

● **Board of Directors**
Water Planning and Stewardship Committee

April 8, 2008 Board Meeting

8-4

Subject

Authorize participation in the funding agreement with the Bureau of Reclamation, Southern Nevada Water Authority and Central Arizona Water Conservation District for the construction of the Drop 2 Reservoir in a maximum amount of \$28.7 million

Description

Authorization is requested to participate in the Drop 2 Storage Reservoir funding agreement. The reservoir would be constructed adjacent to the All-American Canal in Imperial County, California ([Attachment 1](#)). Metropolitan has the opportunity to acquire 100,000 acre-feet of Colorado River supplies by partially funding construction that would be accomplished by the Bureau of Reclamation (Reclamation) if it provides formal notification to do so by May 1, 2008. In return for a \$28.7 million payment, Metropolitan would receive 100,000 acre-feet of conserved Colorado River water.

Background

In December of 2007, the Secretary of the Interior established new guidelines for operation of the Colorado River System. Those guidelines included the ability for agencies to create and store new water supplies, known as “Intentionally Created Surplus” (ICS). One of the methods by which ICS can be created is through developing and funding system efficiency projects – projects that conserve or more efficiently manage existing Colorado River supplies. A portion of the water conserved would then be made available to the project funding partners of such projects.

Drop 2 Reservoir

Based on historical water releases, Reclamation estimates that 70,000 AF of water could be conserved annually through development of the proposed Drop 2 Reservoir. The reservoir operation would allow Reclamation to capture and store water that would otherwise be lost. Reclamation would make available a total of 600,000 AF of ICS water credits for use by the potential project funding partners as follows:

Southern Nevada Water Authority	400,000 AF
Central Arizona Water Conservation District	100,000 AF
Metropolitan Water District	100,000 AF
Total	600,000 AF

Reclamation would design and construct the Drop 2 Reservoir, which is anticipated to be fully operational by September 2010. Water conserved in excess of 600,000 AF would benefit all users of the Lower Colorado River system including Metropolitan by continuing to bolster water levels in Lake Mead over time.

Funding Agreement

Under an existing agreement, Southern Nevada Water Authority expects to make full payment of \$172 million to Reclamation by April 4, 2008 for the total construction cost of the Drop 2 Reservoir. Metropolitan has an opportunity to enter into an agreement with Reclamation, Southern Nevada Water Authority and Central Arizona Water Conservation District to share the construction costs and receive 100,000 AF of water supply. There are no further approvals required to receive the water supply once Metropolitan's reimbursement to Southern Nevada Water Authority of \$28.7 million is made. Metropolitan would receive its ICS credit regardless of any potential construction delays. Metropolitan would not be liable for cost overruns should they occur. If needed, the Southern Nevada Water Authority would increase its payment to as much as \$206 million to cover any potential cost overruns. Metropolitan would need to execute a Notice of Election to Participate by May 1, 2008 to secure the ICS water credit. The Central Arizona Water Conservation District has already expressed its intent to participate. A summary of the key terms and conditions of the funding agreement is attached ([Attachment 2](#)).

Benefits

A maximum of 34,000 AF per year can be delivered to Metropolitan between 2008 and 2010, even before construction of the Drop 2 Reservoir is completed. Only Metropolitan can recover Drop 2 ICS water supply during this period. Full delivery of the 100,000 AF is allowed by 2010 provided the Secretary of the Interior does not declare a Colorado River shortage during that time period, which is unlikely given current reservoir conditions. Metropolitan may defer recovering the ICS water until later years. After 2016, Metropolitan's annual take would be limited to 25,000 AF. Any portion of ICS water not recovered remains in Metropolitan's ICS credit account and would not be reduced because of reservoir evaporation loss or spill.

Policy

By Minute Item 43344, dated January 2, 1999, the Board recognized that the price of water will differ depending upon whether it is from supplies subject to allocation by the Federal Government or secured under other rights.

By Minute Item 47327, dated December 11, 2007, the Board adopted multiple agreements collectively referred to as the "Colorado River Agreements" including the creation of ICS credits and the ability to store water in Lake Mead.

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is categorically exempt under the provisions of CEQA and the State CEQA Guidelines. The proposed action involves an agreement associated with the leasing, licensing, and operating of existing public water conveyance facilities with negligible or no expansion of use and no possibility of significantly impacting the physical environment (i.e., Metropolitan's Intake Pumping Plant to divert the additional water from the Colorado River for delivery to Metropolitan's service area). Accordingly, the proposed action qualifies for a Class 1, Categorical Exemption (Section 15301 of the State CEQA Guidelines). In addition, where it can be seen with certainty that there is no possibility that the proposed actions in question may have a significant effect on the environment, the proposed actions are not subject to CEQA (Section 15061(b)(3) of the State CEQA Guidelines). Metropolitan's action will not affect the Drop 2 Storage Reservoir construction. That project is mandated by federal law, and is being funded by Southern Nevada Water Authority. Metropolitan's action is limited to providing funding to the Southern Nevada Water Authority in consideration of receiving delivery of a portion of the water conserved by the Drop 2 reservoir. Without Metropolitan's action, this conserved water would be retained in Lake Mead for delivery to Southern Nevada Water Authority. Metropolitan's proposed action would allow a portion of the water to be released downstream of Hoover Dam, thereby increasing flows in the Colorado River between Lake Mead and Lake Havasu. Finally, the environmental effects of the Drop 2 Storage Reservoir and allocation of the conserved water have been considered in the U.S. Bureau of Reclamation's Final Environmental Assessment (June 2007) in compliance with the National Environmental Policy Act. Therefore, CEQA does not apply to the portion of Metropolitan's proposed action that affects storage in Lake Mead or flows in the Colorado River outside of California (Section 15277 of the CEQA Guidelines).

The CEQA determination is: Determine that pursuant to CEQA, the proposed action qualifies under a Categorical Exemption (Class 1, Section 15301 of the State CEQA Guidelines). In addition, the proposed action with respect to the Colorado River as it relates to the Drop 2 Reservoir is not subject to the provisions of CEQA pursuant to Section 15061(b)(3) and Section 15277 of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination and

- a. Authorize the General Manager to enter into a funding agreement with the Bureau of Reclamation to reimburse Southern Nevada Water Authority for a portion of the Drop 2 Reservoir and secure 100,000 AF of additional water supply; and
- b. Appropriate and authorize the use of \$28.7 million of capital funds in the Replacement and Refurbishment account during fiscal year 2007/08 to fund Metropolitan’s share of the Drop 2 Reservoir.

Fiscal Impact: If Metropolitan elects to participate in the funding of the project, Metropolitan’s capital contribution of \$28.7 million is due to Southern Nevada Water Authority by May 4, 2008. A 5 percent annual interest charge would be applied to any portion of Metropolitan’s capital contribution not paid by that date. This payment will reduce the balance in the Replacement and Refurbishment Fund to an estimated \$35 million at June 30, 2008.

Business Analysis: Authorization would provide Metropolitan 100,000 AF at a cost of \$287 per acre-foot. This water could be fully recovered within three years. Any portion of ICS water not recovered remains in Metropolitan’s ICS credit account through 2036 and would not be reduced because of reservoir evaporation loss or spill.

Option #2

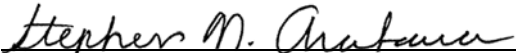
Do not authorize entering into a funding agreement with Reclamation.

Fiscal Impact: None

Business Analysis: Not authorizing entering into the funding agreement would result in a lost opportunity to secure near-term additional water supply.

Staff Recommendation

Option #1


 _____ 3/19/2008
 Stephen N. Arakawa Date
 Manager, Water Resource Management


 _____ 3/20/2008
 Jeffrey Nightlinger Date
 General Manager

Attachment 1 – Location Map

Attachment 2 – Terms and Conditions – Lower Colorado River Drop 2 Storage Reservoir Funding Agreement

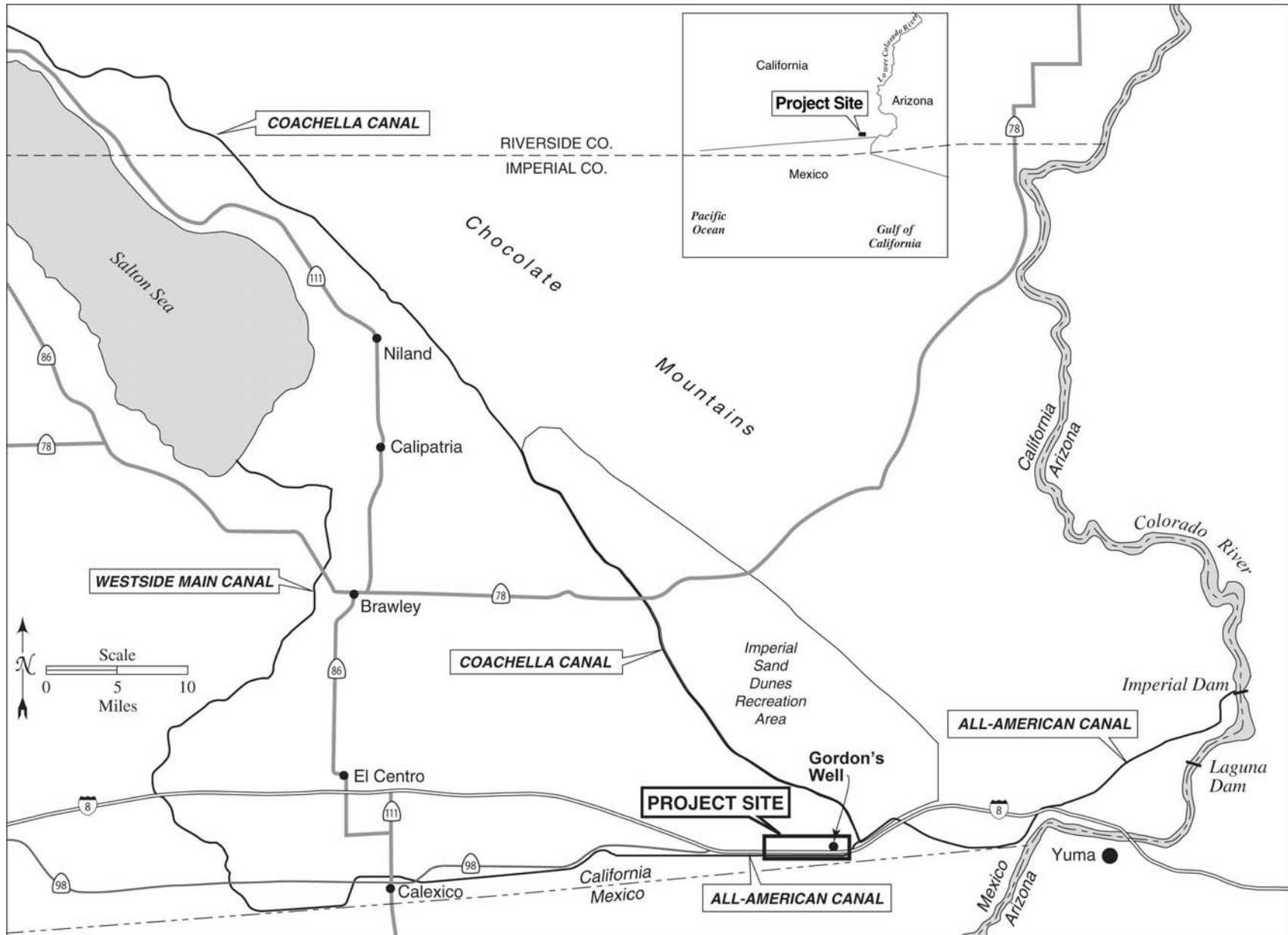


Figure ES-1. Project Location

Terms and Conditions

Lower Colorado River Drop 2 Storage Reservoir Funding Agreement

Term

December 31, 2036, or when all ICS deliveries (600 TAF) are made.

Design, Construction, and Operation, Ownership

- U.S. Bureau of Reclamation (Reclamation) to design and construct the Project.
- Construction complete and fully operational in September 2010.
- Title to the Project to be held by the United States.

Project Costs

- Total Capital Cost Estimate: \$172,000,000

Funding and Payment for Project Costs

- SNWA to provide \$172,000,000 as funding for the Capital Cost to Reclamation.
- SNWA to provide up to \$34,000,000 as additional funding for any cost overruns.
- Reclamation to refund any monies contributed in excess of the actual capital cost.

Availability of System Efficiency ICS to SNWA:

- Reclamation to credit SNWA's ICS Account with 600,000 acre-feet of System Efficiency ICS immediately upon transfer of \$172 million to Reclamation.
- Reclamation to credit SNWA's ICS Account with one additional acre-foot of System Efficiency ICS for every \$600 transferred above \$172 million.
- Reclamation to deduct one acre-foot of ICS from SNWA's ICS Account if any portion of the additional capital contribution is refunded to SNWA for every \$600 of such refund.
- Limits SNWA's receipt of System Efficiency ICS from the Project to:
 - 100,000 acre-feet from 2011 through 2015,
 - 40,000 acre-feet in any year.

Election By Metropolitan and/or CAWCD to Become Parties

- Metropolitan and/or CAWCD may become a Party to the Agreement by executing a Notice of Election to Participate by May 1, 2008.
- Requires transfer of \$28,666,667 to SNWA and provide notice of such transfer to Reclamation within 90 days.
- Five percent annual interest on any portion of the money not transferred within 30 days of SNWA's transfer of all \$172 million.

Availability of System Efficiency ICS to Metropolitan:

- Reclamation to credit Metropolitan's ICS Account with 100,000 acre-feet of System Efficiency ICS and reduce SNWA's ICS Account by 100,000 acre-feet.
- SNWA to provide Metropolitan with its proportionate share of a refund within 30 days of SNWA's receipt of such refund, if the actual capital costs are less than \$172 million.
- Metropolitan can recover up to 34,000 acre-feet per year of System Efficiency ICS from 2008 through 2010.

Project Operations and Accounting

- Requires Reclamation to determine the quantity of water conserved by the Project annually and prepare a Summary Report.
- Parties to consult regarding the quantity of water conserved and projected to be conserved by the Project.