



OFFICE OF THE CITY MANAGER

**PALO
ALTO**

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November 14, 2014

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SCVWD Board of Directors
5750 Almaden Expressway
San Jose, CA 95118

Dear SCVWD Board Members:

On behalf of the City Council, I am pleased to see that the District discussed the State Water Project (SWP) tax allocation at your July 8, 2014 Board meeting and will do so again on November 18. The District's allocation of 100% of its SWP costs to property taxpayers instead of water ratepayers is of particular concern to the City of Palo Alto. This is of course because City residents receive no SWP water, yet Palo Alto taxpayers contribute approximately \$1.5 million annually toward the District's SWP costs, and have contributed \$19-\$25 million over the last 30 years. The City raised this issue with the District over 4 years ago, but the District has continued to collect 100% of its SWP costs from taxpayers, while allocating none of SWP costs to ratepayers.

We thank you for discussing the issue and encourage the Board to take this opportunity to make a meaningful and equitable change to the District's current practice. At this point, it is important to build upon and correct a few statements made at the July 8, 2014 meeting and in the accompanying staff memorandums for the July 8 and November 18 meetings:

1. District staff statement that all County residents, even those who receive no SWP water, benefit from the District's participation in the SWP is incomplete and potentially misleading.



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First, the statement ignores the key benefit and primary purpose of the SWP: the provision of water. The District's Water Utility Taxing and Pricing Policy requires the District to "charge recipients for benefits received." Palo Alto receives zero SWP water. This should be the starting place for any discussion of cost allocation for the SWP.

Second, as to any potential secondary benefits, such as avoiding subsidence and saltwater intrusion and general economic development, the District ignores similar and offsetting benefits that other users receive as a result of the City's use of 100% Hetch Hetchy water and the San Francisco Public Utilities Commission (SFPUC) intertie connecting the two systems.

Palo Alto agrees that having multiple water supply sources in the County provides the District with the flexibility to effectively manage water resources. But Palo Alto's total reliance on its SFPUC supply provides comparable, if not superior, benefits to the District and other users: it relieves the District of the obligation to build facilities to manage water supply in Palo Alto, and it allows the District to reallocate SWP water elsewhere in the County, reducing the risk of subsidence and saltwater intrusion, recharging groundwater, and contributing to economic growth.

2. Contrary to statements made by the District's General Counsel at the July 8, 2014 meeting and a memorandum prepared for the November 18th meeting, the District is not "required to tax" to pay its SWP costs. The District has the authority to fund its SWP costs in a variety of ways, including through rates charged to water users. In fact, according to the District's contract with the State Department of Water Resources, the Water Code, and the Burns-Porter Act, property taxes are intended to be a secondary collection method that provides assurance to bond holders that debts will be paid in years when other funding sources are insufficient to meet SWP costs.
3. Staff's July 8th and November 18th presentations provide helpful information about how some other state water contractors recover their SWP costs. The District is one of 27 SWP customers; several collect their SWP costs entirely or primarily from retail water sales, not taxes. In fact, the two agencies that take approximately 70% of all SWP water - Metropolitan Water District (MWD) and Kern County Water Agency - collect only 8-14% of their SWP costs through taxes, and the rest through water rates. The Alameda County Water District relies on taxes to pay for 50% of its SWP obligation.

The Metropolitan Water District's SWP cost allocation practice is illustrative. MWD collects only 8-10% of its SWP obligation from taxpayers. At the July 8th Board meeting, the District's outside counsel noted that this was due to legislation directing MWD to cap the taxpayer contribution. While that is true, the legislation was largely an outcome of a

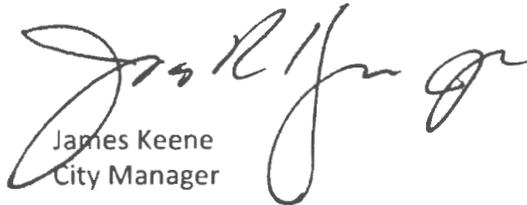
lawsuit the City of Los Angeles filed against MWD in 1975. Los Angeles argued that because it received little SWP water, MWD's practice of collecting the majority of its SWP costs from Los Angeles taxpayers violated the law. The parties settled the suit in 1980, when MWD adopted a "proportionate use" cost sharing formula, under which water sales revenues paid operating expenses and an increasing share of MWD's capital costs. Taxpayers' share of MWD's SWP costs decreased as water sales increased.

4. At the July 8th Board meeting, several Board members discussed what voters intended when they approved the Burns-Porter Act in 1960, authorizing the issuance of state bonds to finance construction of the SWP. The Burns-Porter Act ballot materials informed voters that the SWP would not burden taxpayers. Voters were told that the system would pay for itself through the sale of SWP water and power. Contrary to statements made at the District's July 8th meeting, voters did not expect to be taxed even if they received no SWP water.
5. The District's funding practices demonstrate awareness that it is inappropriate to charge taxpayers for a water system they do not use. Until 1984, the Hetch Hetchy water users (Milpitas, Mountain View, Palo Alto, Purissima Hills, San Jose Municipal Water Company, Santa Clara, Stanford University, and Sunnyvale) received an "in-county credit" in recognition of the fact that they used little or no SWP water. While the District ended the credit in 1984, it continues to credit South County taxpayers, who also receive no SWP water, for the 6% of the District's SWP costs they contribute via property taxes.
6. During the July 8th Board meeting, the City's water conservation programs were mentioned. It is true that the City and the District have a longstanding partnership administering a variety of water conservation rebates and programs. In fact, the City has a Memorandum of Understanding with the District, in effect since at least 2002, under which both parties fund and administer ten different water conservation programs for City water customers. Program costs are shared equitably; the District does not cover 100% of these costs.

The City of Palo Alto greatly values its relationship with the District, and appreciates the District's partnership on water-related issues like flood protection and conservation. The City wants that to continue. At the same time, the District should correct its practice of relying on property taxpayers to meet 100% of its SWP obligations. This is particularly important during a time when District staff is forecasting significant increases to SWP costs, even before the state embarks on an ambitious plan to build water conveyance tunnels through the Delta that could increase the current tax collection even further. Doing this would be fair to County taxpayers who receive no SWP water, and consistent with state law and promises made to voters when the SWP was approved.

Once again, on behalf of the City, we thank you for discussing the issue, and look forward to continued dialogue and to crafting a mutually beneficial solution. Please have Beau Goldie contact me or my staff if we may assist in any way.

Sincerely,



James Keene
City Manager

cc: Mayor and City Council
Beau Goldie, CEO, Santa Clara Valley Water District
Stan Yamamoto, District's General Counsel
Molly Stump, City Attorney
Val Fong, Director Utilities