# SAN DIEGO COUNTY WATER RATES: HIGH TODAY, HIGHER TOMORROW

**A Report by the**
**2010/2011 San Diego County Grand Jury**
**May 31, 2011**

# *SAN DIEGO COUNTY WATER RATES: HIGH TODAY, HIGHER TOMORROW*

## *INTRODUCTION*

Most of San Diego's water must be transported to the County from distant sources, a fact that significantly drives up water rates. Only about 20% of our water comes from local sources with the balance transported from the Colorado River (50%) and northern California (30%).

The 2010/2011 San Diego County Grand Jury (Grand Jury) sought to understand this vast water supply system and the inherent pricing pressures that produce water rate increases.

## *INVESTIGATION*

Water rates continue to increase throughout southern California's water distribution system; the Grand Jury studied major reasons for water rate increases by the 24-member water agencies (retailers) of the San Diego County Water Authority (CWA). No investigation of our region's water rates would be complete without understanding our primary source of wholesale water, and the fundamental pricing power that the Metropolitan Water District (MET) wields on our local water rates.

As local media reported water rate increases in the summer of 2010, complaints flowed into the Grand Jury. In addressing the complaints, the Grand Jury interviewed complainants, reviewed a multitude of materials and conducted informational interviews with water officials from both wholesale and retail agencies. The Grand Jury also reviewed official documents, conducted physical site tours, reviewed related websites and attended public meetings.

The Grand Jury investigated the contributing factors associated with the rate hikes. The Grand Jury's attention was focused on the following questions:

- What does the overall distribution system look like?
- How many agencies touch our water and tack on costs?
- Why do water rates increase despite increased conservation?
- What will be the new 'normal' for water rates in the future?
- When will water rates level off?

## *DISCUSSION*

Billions of dollars have been spent on California's vast water distribution system, and billions more are planned. As water continues to be imported, the costs of capital improvements needed for the distribution system will be reflected in increased rates.

The CWA is the San Diego county water wholesaler. CWA manages supply relationships with MET and sells wholesale water to CWA member agencies. These retailers then deliver water to our homes and businesses. The board of directors of CWA is comprised of representatives of these 24 retailers. Today, CWA relies on MET to supply 53% of its water; it is projected to decline to 29% by 2020.

During the 1990 drought, CWA was fully dependent on water deliveries from MET. Citing the drought, MET reduced the amount of water delivered to CWA by one-third. Related mandatory conservation and increased costs during this period forced many local farmers out of business. San Diego County was dependent on MET, but MET couldn't deliver.

After these drastic cuts, CWA embarked on a mission to lessen its dependence by diversifying the County's water supply. In the process, CWA embarked upon a Capital Improvement Program (CIP) to build reservoirs and upgrade its current storage infrastructure. This diversification plan did not come without a cost: CWA will spend nearly $3.8 billion over the period of 1989-2030. Further rate increases may result from these expenditures.

CWA's strategy is to change the relationship with MET from a sole supplier to a supplier and transport partner. The transport comes from the conveyance of CWA-controlled water from sources such as the Imperial Irrigation District through MET's system to CWA facilities.

CWA is MET's largest customer, but is under-represented on MET's board of directors. This disproportionate representation on MET's board suggests that MET will continue to levy a hefty fee to convey CWA water, regardless of source, since CWA has little influence on that decision.

MET was sued by CWA June 11, 2010. The lawsuit claims that MET adopted rates and charges on April 13, 2010 that will overcharge CWA by $30M annually, and that the overage uniquely mischaracterizes certain water supply costs as water transportation costs, thus stabilizing other MET members at CWA expense.

CWA's ongoing investment in a diversification program has been successful in securing supplies from the Imperial Irrigation District. There have been efforts in recycling, desalination, ground water exploration and development to diversify San Diego County's water supply and distance CWA from MET. MET's loss of water sales, along with the state's 20% conservation target, means a significant loss of revenue to MET.

MET is not immune to pricing pressures of its own; as a result, the price increases will flow directly down to ratepayers. Some examples are:

- Substantial reductions in MET's lowest cost supplies from the Colorado River as a result of MET's loss of past Arizona and Nevada surplus water now being used by a growing population in those states.
- Substantial increases in MET's higher water cost from the State Water Project as a result of court rulings limiting the amount of water which may be delivered

through its facilities because of environmental concerns such as river smelt protection.

- State-mandated water conservation targets of 20%.
- MET can restructure water rates such that CIP and various reserves are not funded through water rates. For instance, some CIP have 40-year life spans that could be funded by borrowing.
- CWA, the largest customer, is buying less water from MET.

The CWA board recently approved an ordinance, effective January 1, 2011, to increase treated water rates by 11.3%. Of the increase, 45.5% is a pass-through from MET, 47% represents its CIP, and the balance is for operations and other expenses. The CIP includes over $1.5 billion in contracts and subcontracts to administer and finish its infrastructure building vision.

Water conservation adds costs to our rates in a perverse cause-and-effect relationship. By conserving water, ratepayers will pay more per gallon used. Additional revenue reductions will result from implementation of California's Water Conservation Act of 2009 due to its requirement to conserve 20% by 2020. By conserving water, the CIP debt must be spread over fewer gallons of water, thus increasing the per-gallon price of water.

CWA wholesale water rates increased by 11.3% to local retailers this year, but the Grand Jury found that less than 11.3% has been passed on to ratepayers. Local water retailers' capital reserves have been absorbing as much of CWA's pass-through markup as their distribution costs, capital improvements, financing, operations, and political will can accommodate. This is unsustainable. Retailers do not have enough cash reserves to absorb these cost increases for long. Customers in the County will eventually get the bill for these continuing costs.

In 1996, California voters passed Proposition 218, requiring sellers to meet strict noticing procedures to inform ratepayers before instituting an increase in water rates. A sampling of these Prop 218 notices by the Grand Jury shows how water professionals are informing the public. The notices produced a blizzard of data including laboratory chemistry, engineering logic, charts and graphs, all in technical language not easily understood by the average citizen. While the notices are professionally produced, the mailers seem to hinder rather than help ratepayers' fundamental understanding of the reasons and impending financial impact of water rate increases.

The Grand Jury found that CWA and its retailers have a public relations challenge. They must communicate effectively with a public who is weary of continued rate increases.

Is there good news for San Diego water users on the horizon? As imported water rates increase, technologies such as reclamation and desalination become economically more viable. Each of these technologies cost more to produce than buying imported water; however, as rates rise, the differences become negligible. San Diego County could finally be in an enviable water supply position, with more than 70 miles of coastline and access to literally an ocean of water. Even these technologies will require CIP infrastructure support. Desalination, reclamation, and ground water recovery are each unique technologies requiring specialized processing and testing prior to releasing water they generate into the delivery system.

These technologies are expected to provide San Diego County a diversified water source free from MET control which will potentially provide a plateau in water rates as these systems come online. CWA has reduced dependence from MET since 1990 from 90% to 53% and new local CIP projects are under construction or planned. As imported water rates continue to increase, local sources of water will become a much more significant factor.

County water ratepayers will continue to look for the payback from CWA's diversification program when new local sources of water produce the majority of our water needs that will stabilize rates for our region into the future.

## *FACTS AND FINDINGS*

***Fact:*** San Diego County began importing water in 1940.

***Fact:*** CWA was organized in 1944 to support wholesale distribution of imported water in San Diego County.

***Fact:*** Today imported water comprises 79% of our water supply, of which 53% is purchased from MET.

***Fact:*** The County Water Authority is its largest customer yet is under-represented on the Metropolitan Water District's Board of Directors. Only four of the 24 members are from San Diego County.

***Fact:*** The estimated annual impact of MET conveyance charges to CWA ratepayers, which are considered by CWA to be excessive, is:

- 2011: $30M
- 2013: $39.6M
- 2015: $45.6M
- 2019: $74.4M
- 2021: $230.4M

***Fact:*** In June 2010, CWA filed a lawsuit against MET challenging high conveyance fees.

***Fact:*** CWA is sensitive to member agencies' needs, and is aggressively representing their member agencies' pricing concerns to MET.

***Fact:*** California instituted a 20% mandated water conservation requirement to be reached by 2020.

***Fact:*** Conserving water increases the cost per unit.

***Fact:*** San Diego County is a semi-arid environment without enough rainfall in most years to support the County's population.

***Fact:*** CWA has a plan to diversify sources of water for San Diego County which relies less on MET for imported water.

***Fact:*** CWA's FY2010/2011 budget includes 47% for CIP and debt service, 46% for water purchases and treatment and 7% for its operating departments.

***Fact:*** CWA's $3.8 billion CIP (1989-2030) includes the Twin Oaks Valley water treatment plant, Olivenhain Dam and Reservoir, Lake Hodges Projects and San Vicente Pipeline.

***Fact:*** San Diego county retailers received an 11.3% increase in 2010 from wholesaler CWA effective January 1, 2011.

**Finding 01:** CWA is under represented on MET's board of directors.

**Finding 02:** CWA member agencies have not communicated clearly to their customers about the reasons for water rate increases.

**Finding 03:** Water rates will undoubtedly continue to increase because of a combination of expanding needs in the region, debt from CIP and conservation measures.

## *RECOMMENDATIONS*

**The 2010/2011 San Diego County Grand Jury recommends that the San Diego County Water Authority:**

**11-61:** **Evaluate and improve public outreach efforts to educate the ratepayers about efforts to diversify and stabilize rates in the future.**

**11-62:** **Aggressively explore and advocate for fair representation on the board of the Metropolitan Water District.**

**11-63:** **Establish a digital outreach and communication program that incorporates social media on County Water Authority and member agency websites that enhances their ability to reach and educate ratepayers.**

**11-64:** **Consider an economic reward for conservation measures taken by ratepayers.**

**11-65:** **Increase the investment in diverse technologies such as desalination and reclamation. It is imperative to bring these sources online in anticipation of higher rates in San Diego County.**

## *REQUIREMENTS AND INSTRUCTIONS*

The California Penal Code §933(c) requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the agency. Such comment shall be made *no later than 90 days* after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made *within 60 days* to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code §933.05(a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

(a) As to each grand jury finding, the responding person or entity shall indicate one of the following:

(1) The respondent agrees with the finding

(2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.

(b) As to each grand jury recommendation, the responding person or entity shall report one of the following actions:

(1) The recommendation has been implemented, with a summary regarding the implemented action.

(2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.

(3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the grand jury report.

(4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

(c) If a finding or recommendation of the grand jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the grand jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with the Penal Code §933.05 are required from the:

| Responding Agency | Recommendations | Date |
| --- | --- | --- |
| **San Diego County Water Authority** | **11-61 through 11-65** | **8/29/11** |

**San Diego County Water Authority**

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




July 25, 2011

Jeffrey Kightlinger
General Manager
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

Dear Jeff:

Re: June 8, 2011 letter to the San Diego County Grand Jury

This letter responds to your June 8, 2011 letter to Richard Carlson, foreman of the 2011 San Diego County Grand Jury. Our interest is ensuring the Grand Jury and the public have all of the facts necessary to increase understanding of the complex, yet critical issues driving our region's water rates. This was ultimately the purpose of the Grand Jury's investigation.

The Grand Jury, comprised of retired police officers, business professionals, government managers, nurses, and other community members undertook a comprehensive review of the important public policy issues affecting water rates. They worked diligently, spending hundreds of hours to increase their understanding of the complex issues driving water rate increases. As outlined in the report, they interviewed residents and water agency professionals, and reviewed a multitude of materials and documents. They also conducted site tours and attended public meetings to increase their knowledge. As a result, a thoughtful report was produced that discusses many of the factors influencing San Diego County's water rates and recommends additional actions and outreach to increase the public's understanding.

The Water Authority is responding to the Grand Jury's findings and recommendations. We offer the following summary statement of the facts to correct errors and misstatements contained in your June 8 letter. We would welcome the opportunity to discuss the facts in greater detail, along with MWD, before the Grand Jury.

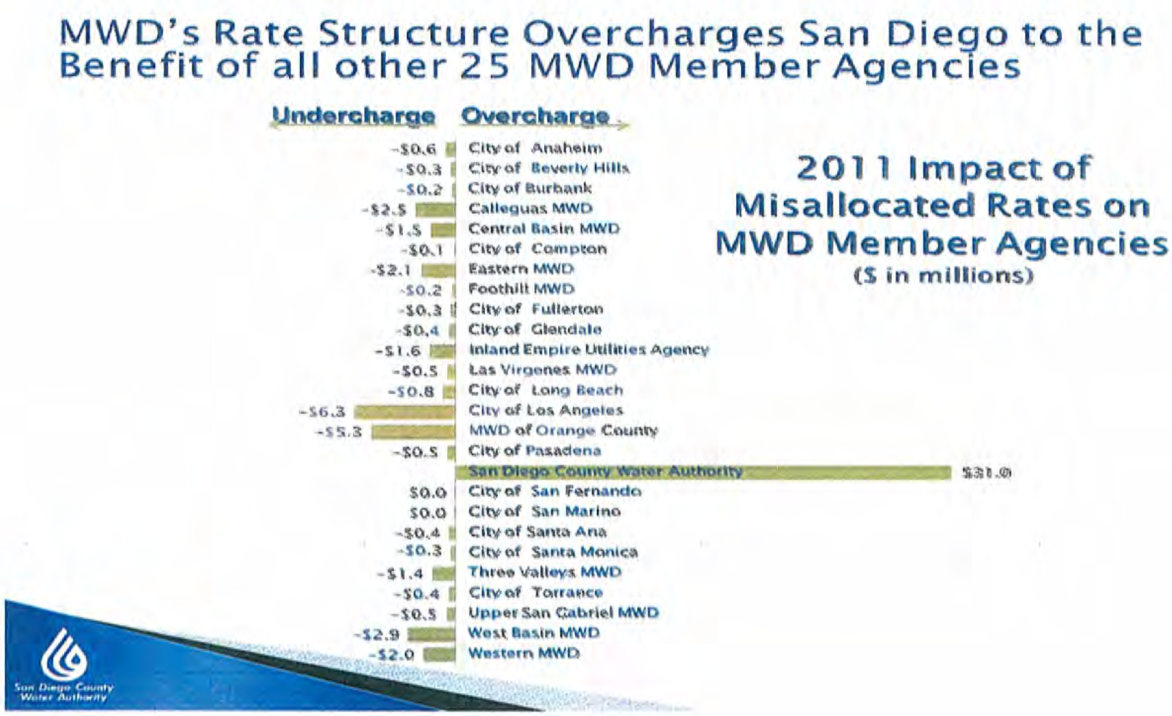
- **MWD's assertion that the Water Authority's IID water is more expensive than its most expensive water transfer in the past fiscal year is an apples-to-oranges comparison.** MWD knows very well that one-year, spot transfers are not comparable in size, water supply reliability or cost to long-term water transfers such as the Imperial Irrigation District-Water Authority 45- to 75-year transfer agreement or the 110-year All American Canal and Coachella Canal Lining Transfer. In fact, comparing a one-year spot transfer – especially in a wet year like last year – to the Water Authority's long-term, highly reliable water transfers is nonsensical.

- **The statement that supplies from IID are projected to increase 40 percent over the next four years is correct, but fails to acknowledge that MWD's untreated water rates have increased 59 percent over the past four years and are expected to continue to climb.** As you know, rate increases from MWD are the single-largest driver of Water Authority rate increases, and far eclipse the impact of increases in the Water Authority's IID supplies. Directing attention to increases in the IID supplies, while failing to acknowledge even higher increases in MWD's rates serves only to obfuscate understanding of the main drivers of rising water rates – the very mission of the Grand Jury's work. More importantly, as Third-Priority on the Colorado River, the Water Authority's IID transfer water is more reliable than MWD's lower-priority Colorado River supply.

- **MWD's statement that the Water Authority opposes funding a portion of MWD's capital improvement program from current revenues is untrue.** The Water Authority funds, on average, 23 percent of its own Capital Improvement Program with current revenues ("pay-as-you-go" or "PAYGO"), which is a prudent fiscal practice. In 2007, when MWD presented unexpected and sharply higher 2008 proposed water rates to its board than it had projected in its 2004 Long-Range Finance Plan, several member agencies – including the Water Authority – advocated that MWD utilize a portion of its PAYGO on a one-time basis to moderate that unexpected rate spike. In fact, the entire MWD board approved this action when it adopted its 2008 water rates and budget. But the Water Authority does not support MWD using PAYGO revenues intended for its capital program on a routine, continuing basis to cover operating expenses, as it has done in five of the last six years. Despite the comment in your letter that this is "...not seen by Metropolitan's Board as a sound, sustainable approach to infrastructure financing," that has nonetheless been MWD's routine practice in recent years. The simple truth is that MWD has failed to reduce its spending to match its sharply lower current and projected water sales revenues.

- **Your letter notes that the Water Authority has a long history and track record opposing MWD's property-based voting system based on assessed valuation, but that the Water Authority will someday have the largest vote entitlement.** In 1928, when MWD was organized, property taxes accounted for all of MWD's revenues, and member agencies' water rights and voting rights were directly and proportionately tied to MWD's source of revenue. Today, property taxes provide only 5 percent of MWD's revenues, and that nexus between revenues and rights no longer exists. The fact that the Water Authority might someday have the largest vote entitlement at MWD based on assessed property valuation is irrelevant to a consideration of what is equitable, fair and logical.

- **MWD knows very well why the rate structure the Water Authority opposes "...is widely supported by the other Member Agencies" – because they all share the benefit of overcharges to the Water Authority.** The chart below shows how overcharges of $31 million to the Water Authority under MWD's rate structure in 2011 subsidize the other 25 MWD member agencies.



The San Diego County Grand Jury report underscored the importance and value of the work of independent and objective third-party watchdogs to examine important public policy matters. Likewise, setting the record straight on the statements made in your letter to the Grand Jury is equally important to ensuring the public has the facts needed to improve public understanding of the issues driving up water rates in our region.

Sincerely,

Maureen A. Stapleton
General Manager

Cc: San Diego County Grand Jury
Water Authority Board of Directors
Metropolitan Water District Board of Directors

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

*Office of the General Manager*

June 8, 2011

Richard Carlson, Foreman
San Diego County Grand Jury
Hall of Justice
330 W. Broadway, Suite 477
San Diego, CA 92101-3830

Dear Mr. Carlson:

On behalf of the Metropolitan Water District of Southern California, I want to express our appreciation for the effort expended by the San Diego County Grand Jury to understand the region's water supply system and the pricing factors that drive water rate increases. Metropolitan was not interviewed in the compilation of the Grand Jury's report ("San Diego County Water Rates: High Today, Higher Tomorrow"), although our District was mentioned extensively. Given the importance of the issue and of understanding the pertinent issues behind the region's water supply system and water rate increases, I would like to share the following information.

Metropolitan strongly endorses the overall conclusion reached by the report that water districts must do more in educating the public about the cost and value of water and how their water rates support the water system. California is no longer a young state and much of our water infrastructure system was originally constructed decades ago. For instance, Metropolitan's Colorado River Aqueduct and support system is over 70 years old. The State Water Project is now more than 40 years old. The majority of Metropolitan's Capital Improvement Program is spent on repair and replacement of aging infrastructure. In addition, we must spend funds to develop new supplies to accommodate continued growth in the region, as well as to replace water supplies lost to growing demands elsewhere and to environmental demands.

Southern California is not unique in this regard. This past decade has seen all major municipalities in the United States average 9 percent annual rate hikes, with cities like New York nearly doubling rates in the past five years and San Francisco will more than double its rates for seismic safety upgrades. And those rate increases were entirely for system reliability and not for new supplies. Clearly, there is an important story to tell the public about maintaining our water supply infrastructure for future generations of Californians so that we can maintain our quality of life and a robust local economy.

In the section related to the cost impacts from the San Diego County Water Authority's (SDCWA) long-term water supply contract with the Imperial Irrigation District (IID) the report did not mention some key points related to that transfer:

- This water supply for SDCWA is part of a broader set of contracts known as the "Quantification Settlement Agreement (QSA)" that detail water allocation among the California districts with rights to Colorado River supplies. This water supply is in jeopardy because a Superior Court ruling invalidated the QSA and related agreements, including the SDCWA's water transfer. This court ruling has been stayed pending appeal. Metropolitan and SDCWA are among the parties that are continuing to defend the QSA in the appellate process.

- SDCWA's water transfer with IID (per-unit costs of water) is about 40 percent higher than Metropolitan's most expensive transfer in the past fiscal year. SDCWA costs for IID supplies will rise another 40 percent in the next four years regardless of inflation over that period: (These costs do not include transportation and treatment.):

| YEAR | PER ACRE-FOOT | AMOUNT (Acre-feet) | TOTAL (Million) |
|---|---|---|---|
| 2011 | $446 | 80,000 | $35.7 |
| 2013 | $540 | 100,000 | $54 |
| 2015 | $624 | 100,000 | $62.4 |
| 2019 | $686* | 160,000 | $109.8 |
| 2021 | $719* | 200,000 | $143.8 |

*Estimate; Increase based on future inflation index

- In addition to these per-unit water charges, SDCWA had a contractual obligation to pay IID an additional $50 million by October 2010 that increases the unit cost of acre-foot beyond the listed costs above.

- Metropolitan's policies and rates for water transportation were all in effect at the time SDCWA entered into the transfer agreement with IID in 2003. The relative high cost of this transfer water was explained at the time of entering into the transaction as necessary to achieve greater reliability for the San Diego area and should be seen in the light of the

SDCWA Board deciding to seek greater reliability and water supply certainty with a clear understanding that this came at a higher cost.

In terms of Metropolitan-related issues in the report:

- The suggestion (Page 3) that Metropolitan rely more on borrowing for long-term projects is contrary to Metropolitan's Board-directed policy to partially pay for capital needs on a pay-as-you-go (PAYGO) basis. This policy has gained the support of bond rating agencies as well as 25 of Metropolitan's 26 Member Agencies. SDCWA is the lone exception. While Metropolitan has not met PAYGO targets in recent years, choosing to conserve cash balances in response to the extreme financial conditions in California and the world, an over-reliance on borrowing today would increase costs long-term for Metropolitan, the SDCWA and our other Member Agencies. Over-borrowing today transfers costs to future generations of rate payers and is not seen by Metropolitan's Board as a sound, sustainable approach to infrastructure financing.

- It is stated as "Fact" (Page 4) that on the Metropolitan Board of Directors, "only four of the 24 members are from San Diego County." Metropolitan has 37 board members representing 26 member agencies. Metropolitan's three largest agencies have four Board members, the SDCWA, the City of Los Angeles and the Municipal Water District of Orange County. A few agencies have two representatives and the majority of member agencies send a single representative to serve on Metropolitan's Board.

- Metropolitan's voting structure, prescribed by on state legislation, weights the vote of each Member Agency based on the property tax valuation within its service area. Based on current growth patterns in our six-county region, SDCWA in approximately a decade is projected to have the largest weighted vote of any member agency regardless of how much or little water it purchases. Representation on Metropolitan's Board of Directors also is based, by law, on the property tax valuation within each member agency's service area. The SDCWA's representation will grow as its share of assessed valuation grows.

- Metropolitan has had to expend almost $2 million over this past decade related to legal challenges by SDCWA to Metropolitan's structure and methods of pricing and allocating water. The SDCWA has spent many times that amount in prosecuting these suits. The previous lawsuits all failed. The current litigation involves SDCWA's challenge to the rate structure that has been in effect since 2003, one that is widely supported by the other Member Agencies. This litigious approach in the pursuit of greater independence has come at a high cost to all the region's rate payers.

Please do not hesitate to contact us if you continue your interest and exploration of issues related to the region's water supply and water rates.

Sincerely,

Jeffrey Kightlinger
General Manager

cc: Grand Jury Coordinator Laura Nicks
Metropolitan Board of Directors
Metropolitan Member Agency Managers