

Principle 1. The Agreement should reflect the mutual interest of the City and the District in expanding the use of recycled water.

- Recycled water is an exceptionally reliable locally controlled all-weather supply, less susceptible to climate than most other water sources. The District is primarily interested in fully integrating recycled water into the District's overall portfolio and water supply system as reflected in District Board policies. The City is primarily interested in recycled water as a means for minimizing treated wastewater discharged to the Bay to protect the South Bay habitat. This was the basis for the investment of over $225 Million for construction of the SBWR system by the San José/Santa Clara Water Pollution Control Plant and its tributary agencies. The City seeks to fully utilize this resource and increase its return on investment by expanding recycled water use.

Principle 2. The Recycled Water Cooperative Agreement should support and enhance each agency's ability to carry out its mission.

- The District will continue to perform and control all functions stated in the District Act. The District is empowered under the Santa Clara Valley Water District Act (Act) to develop, store, manage, recycle, distribute, sell, and deliver water for domestic, industrial and agricultural uses in Santa Clara County; and the Act empowers the District to acquire water and water rights within the state; protect and manage the groundwater basin; develop, store and transport water, provide, sell and deliver water at wholesale for domestic, industrial and agricultural purposes; set the rates for its water; and acquire, construct, operate and maintain any facilities, improvements and property necessary for this function. In order to achieve greater water supply certainty, the District is interested in long term local relationships. By this agreement, the District seeks to more effectively integrate recycled

water into the overall long-term water supply portfolio and thus into the water supply system.

- The City, operating as the Administering Agency of the South Bay Water Recycling Program and the San José/Santa Clara Water Pollution Control Plant, has obtained approval to distribute recycled water for approved purposes from the California Regional Water Quality Control Board, San Francisco Region, pursuant to order No. 95-117, and any orders supplementary or amendatory thereof. By this agreement, the City seeks to increase the utilization of SBWR water as a water resource and increase its return on investment by expanding recycled water use.
- The Recycled Water Cooperative Agreement should facilitate the management and utilization of recycled water for the maximum good of the community. This can best be achieved through ongoing communication and coordination between the two agencies. The City is responsible for the operations of the Water Pollution Control Plant, of which SBWR is a component. The District is responsible for water supply management for the County. The Cooperative Agreement should not infringe or run counter to either agency's procedures, policies, other obligations, constraints or agreements.

Principle 3. **In order to fully integrate recycled water into the Countywide water supply portfolio, the Agreement should establish a framework for both agencies to meet regularly to discuss and participate in planning for development of new recycled water treatment and major distribution facilities and the future allocation and use of recycled water.**

- Both agencies commit to regular and ongoing staff level discussions to optimize the management of the recycled water supply.
- A suitable framework, such as a steering committee, may be recommended for assuring full participation by both agencies in policy level decisions.
- The framework will recognize that ultimate policy level authority, including funding and budget decisions, will remain City Council and/or District Board approval.
- The City will consult with the District on recycled water pricing, including the establishment of additional rate categories and rates appropriate for each use.

Principle 4. **The Agreement should provide for equal cost sharing by both agencies in the cost of operating and maintaining the South Bay Water Recycling Program.**

- For the purposes of this agreement, the operation and maintenance costs means the management and administration of South Bay Water Recycling, customer service and support, and operation and maintenance of existing

facilities, as well as those under design or construction (including the proposed AWT at the Plant), as of the day that the Cooperative Agreement is executed. The FY 2007-08 budget for the entire South Bay Water Recycling Program, as defined above, is approximately $5.2 Million. The program components that make up "operations and maintenance" will be specifically defined in the Agreement.

- Each party will contribute one half of the operations and maintenance cost of the South Bay Water Recycling Program.
  - The 50-50 cost split on operations and maintenance will continue until revenue from the sale of recycled water equals the actual cost of operations and maintenance.
  - Both agencies recognize the need to establish a sinking fund to put aside money for future infrastructure asset replacement needs.
  - As revenue approaches the cost of operations and maintenance, the City and District will meet to evaluate options and contribution rates necessary to build an appropriate SBWR sinking fund. If the parties agree to establish a sinking fund, the District agrees to contribute one-half of the funding for the sinking fund on an annual basis, provided that the City matches that contribution.
- Cost sharing for operations and maintenance of future expansion will be negotiated on a case by case basis.

Principle 5. **Cost sharing on future capital expansion *will be negotiated on a project by* project basis.**

- Both agencies recognize the need to fund future capital expansion of the recycled water system.
- Each agency's participation will be negotiated based on the overall value of the project, the identified benefit to each agency, and the availability of other funding sources including grants, developers, and other partners and beneficiaries.
- As much as possible, other participants, water retailers, customers, and beneficiaries will contribute proportional to the benefit that they receive and other state and federal funding will be sought.

Principle 6. **The Agreement should reflect the City and District interest a long-term, stable, cooperative relationship.**

- *Both agencies* demonstrate their commitment in long-term operations, management, and expansion of recycled water and truly integrate recycled water into the overall water supply.

- The Agreement should have a stated minimum term of at least 25 years, *although the Agreement will need to have termination provisions that reflect* other legal obligations and constraints of the parties.

Principle 7. **The preferred location for environmental review and engineering design of an AWT facility should be Treatment Plant lands located near the SBWR Transmission Pumping, and the review and design should be for an AWT facility that is sized to provide treatment sufficient to meet future water quality goals and to support flexible operation of treatment plant processes.**

- The District is interested in expanding the storage reserves of its groundwater basins, which provide 40-50% of drinking water in this County, while continuing its policy of aggressively protecting groundwater quality.
- The City is interested in adding added filter capacity while avoiding the cost of building additional conventional filters.
- The South Bay Water Recycling Collaborative Effort of 2002 recognized that some future uses of recycled water may be enhanced by a higher level of water quality.
- Upsizing the proposed advanced water treatment facility to 10 MGD (double its initial 5 MGD capacity) will ensure that there is sufficient capacity to meet the water quality objectives and provide sufficient filter capacity through 2015.
- Both agencies agree that, for maximum efficiency and benefit, the advanced water treatment facility should be located at the San José/Santa Clara Water Pollution Control Plant. This location also facilitates removal of brine added by any future downstream facility.
- The capital cost of the advanced water treatment facility will be shared by the City and District as follows:
  - City will contribute $11 million in cash and the Plant land (valued at approximate $2 million) to locate the facility.
  - District will initially fund the balance. The District contribution will be offset in part by any grants that may be received for the purpose of funding the AWT.

- Consistent with Principle #4, the operations and maintenance costs for this 10 MGD advanced treatment facility will be shared equally by both parties.
- Consistent with Principles #4 and #5, cost sharing for capital, operations, and maintenance expenses for other advanced water treatment facilities will be negotiated on a case by case basis.

EVALUATION AND FOLLOW-UP

Following approval of these recommendations, staff and legal counsel for both agencies will negotiate the agreements discussed above. The long-term Recycled Water Cooperative Agreement will be brought back for recommendation by the Treatment Plant Advisory Committee and approval by the Council and District Board. The Recycled Water Reimbursement Interim Agreement will be executed by the City Manager and implemented immediately thereafter.

PUBLIC OUTREACH/INTEREST

Public outreach on the important role of recycled water in our water supply has been part of both agencies' outreach at public events, public education, school outreach, etc. Stakeholder and public outreach has also been a part of the SBWR Collaborative effort of 2002 also included participation from all of the key stakeholders including the Tributary agencies, all of the water retailers, and representatives of the business and environment community. Expansion of the recycled water system was also a primary topic at the Joint Study Session on Water Supply in September 2006, which was televised, and to which all of the stakeholders were invited and many attended. In the future, there will more joint agency recycled water outreach on the importance of the water as well public outreach and coordination for the Advanced Water Treatment Facility CEQA process.

COORDINATION

This memo was developed and coordinated with the City Attorney's Office and the Santa Clara Valley Water District and is scheduled to be considered at the September 13, 2007 meeting of the Treatment Plant Advisory Committee.

COST IMPLICATIONS

Adoption of the principles does not have any cost implications. The $11Million City contribution toward construction of the AWT facility is part of the 5 year CIP budget in Fund 512, the Treatment Plant Capital Fund. It will be brought forward for approval with the 2008-09 Budget and the recommendation for approval of the Recycled Water Cooperative Agreement. The current annual operations and maintenance costs for the South Bay Water Recycling Program, including management and administration, customer service and support, and operation and maintenance of existing facilities, as well as those under design or construction is estimated at $5.2 million. The District contributed just over $1 million toward Program costs under the FY2006-07 Recycled Water Reimbursement Agreement.

CEQA

Adoption of these principles is not a project. The Advanced Water Treatment Facility will require CEQA clearance. The final Cooperative Agreement will not be brought back to Council and the Board until CEQA is complete.

JOHN STUFFLEBEAN
Director, Environmental Services

For questions, please contact Mary Ellen Dick, Assistant to the Director, Environmental Services Department, (408) 535-8555

SUPPLEMENTAL

COUNCIL AGENDA: 10-02-07
ITEM: 7.3

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: John Stufflebean

SUBJECT: SEE BELOW

DATE: 9-27-07

Approved Kim Walesh Acting City Manager

Date 9·28·07

COUNCIL DISTRICT: City-Wide
SNI AREA:

SUPPLEMENTAL

SUBJECT: DEVELOPMENT OF A LONG-TERM COOPERATIVE AGREEMENT WITH THE SANTA CLARA VALLEY WATER DISTRICT FOR THE SOUTH BAY WATER RECYCLING PROGRAM

REASON FOR SUPPLEMENTAL

The Santa Clara Valley Water District (District) Board has requested that Recommendations #1 and 2 be deferred until they have time to review other options for greater control of the recycled water, including potentially offering to purchase the entire South Bay Water Recycling system, purchasing tertiary treated water from the San Jose/Santa Clara Water Pollution Control Plant, or proposing creation of a new Joint Powers Authority to manage the recycled water program. Since the District Board's deliberation may take several weeks or months, staff is recommending that these two elements be dropped until a proposal is ready for Council discussion. The Board approved Recommendation 3 and directed its General Manage to extend the existing Recycled Water Reimbursement Agreement to provide continued support for development and expansion of South Bay Water Recycling until a final agreement on the system is reached.

RECOMMENDATION

1. Drop Recommendation 1: Adopt the following principles as the basis for developing a long-term cooperative agreement on the South Bay Water Recycling program with the Santa Clara Valley Water District:

   - Principle 1. The Agreement should reflect the mutual interest of the City and the District in expanding the use of recycled water.
   - Principle 2. The Recycled Water Cooperative Agreement should support and enhance each agency's ability to carry out its mission.
   - *Principle 3.* *In order to fully integrate* recycled water into the countywide water supply portfolio, the Agreement should establish a framework for both agencies to meet regularly to discuss and participate in planning for development of new recycled

water treatment and major distribution facilities and the future allocation and use of recycled water.

- Principle 4. The Agreement should provide for equal cost sharing by both agencies in the cost of operating and maintaining the South Bay Water Recycling Program.
- Principle 5. Cost sharing on future capital expansion will be negotiated on a project by project basis.
- Principle 6. The Agreement should reflect the City and District interest in a long-term, stable, cooperative relationship.
- Principle 7. The preferred location for environmental review and engineering design of an advanced water treatment facility should be Treatment Plant lands located near the SBWR Transmission Pumping, and the review and design should be for an advanced water treatment facility that is sized to provide treatment sufficient to meet future water quality goals and to support flexible operation of treatment plant processes.

2. Drop Recommendation 2: Direct staff to negotiate a draft Recycled Water Cooperative Agreement based on the principles set forth herewith and agendize for approval by Council.

3. Adopt a resolution authorizing the City Manager to negotiate and execute a new "South Bay Water Recycling Reimbursement Agreement for Development and Utilization of Recycled Water Between the Santa Clara Valley Water District and the City of San José.", under which the District pays the City $115 per acre foot of recycled water used, for a term of July 1, 2007 through July 15 2008 or until a long-term agreement on the operation of the Recycled Water program is approved by Council and the Board, whichever comes first.

OUTCOME

At its meeting on September 25, 2007, the Santa Clara Valley Water District expressed its continued commitment to long-term expansion of the use of recycled water as a key part of the county's water supply. Their discussion was focused on how they could more fully integrate recycled water into their overall water supply portfolio. They have asked for additional time to fully discuss all of their options and intend to bring a final proposal forward for Council and Treatment Plant Advisory Committee approval in the next few months. Staff from both agencies will continue to meet regularly to support the District Board discussion and City staff will bring Council updates as progress is made.

BACKGROUND

In 2002, as part of the South Bay Water Recycling Collaborative stakeholder process, representatives from the water retailers, business and environmental communities, and the tributary agencies, led by City and District staff, held a series of meetings to develop recommendations for long term operations and management of the South Bay Water Recycling program. That group spent a significant amount of time analyzing the pros and cons of eight alternatives including:

1) District purchase of the South Bay Water Recycling infrastructure.
2) *District owns and builds all new extensions to the South Bay Water Recycling system.*
3) District buys recycled water from the Treatment Plant and treats and resells it.
4) Establishment of a new, independent Joint Powers Authority that would own and operate the South Bay Water Recycling system.
5) Development of a long-term comprehensive agreement between the Treatment Plant Joint Powers Authority (JPA) and the District related to operation of the South Bay Water Recycling system.

The analysis and recommendations of the Collaborative group were presented to joint meeting of the Council and Board in January 2003. After a lot of discussion, the Board and Council directed staff to work on the long term plan for enhancing water quality and developing a long-term comprehensive agreement for operations and maintenance of the South Bay Water Recycling system. That discussion was the basis of the collaborative work on recycled water since then. Each subsequent joint memo to the Council and Board has included a status of progress to date and discussion of next steps.

ANALYSIS

The District Board's proposed delay in adopting principals as the basis for a long-term agreement on the operations and maintenance of the South Bay Water Recycling program does not denote their reluctance to expand their use of recycled water. Rather, the focus of Board discussion was on how the District, as the agency responsible for water supply for the county, could better manage the overall water portfolio by having complete control of the recycled water They discussed their goals and preferred outcomes and asked staff to present information on the following three options for discussion at their next meeting:

1) District purchase of the South Bay Water Recycling infrastructure.
2) District buys recycled water from the Treatment Plant and treats and resells it.
3) Establishment of a new, independent Joint Powers Authority that would own and operate the South Bay Water Recycling system.

At the same time, the Board realized that they had not yet formally adopted a policy allowing recycled water to be used for groundwater recharge and directed that such a policy be brought back for their consideration at the next meeting. Their General Manager reminded them that adoption of such a policy will take several meetings so it could not be accomplished by October 9th, 2007.

The Board recognized the importance of continuing to support the recycled water program during this interim period and voted to authorize the District General Manager to renew the "South Bay Water Recycling Reimbursement Agreement for Development and Utilization of Recycled Water Between the Santa Clara Valley Water District and the City of San José.", under which the District pays the City $115 per acre foot of recycled water used, for a term of July 1,

2007 through July 15, 2008 or until a long-term agreement on the operation of the Recycled Water program is approved by Council and the Board, whichever comes first. They also commented that, if an agreement was not in place by July 15, 2008, they would renew the Reimbursement Agreement again until an agreement was reached as long as the Reimbursement Agreement was not an impediment to concluding a long-term agreement.

COORDINATION

This memo has been coordinated with the City Attorney's Office.

BUDGET REFERENCE

This addendum does not change the cost analysis in the original memo.

CEQA

This addendum does not change the CEQA analysis in the original memo.

for Zientek for
JOHN STUFFLEBEAN
Director, Environmental Services

For questions please contact MaryEllen Dick, Assistant to the Director, at (408) 535-8555.

ATTACHMENT B

Analysis of Three Options for Ownership and Operation of South Bay Water Recycling in Cooperation with the Santa Clara Valley Water District

Advantages and Disadvantages

October 24, 2007

Ownership Option and Description	Advantages to City and Tributary Agencies [1]	Disadvantages to City and Tributary Agencies
Option #1. District procures SBWR and owns and operates recycled water system as wholesaler. District and City, as administrator of the Plant, enter into "Producer-Wholesaler" agreement for purchase of recycled water, District and retailers enter into "Wholesaler-Retailer" agreement for resale of water.	• City will be relieved of some portion of responsibility for the management, operation and maintenance of SBWR.[2] • Some portion of the initial capital investment may be returned to the City and tributary agencies.[3] •	• City will be unable to ensure discharge under 120 mgd in compliance with NPDES permit. • City will lose a major portion of its currently diversified water portfolio, and may be unable to guarantee delivery of recycled water to new developments. • City and tributary agencies will not be compensated for the loss of 100,000 afy water rights with a market value of $50 million to $100 million per year. • Public funds invested by District will not contribute to improved water quality or increase use of recycled water. • Loss of ability to promise recycled water to support business expansion.

[1] All subsequent references to "City" means "City and Tributary Agencies" unless otherwise specified.

[2] Legal requirement to maintain flows below 120 mgd and City's obligation to existing customers may required its continued participation in management and oversight of the SBWR system even after assets are transferred.

[3] Advantage of return of capital investment depends upon purchase price negotiated with District. Note that some ownership scenarios now being considered by Santa Clara Valley Water District do not involve purchase of system infrastructure.

Option #2. District and City execute a partnership agreement to share equally in cost of managing and operating SBWR; City retains ownership of SBWR and shares cost of constructing AWT facilities. Investment of future facilities will be determined on a case-by-case basis.	1. City can continue to ensure discharge under 120 mgd in compliance with NPDES permit. 2. City maintains a diversified water supply portfolio, including both Hetch-Hetchy and South Bay Water Recycling. 3. City retains water rights and sells recycled water at a price commensurate with the market value of potable water. 4. Additional resources available to increase use and improve recycled water quality. 5. Sewer and water rate payers can contribute proportionally to the benefits they receive. 6. Continued availability of recycled water as an economic incentive tool.	1. Requires increased cooperation between the City and the District. 2. Purchase price below market value may be negotiated with SCVWD to reflect other contributions. 3. May require City to dedicate some Plant lands and to contribute $11 million to construction of AWT facilities.
Option #3. District purchases recycled water from City at market rates for delivery at a specified point or points.	1. City can continue to ensure discharge under 120 mgd in compliance with NPDES permit. 2. City maintains a diversified water supply portfolio, including both Hetch-Hetchy and South Bay Water Recycling. 3. City retains water rights and sells recycled water at a price commensurate with the market value of potable water, and all future revenues are retained by City and tributary agencies. 4. No changes in the management of SBWR are required. 5. Continued availability of recycled water as an economic incentive tool. 6. Continued ability to be an advocate for recycled water as a water supply.	1. Relative to Option 2 (Partnership) does not commit the District to development of recycled water program. 2. Fewer resources available to increase use and improve recycled water quality. 3. Lack of District advocacy may reduce public trust in recycled water beyond no potable use.

Analysis of Three Options for Ownership and Operation of South Bay Water Recycling in Cooperation with the Santa Clara Valley Water District
Assumptions and Explanations

1. According to its NPDES permit, the City is required to continue to develop the use of recycled water and to ensure that flows from the San Jose/Santa Clara Water Pollution Control Plant remain below 120 million gallons per day (mgd).

2. In order to develop their communities in conformance with their general plans, the City of San Jose and the other cities served by the tributary agencies must be able to ensure diversion of sufficient effluent to maintain flows below 120 mgd.

3. State law requires that prior to approval by the responsible land use planning entities all new developments must identify an adequate supply of water to meet their projected future needs (SB 610).

4. In order to develop their communities in conformance with their general plans, the City of San Jose and the other cities served by the tributary agencies must be able to ensure the availability of water adequate to meet projected future needs.

5. Water is in increasingly limited supply in California, and the ability to bring additional supplies into Santa Clara County will become increasingly expensive in years to come.

6. In order to meet projected average-year and dry-year demands, the Santa Clara Valley Water District (District) has identified a need for approximately 45,000 AFY of recycled water (county-wide) by 2030, based on the availability of existing allocations of federal (CVP) and state (SWP) water supplies.

7. According to California law, as owners of the San Jose/Santa Clara Water Pollution Control Plant the cities of San Jose and Santa Clara jointly own rights to water treated at the Plant, currently averaging 100 mgd or roughly 110,000 acre feet per year (AFY). The Plant has the capacity to treat up to 167 mgd (190,000 AFY.)

8. The current retail value of recycled water in Santa Clara County is between $700/AF and $1300/AF based on a current wholesale price of $330/AF. The wholesale price of recycled water is projected to reach about $500/AF by 2010 and $1000/AF by 2020. Demand for recycled water, currently about 10,000 AFY, is expected to double within the next ten years. **Before entering into an agreement to transfer ownership of water rights to the District or to sell recycled water to the District at below market rates, the City should recognize that by 2020 the value of rights to 20,000 AFY of recycled water could be worth $20 million/year on a wholesale basis.**