

Revised
AGENDA ITEM SUBMITTAL

Meeting Date: May 14, 2015

To: Board of Directors

From: Mike Markus

Staff Contact: J. Kennedy

Budgeted: No

Budgeted Amount: N/A

Cost Estimate: \$230,000

Funding Source: General Reserves

Program/ Line Item No. 1045.53001

General Counsel Approval: N/A

Engineers/Feasibility Report: N/A

CEQA Compliance: N/A

**Subject: PROPOSED POSEIDON RESOURCES CITY OF HUNTINGTON BEACH
OCEAN DESALINATION PROJECT**

SUMMARY

On March 18, 2015 staff provided a draft Term Sheet which outlined the overall structure of a potential partnership with Poseidon Resources regarding the City of Huntington Beach Ocean Desalination Project. Since that time, changes to the Term Sheet have occurred which are shown in the attached document.

On May 11, 2015 staff and Poseidon Resources agreed to additional changes to the Term Sheet which are separately shown in the document with yellow highlighting.

Four meetings recently occurred with the Ocean Desalination Citizens Advisory Committee (ODCAC) as approved by the Board. A written report on those meetings from the facilitator Paul Brown is attached.

Attachments to this report are listed below.

- A. Term Sheet – edited version as compared with March 18, 2015 document
- B. Term Sheet – clean version
- C. Presentation material
- D. Recent comment letters received on the project and/or Term Sheet
- E. Paul Brown Summary of ODCAC Deliberations and Findings
- F. Questions and Answers document
- G. March 26, 2015 meeting minutes
 - a. March 26, 2015 presentation on OCWD
 - b. March 26, 2015 presentation on the Poseidon project
 - c. March 26, 2015 general presentation on the Term Sheet
- H. April 9, 2015 meeting minutes
 - a. Detailed presentation on the Term Sheet
- I. April 23, 2015 meeting minutes
 - a. Individual summary comments provided by the CAC members
- J. April 30, 2015 meeting minutes
- K. Information regarding the individual Committee members

RECOMMENDATION

- 1) ~~Approve Review~~ the Term Sheet ~~and consider action~~;
If the Term Sheet is approved
- 2) Establish a project budget of \$230,000; and
- 3) Authorize staff to hire consultants for project issues relating to distributing the Poseidon water, water quality, considering alternative supplies and financial assistance and execute the necessary contracts.

BACKGROUND/ANALYSIS

Term Sheet

On January 7, 2015 staff was directed to begin negotiations for a Term Sheet with Poseidon Resources and to report back to the Board on March 18, 2015. Different options are available to the District to partner with Poseidon to advance the proposed project. These options directly impact the price of the water and the allocation of risk to the two parties. The Term Sheet provides the overall business terms and structure of such a partnership and if approved would be used in the future to assist in the development of an actual water purchase contract (Contract).

On March 18, 2015 the District released a draft Term Sheet to the community for review and comment. Additionally, the Board authorized four meetings with the ODCAC.

Staff has continued to meet with Poseidon Resources and negotiate the language of the Term Sheet. The ODCAC also provided comments and input in modifying the Term Sheet. Staff's approach to the meetings and the development of the Term Sheet was to keep the relationship between OCWD and Poseidon easily understandable and for the District to avoid becoming involved in the: (1) financing of the treatment plant; and (2) permitting issues regarding the California Coastal Commission and the State Regional Water Quality Control Board. The Term Sheet is summarized below:

- Poseidon would be responsible for permitting, financing, designing, constructing and operating the ocean desalination treatment plant,
- OCWD would purchase the plant water,
- OCWD would determine how the plant water would be distributed and its use,
- OCWD would be responsible for permitting, financing, designing, constructing and operating the necessary distribution facilities to transmit the water to the end users,
- The life of the agreement is for 50 years,
- OCWD can purchase the plant in 30 years,
- OCWD would pay Poseidon the Metropolitan Water District (MWD) treated full service rate (currently \$923/acre-foot) including an allowance for the MWD readiness to serve and capacity charges (approximately \$80 per acre-foot) plus an additional premium. The additional premium would be:
 - Up to 20% of the total MWD rate for the first 10 years of the contract,
 - Up to 15% for the second ten year period,
 - Up to 10% for the third ten year period,

- Up to -5% for the fourth ten year period, and
- 0% for the last ten year period.

~~The reliability premium averages 10% over the 50-year life of the contract.~~

- Starting with the fifteenth (15) anniversary of commercial operations and every five (5) years thereafter, the premium amount will be reviewed and adjusted down (can go below 0%) if the Seller is receiving an economic return above an agreed upon amount.
- The MWD rate is subject to a minimum cumulative annual escalation rate of approximately 3% to be negotiated prior to possible execution of a final contract.
- OCWD can take possession of the treatment plant at the end of the contract for \$1,
- The price of the water would be reduced and readjusted if new technological improvements can be installed,
- Poseidon would need to demonstrate successful operation of the plant in the City of Carlsbad,
- Poseidon would provide water at an agreed to water quality that meets all federal and state standards,
- Assumes the MWD Local Resources Program subsidy is received. If the subsidy is not received neither party will enter into a final Contract, and

The Term Sheet is not definitive and does not legally commit either party to any future actions. However if OCWD decides to move forward with the Term Sheet, the District is signaling a desire to explore in much greater detail the exact terms of a final Contract with Poseidon Resources to purchase the plant water.

If the Board agrees with the provisions within the Term Sheet and approves the document, staff would need to study and fully understand the issues, costs and risks of taking on the task of purchasing and then distributing the Poseidon water. The District would also need to obtain firm commitments from retail water agencies to purchase the water.

Term Sheet Pros and Cons

The Term Sheet approach has several benefits or transfers of risk that are listed below:

- Interest rates are relatively low – any increase between now and when project financing would be obtained would be absorbed by Poseidon.
- Power rates increase – California has mandated the development of new “green energy” projects. This will put upward pressure on the cost of energy. Poseidon would have to absorb these increases.
- New regulatory requirements – Under the Term Sheet, Poseidon would have to comply with any new regulatory mandates or requirements.
- Construction cost increases – Poseidon would have to absorb any construction cost increases.

Conversely the Term Sheet as prepared has the following risk and/or issues that would have to be successfully managed.

- ~~If the price of MWD water significantly increases over time, payments to Poseidon could be much greater than the actual cost to create the water.~~

~~Note: Staff and Poseidon were still negotiating a new provision for the Term Sheet to address this issue at the time this report was being finalized for the Board agenda mail-out.~~

- OCWD construction of the necessary distribution system improvements – The District will have to ensure that sufficient time is provided in a final water purchase contract to complete the distribution system to avoid liquidated damage penalties from not finishing this work on time to match the completion date of the treatment plant,
- Take or Pay arrangement – The District will always have to purchase the Poseidon water and will need parallel agreements with any cities and retail water districts who decide to take the water. Additionally the District will need to verify that there is a benefit to taking the Poseidon water for all reasonable future water demands and supply scenarios that could exist.
- Avoid a pipeline to nowhere scenario – The District does not want to construct a new distribution system and for some reason Poseidon is unable to construct the treatment plant. Sufficient safeguards need to be put in place to avoid such a scenario.

Moving Forward

If the Board approves the Term Sheet and the recommended project budget, staff would work on the following issues with assistance from technical consulting experts and the Municipal Water District of Orange County (MWDOC). Staff is estimating the cost of the outside consultants to be approximately \$230,000 with the work taking six to nine months.

- Distribution - Determine exactly how much water the District can reasonably take and what facilities and institutional approvals are needed to transport and recharge the water and estimate the costs; Determine which retail agencies would commit to taking Poseidon water and the quantity and flow rate. This would be accomplished by executing some type of document between the District, MWDOC and the interested retail agency; Determine how the Poseidon water would be transmitted to the retail agencies, the necessary institutional approvals and the estimated costs; Determine what the District would charge agencies receiving the Poseidon water.
- Water Quality - Based upon where the Poseidon water would be transmitted, determine what potential water quality integration issues could develop. The Poseidon water would have a different chemistry as compared with MWD imported water and groundwater. Would recharging the water potentially mobilize any elements naturally occurring in the aquifer formations? Under what conditions will MWD allow the water into their pipelines? Can issues such as the District is experiencing with the GWRS pipeline occur? What types of piping materials would be receiving the water? Any integration issues that may arise would not be unique and could be managed. However contingency plans and funding may need to be

set aside to allow the treatment process for the Poseidon water to be modified if necessary.

- Financial - Review in detail the project finances. Poseidon needs to have sufficient revenues to support the debt issuance needed to finance the project. However the District wants to avoid a scenario where the cost to actually produce the water is significantly less than what is being paid for the water. Review the debt and equity mix to fund the project and the implications to Poseidon's actual cost. Provide an analysis of past Metropolitan Water District (MWD) rate increases and future projections.
- Reliability Analysis – The reliability of imported MWD water supplies needs to be assessed. What types of assumptions has the MWD Integrated Resources Plan been built upon? Additionally, an analysis of what alternative water supply projects and/or programs could be considered needs to be completed. What is the cost of not having sufficient water supplies for the OCWD service territory? A review of the San Diego County Water Authority reliability analysis would also be conducted. The District would take advantage of work currently being completed by MWDOC (“Orange County Water Reliability Study”) to assist in this effort.

Comments Received on the Term Sheet

As of May 8, 2015 the District had received six letters on the project and/or Term Sheet which are attached. Additional letters are expected prior to the May 14, 2015 Board meeting date.

Ocean Desalination Citizens Advisory Committee (ODCAC)

The ODCAC met four times (March 23, April 9, 23 & 30). The committee facilitator Paul Brown has provided a detailed report to the Board which is separately attached. This report includes an attachment with general comments on the project and the Term Sheet from each committee member from the April 23, 2015 meeting. Additionally a “Question and Answer” document was generated from the committee meetings which addresses many of the project issues. Unfortunately Mr. Brown will not be able to attend the Board meeting due to a prior commitment.

PRIOR RELEVANT BOARD ACTION(S)

05/22/13 R13-5-48 – Adopt resolution stating that ocean desalination supplies should be considered in the District's water supply portfolio.

07/24/13 R13-7-97 - Authorize execution of a confidentiality agreement and receive information from Poseidon Resources to study the economic feasibility of a seawater desalination facility in Huntington Beach that may lead to a water purchase agreement for the entire productive capacity of the plant; and Establish a “Citizen's Advisory Committee” for the potential project;

11/11/13 – Support California Coastal Commission approval of the proposed Poseidon Project

01/08/14 M14-2 – Direct staff to arrange a Board meeting with the consultants used by SDCWA for their Carlsbad desalination project.

02/19/14 M04-36 - Request proposals from the three firms that assisted the SDCWA with the City of Carlsbad desalination project

04/02/14 M14-61 – Authorize staff to issue financial RFP's

05/21/14 M14-87 – Defer action to select a financial consultant to June 4, 2014

06/04/14 R14-6-80 – Approve agreement to Clean Energy Capital for \$49,720 to provide financial analysis on the proposed Poseidon Resources City of Huntington Beach Ocean Desalination Project

12/03/14 R14-12-155– Increase the Clean Energy Capital contract by \$27,000 to respond to comments on the financial analysis report.

01/07/15 M15-5 – Direct staff to begin negotiating a Term Sheet with Poseidon Resources and began establishing a Citizens Advisory Committee

03/18/15 – Directed that meetings of the Ocean Desalination Citizens' Advisory Committee begin