



**SPECIAL MEETING  
BOARD OF DIRECTORS  
MONTECITO WATER DISTRICT  
AT  
MONTECITO FIRE PREVENTION DISTRICT  
595 SAN YSIDRO ROAD  
MONTECITO, CALIFORNIA**

**MONDAY, JANUARY 28, 2019  
9:30 A.M.**

**AGENDA**

**1. CALL TO ORDER, ROLL CALL, DETERMINATION OF QUORUM**

**2. PLEDGE OF ALLEGIANCE**

**3. PUBLIC FORUM**

This portion of the agenda may be utilized by any member of the public to address and ask questions of the Board of Directors on any matter not on the agenda within the jurisdiction of the Montecito Water District. Depending upon the subject matter, the Board of Directors may be unable to respond at this time, or until the specific item is placed on the agenda at a future MWD Board meeting in accordance with the Ralph M. Brown Act.

**4. DISTRICT OPERATIONS AND GENERAL MANAGER'S REPORTS**

A. BOARD ACTION: Presentation of negotiated Term Sheet for a Water Supply Agreement with City of Santa Barbara and consideration of approval to proceed with development of a Water Supply Agreement.

**5. ADJOURNMENT**

**Note:** This agenda was posted at the Montecito Water District front counter and outside display case at 5:00 p.m. on January 25, 2019. The Americans with Disabilities Act provides that no qualified individual with a disability shall be excluded from participation in, or denied the benefits of, the District's programs, services or activities because of any disability. If you need special assistance to participate in this meeting, please contact the District Office at 805-969-2271. Notification at least twenty-four (24) hours prior to the meeting will enable the District to make appropriate arrangements.

Supporting documents for agenda items are available at the District front counter during normal business hours.

Materials related to an item on this agenda submitted to the Board after distribution of the agenda packet are available for public inspection in the Montecito Water District offices located at 583 San Ysidro Road, Montecito, during normal business hours.



**MONTECITO WATER DISTRICT  
MEMORANDUM**

**SECTION: 4-A**

**DATE: JANUARY 28, 2019**

**TO: BOARD OF DIRECTORS**

**FROM: GENERAL MANAGER**

**SUBJECT: PRESENTATION OF THE NEGOTIATED TERM SHEET FOR A WATER SUPPLY AGREEMENT WITH THE CITY OF SANTA BARBARA AND CONSIDERATION OF APPROVAL TO PROCEED WITH THE DEVELOPMENT OF A WATER SUPPLY AGREEMENT**

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**RECOMMENDATION:**

1. Approve the negotiated Term Sheet outlining the governing principles and key terms including water pricing to be included in a Water Supply Agreement;
2. Direct staff to proceed with the development of a draft Water Supply Agreement in accordance with the negotiated Term Sheet;
3. Approval of budgets for Clean Energy Capital and Hawkins, Delafield & Wood LLP for financial and legal support services, respectively to assist with development of the Water Supply Agreement with the City of Santa Barbara.

**DISCUSSION:**

*Background*

In March 2018, the Board authorized District staff to proceed with Phase II negotiations which involved negotiating the terms of the Conveyance Pipeline and further refining other key terms of a Water Supply Agreement (WSA). Since that time, District and City staff have been actively meeting in an effort to develop a Term Sheet to be used to draft a WSA. In December 2018, District staff presented the negotiated terms of a possible WSA to the District's Strategic Planning Committee and although several questions and concerns were voiced, in general the Committee and members of the public who were present voiced support for the negotiated terms. In early January 2019 following continued negotiations, District and City staff reached consensus on the key terms of a WSA. Both the District and City staff agreed to present the negotiated Term Sheet to their respective governing bodies for approval before proceeding with development of a WSA.

### *Term Sheet Overview*

In general, the Term Sheet proposes a 50-year agreement whereby the District will purchase and receive 1,430 acre feet of reliable water from the City annually (along with the possibility to purchase and receive an additional amount of 445 acre feet of water each year). The City will be obligated to deliver and the District will be obligated to accept delivery of that water irrespective of hydrological conditions, except under several severe and rare uncontrollable circumstances impacting the City's ability to meet its customers' basic public health, safety and sanitation needs. The City will be required to reasonably manage its potable water supplies, including the Desalination Plant, such that water is available to meet the City's delivery obligations under the WSA.

The water delivered to the District will meet all State and Federal primary water quality requirements and could be supplied from any City water supply source or combination thereof.

In order for the City to have surplus water to sell to the District, it must develop that capacity by increasing the production capacity of its Charles E. Meyer Desalination Plant from its current capability of 3,125 to 5,000 AFY. In addition to expanding the Desalination Plant, the City must also install a Conveyance Pipeline to convey desalinated water from the Desalination Plant to the Cater Water Treatment Plant, where it can utilize the South Coast Conduit for its delivery to the District.

The water unit pricing will be based on the financing and operational costs of the Desalination Plant and the Conveyance Pipeline including additional payments in consideration of the City's investments and risks. Based on a 5,000 acre foot Desalination Plant, the unit water price is estimated to range from \$2,637 and \$2,742 per acre foot (which depends on whether additional water, up to 445 AFY, is offered by the City and accepted by the District). Although the water pricing is based on the Desalination Plant, the District will have no ownership rights in the Desalination Plant or other City water facilities and will have no control over its operations. The City is required to maintain the Desalination Plant's ability to produce water, which, at a minimum, means that the Plant will be able to promptly resume operation in event of a shut-down if resumption of operations is necessary to meet its delivery obligation under the WSA.

The deal points including general principles are described in further detail in the attached Term Sheet.

Staff recommends approval of the negotiated Term Sheet outlining the governing principles, water pricing, and key concepts to be included in a Water Sales Agreement. Drafting of the WSA will likely take several months, given the complexity. A final WSA for consideration by the Board is not anticipated until late spring 2019.

## *Fiscal Impact*

### Status of District/City Funding Agreement

On June 21, 2016, the Board authorized entering into a funding agreement with the City of Santa Barbara to fund certain engineering design and legal expenses undertaken by the City that were determined to be necessary to develop a Water Supply Agreement (WSA). That agreement authorized Phase 1 work which included all work necessary to negotiate the terms of the WSA excluding work associated with a conveyance pipeline. On March 20, 2018, the Board authorized Phase 2 work which included all work necessary to negotiate the terms of the WSA pertaining to the conveyance pipeline. The total authorize budget for Phase I and II work is \$479,223 (\$193,594 for Phase I and \$285,629 for Phase II), of which \$252,132 remains unspent. The City anticipates the remaining balance to be utilized on required work yet to be performed including technical support negotiating with IDE Americas for the plant expansion and technical/environmental support for the SRF loan application for the plant expansion.

### Additional Support Services

The District will incur additional costs from both Clean Energy Capital and Hawkins, Delafield & Wood LLP for financial and legal support during the development phase of the WSA. Cost estimates received from Clean Energy Capital and Hawkins, Delafield & Wood LLP for work performed through execution of a WSA are \$120,000 and \$340,000 respectively.

## **ATTACHMENTS**

1. Final Term Sheet for a WSA between MWD and City of Santa Barbara

# TERM SHEET

For a

WATER SUPPLY AGREEMENT

Between

City of Santa Barbara

and

Montecito Water District

Final Draft

## GENERAL TERMS

1. Purpose	The purpose of this Term Sheet is to set forth summary terms for a potential Water Supply Agreement (“ <b>WSA</b> ”) between the City of Santa Barbara (the “ <b>City</b> ”) and the Montecito Water District (the “ <b>District</b> ”) (together, the “ <b>Parties</b> ”). This Term Sheet is a summary only and is not comprehensive or definitive. The parties understand that substantive terms and detailed provisions not noted or fully developed in this Term Sheet are expected to be included in any final WSA. The WSA relates sale by the City of water made available from increased production at the Plant and construction of the Conveyance Pipeline (“ <b>Contract Water</b> ”).
2. Not a Water Supply Agreement	This Term Sheet is not a WSA. The potential terms and conditions set forth herein do not bind the City or the District in any manner, and do not commit either Party to enter into a WSA.  Any final and binding WSA will be subject to review and approval by the City’s City Council and the District’s Board of Directors.
3. Term of WSA	The term of the WSA (“ <b>Term</b> ”) will be fifty (50) years from Commencement of Deliveries (see Section 11), subject to termination as provided in the WSA.
4. The Plant	“ <b>Plant</b> ” means: the Charles E. Meyer Desalination Facility and related intake, outfall, pretreatment and pumping facilities. The Plant is owned by the City and currently operated through a design-build-operate contract with IDE Americas (the “ <b>DBO Contract</b> ”).
5. Conveyance Pipeline	“ <b>Conveyance Pipeline</b> ” means: a City facility that will convey desalinated water from the Plant to the Cater Clearwell. Water from the Clearwell will be conveyed to the District via existing facilities as defined in the Cater JPA. The Conveyance Pipeline is expected to consist of a newly constructed pipeline from the Plant to Mission Street and use an existing City water transmission main from Mission Street to the Cater Clearwell. The Conveyance Pipeline includes the new and existing pipeline and ancillary and accessory pipes, valves, meters, and similar facilities necessary to effectuate deliveries from the Plant to the Delivery Point, but does not include the Cater Water Treatment Plant.  The cost of the Conveyance Pipeline will be allocated between the Parties as set forth in Section 38.  The expected construction completion of the Conveyance Pipeline is set forth in Section 7.
6. Plant Capacity	Plant Capacity means the annual capacity of the Plant to produce desalinated water meeting all legal and regulatory requirements, measured in acre-feet per year (“ <b>AFY</b> ”).

	<p>Currently, Plant Capacity is 3,125 AFY of water. The Plant is operating with three reverse osmosis skids, each with capacity of about 1,042 AFY. An increase in Plant Capacity is required to create a Contract Water that the City can sell to the District. To accomplish the increase, the City plans to (i) build a fourth skid which will be able to produce 1,250 AFY of water; and (ii) expand the existing three skids so that each one will also have the capacity to produce 1,250 AFY of water ((i) and (ii) collectively, the <b>“Fourth Skid”</b>), after which the Plant Capacity will be 5,000 AFY.</p>
<p>7. Construction of and Payment for the Conveyance Pipeline and Fourth Skid</p>	<p>a. <u>Expected Construction Completion Dates of the Conveyance Pipeline and Fourth Skid.</u>                  Upon the satisfaction of conditions set forth in the WSA (which the City shall work diligently to fulfill), the City will issue a notice to proceed for the construction of the Conveyance Pipeline.</p> <p>The City expects that construction of the Conveyance Pipeline and piping alterations at the Cater Clearwell will (i) take approximately 18 months to complete, and (ii) be completed by December 31, 2020 based on a notice to proceed issued in June 2019.</p> <p>In addition, the City expects completion of the Fourth Skid will (i) take approximately one year to acquire a State Revolving Fund loan, (ii) approximately one year to complete construction, and (iii) be completed by December 31, 2020. However, if the City decides to postpone commencement of construction of the Fourth Skid this date would move accordingly. By May 31 of each Contract Year, the City will notify the District whether it will be delaying the construction of the Fourth Skid.</p> <p>b. <u>Payment for the Conveyance Pipeline and the Fourth Skid.</u>                  The District will not be obligated to make any payments related to the Conveyance Pipeline (see Section 38) until substantial completion of the Fourth Skid.</p>
<p>8. Base Volume</p>	<p>The annual volume of water committed to the District under the Water Supply Agreement is 1,430 AFY (the <b>“Base Volume”</b>).</p>
<p>9. TIO Volume</p>	<p>Each Contract Year, the City may make available to the District up to 445 AF of take-if-offered water that is in addition to the Base Volume (the <b>“TIO Volume”</b>). The TIO Volume made available in each Contract Year will be determined as set forth below.</p> <p>Within 90 days after the beginning of each Contract Year, the Parties will complete the following planning process to establish the TIO Volume for the current year (<b>“TIO Year 1”</b>) and the next year (<b>“TIO Year 2”</b>), and to estimate the TIO Volume available two years in the future (<b>“TIO Year 3”</b>).</p> <p>a. <u>Estimate of TIO Volume in TIO Year 3.</u></p>

	<p>The City shall provide the District a written estimate of the TIO Volume that the City will make available to the District in TIO Year 3. This estimate is only being prepared to assist the District in its water planning efforts. The City has the right to adjust its estimate at any time until the TIO Volume becomes fixed the following year pursuant to the procedures set forth in subdivision b. below.</p> <p>b. <u>Establishing TIO Volume in TIO Year 2.</u>          To establish the TIO Volume in TIO Year 2:</p> <p>(i) The City shall inform the District of the TIO Volume (up to 445 AF) that the City will make available in TIO Year 2 (the “<b>TIO Amount</b>”). The TIO Amount may differ from the City estimate provided to the District the previous year in accordance with subdivision a. above.</p> <p>(ii) The District is not required to accept the entire TIO Amount offered by the City, but may not accept less than 50% of the offered amount. Once the District informs the City of the acceptance amount, the TIO Volume in TIO Year 2 will be fixed and may not be adjusted.</p> <p>c. <u>TIO Volume in TIO Year 1 is Fixed.</u>          The TIO Volume in TIO Year 1 will have already been established the previous year pursuant to the procedures set forth in subdivision b. above and may not be adjusted.</p> <p>“<b>Contract Year</b>” means a year or partial year ending June 30.</p>
<p>10. Total Annual Water Commitment</p>	<p>“<b>Total Annual Water Commitment</b>” means the annual amount of water that the District is required to take and the City is required to deliver to the District each Contract Year. The Total Annual Water Commitment for any Contract Year is equal to: (i) the Base Volume, and (ii) the TIO Volume for such Contract Year.</p> <p>The Total Annual Water Commitment is subject to Conveyance Loss (see Section 17).</p>
<p>11. Commencement of Deliveries</p>	<p>The City will begin delivering water pursuant to the WSA on January 1, 2021 or the date substantial completion of the Conveyance Pipeline (the “<b>Commencement of Deliveries</b>”), whichever is later.</p>
<p>12. Governing Principles</p>	<p>The Parties agree to the following governing principles:</p> <p>a. The City shall own and operate the Plant and the Conveyance Pipeline. The WSA does not convey any ownership interest in either the Plant or the Conveyance Pipeline to the District.</p>

- b. The District is purchasing a wholesale supply of water made available by the City. In exchange for a reliable water supply, the District agrees to pay for the Total Annual Water Commitment even if hydrological conditions make the Total Annual Water Commitment surplus to the District's needs. The price for the Total Annual Water Commitment includes a portion of the Plant's fixed and variable costs. The Base Volume also includes additional payments in consideration of the City's investments and risks described in subdivisions c. and d. of this Section below. In addition, the District shall pay a ratable portion of potential increases in Plant costs that may result from future Capital Modifications or operating cost increases required in response to uncontrollable circumstances as defined in the DBO Contract, including future changes in law.
- c. In consideration for the District's agreement to the above-described costs, the City will provide the District a reliable water supply. For the term of the WSA, the City will (i) deliver the Total Annual Water Commitment to the District, and (ii) reasonably manage its potable water supplies, including the Plant, such that the Contract Water is available to meet the City's delivery obligations under the WSA. The City's annual water supply commitment under the WSA will be subject to Production Uncontrollable Events, District Uncontrollable Events, and Critical Water Emergencies, all as defined in the WSA. The City's monthly water supply commitment will also be subject to production interruptions at the Plant due to permitted downtime for scheduled maintenance, repairs and replacements. However, such production interruptions will not reduce the City's obligation to deliver the Total Annual Water Commitment.
- d. The Parties acknowledge and recognize the City's unique contribution to the WSA as owner of the Plant. The City has borne expenses, including permitting and maintenance costs of the Plant, dating back as early as 1995; and is providing the Plant site, intake and outfall facilities, and other physical assets necessary for Plant operations.
- e. For operational convenience of the City's potable water system, the City shall have the right to supply the Total Annual Water Commitment from the City's potable water supply system as a whole. However, because the Contract Water is made available by the Plant the City will, using good industry practice, maintain the Plant's ability to produce the Contract Water, including to promptly resume water production in event of a shut-down.
- f. The WSA will be subject to the implied covenant of good faith and fair dealing.
- g. The Parties seek to finalize, approve and execute a binding WSA as soon

	as possible with a target execution date of June 30, 2019.
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**SUPPLY OF WATER AND OPERATION OF THE PLANT BY THE CITY**

<p>13. Delivery of Water</p>	<p>Water will be delivered to the District at the Delivery Point.</p> <p>a. <u>Annual Volume</u>                  Each year, the City is required to deliver the Total Annual Water Commitment to the District. If the District accepts less than the Total Annual Water Commitment, the District will not have the right to carry over the unused amount except as authorized in connection with a District Uncontrollable Event (see Section 22).</p> <p>The WSA will set forth provisions regarding the Parties’ rights to cure water delivery or acceptance shortfalls within the same Contract Year.</p> <p>b. <u>Monthly Volume</u>                  The Total Annual Water Commitment will be delivered in equal amounts each month unless the Parties agree otherwise for a particular year (the “<b>Monthly Volume</b>”). The City will use reasonable efforts to accommodate the District’s requests for modifications to the Monthly Volume, provided that the requests are reasonable and timely. Consistent with the City’s right to manage its supplies and deliver water from any source, temporary shutdowns, delivery deficiencies, and other operational interruptions affecting the Plant that are not the result of a circumstance described in paragraph e. of this section will not be a basis for reducing a monthly volume.</p> <p>c. <u>Daily Volume</u>                  The WSA will set forth provisions for the scheduling of Daily Volumes.</p> <p>d. <u>Measurement</u>                  Deliveries will be measured at the Delivery Point.</p> <p>e. <u>Limitations</u>                  The City’s obligation to deliver the Total Annual Water Commitment will be subject to Production Uncontrollable Events, District Uncontrollable Events, and Critical Water Emergencies, all as defined in the WSA.</p> <p>The City’s monthly water delivery commitment is also subject to production interruptions at the Plant due to permitted downtime for scheduled maintenance, repairs and replacements. However, such production interruptions will not reduce the City’s obligation to deliver the Total Annual Water Commitment.</p>
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14. Water Quality	Water delivered to the District must meet all state and federal primary water quality requirements at the Delivery Point.
15. Source of Water	The City shall have the right to deliver the Total Annual Water Commitment of water to the Delivery Point from any source as it determines in its sole discretion.
16. Delivery Point	The Delivery Point will be an existing metering point on the South Coast Conduit immediately downstream from the Cater Water Treatment Plant, or such other point as agreed by the Parties.
17. Conveyance Loss	<p>Conveyance Loss from the Plant to the Delivery Point is fixed at 1.5% of the Total Annual Water Commitment.</p> <p>The Parties acknowledge that there will be conveyance losses (the “<b>South Coast Conduit Conveyance Losses</b>”) from the Delivery Point to the point of withdrawal from the South Coast Conduit by the District. The South Coast Conduit Conveyance Losses are for the District’s account and outside the scope of the WSA.</p>
18. Maintenance of the Plant as a Source of Contract Water	<p>The Plant is the source of Contract Water in the amount equivalent to the Base Volume, plus any TIO Volume. The City will operate and maintain the Plant during the term of the WSA; provided, however, that after the 25th year of the WSA, the City may replace the Plant with another water production facility or source that (i) has a water production reliability greater than or equal to the Plant and (ii) has a cost to the District that is less than or equal to the costs under the WSA as if the Plant continued to operate for the remainder of the WSA term. The replacement facility or source will be a new facility or source that excludes the City’s Non-Plant Core Water Supplies (see Section 23). If the City intends to exercise its right to replace the Plant, it will give at least two years notice to the District. Upon delivery of the notice, the City and District will negotiate in good faith for amendments to the WSA that provide equivalent financial and water supply terms with respect to the new facility or source as are provided with respect to the Plant. If the City and District are not able to reach agreement on amendments to the WSA within one year from the date of the notice, either the City or the District may terminate the WSA.</p>
19. Plant Operating Mode	<p>The operation of the Plant at each point in time throughout the Term of the WSA will be categorized as one of the following Plant Operating Modes:</p> <p>a. <u>Base Operating Mode</u> When the City orders the Plant to be operated at a production capacity of at least 1,430 AFY.</p> <p>b. <u>Curtailed Operating Mode</u> When the City orders the Plant to be operated at a production capacity</p>

	less than 1,430 AFY.
20. Notification of District	The City shall notify the District of each change in Plant Operating Mode. The Plant Operating Mode shall be determined at the City’s sole discretion.
21. Production Uncontrollable Event	<p>A Production Uncontrollable Event means: (i) an uncontrollable circumstance event affecting the Plant as defined in the DBO Contract; (ii) a failure by the DBO Contractor to produce desalinated water in accordance with the DBO Contract; or (iii) damage to the Conveyance Pipeline as a result of a force majeure event.</p> <p>“<b>DBO Contractor</b>” means IDE Americas or such other third-party contractor as may be engaged by the City to operate the Plant. ‘DBO Contractor’ does not include the City if it has chosen to self-perform Plant operations.</p> <p>During a Production Uncontrollable Event, the City will use reasonable efforts to minimize the adverse impact of the event on the production of water at the Plant including the potential delivery of water in a subsequent month. The District will use reasonable efforts to accept water in a subsequent month.</p> <p>a. <u>Effect of a Production Uncontrollable Event during Base Operating Mode.</u></p> <ol style="list-style-type: none"> <li>1. During a Production Uncontrollable Event caused by damage to the Conveyance Pipeline, the City will be relieved of its obligation to deliver water to the District. The City will use reasonable efforts to expeditiously repair the Conveyance Pipeline.</li> <li>2. During a Production Uncontrollable Event that causes a full shutdown of the Plant, the City will be relieved of its obligation to deliver water to the District.</li> <li>3. This subparagraph 3 will apply only after completion of the Fourth Skid. During a Production Uncontrollable Event that results in a reduction in the amount of water produced by the Plant, the City’s delivery obligation will be based on a fraction of Total Annual Water Commitment divided by the Plant Capacity times the daily production of the Plant during the event. (For example: if the TAWC is 1,500 AFY and the Plant Capacity is 5,000 AFY at the time of the uncontrollable event, the fraction is 1,500/5,000; if the TAWC is 1,500 and the Plant Capacity is 7,500 AFY at the time of the uncontrollable event, the fraction is 1,500/7,500).</li> <li>4. This subparagraph 4 will apply only before completion of the Fourth Skid. During a Production Uncontrollable Event that results in a reduction in the amount of water produced by the Plant, the City will not be relieved of its obligation to deliver Contract Water.</li> </ol>

	<p>b. <u>Curtailment Operating Mode.</u> Production Uncontrollable Events do not apply when the Plant is in Curtailment Operating Mode.</p> <p>c. <u>DBO Contractor Fault</u> In the event of a failure by the DBO contractor to produce desalinated water in accordance with the DBO Contract, the City may be entitled to receive damages from the DBO contractor. The City shall have sole discretion to determine whether and how to pursue collection of damages in such event. The City and the District will share the directly allocable pursuit costs, and the directly allocable damages actually received from the DBO contractor, in proportion to the Total Annual Water Commitment and Plant Capacity as of the date of the alleged non-delivery of water.</p> <p>During a Production Uncontrollable Event, the District will pay (i) the fixed cost components of the Monthly Water Purchase Price, and (ii) the variable cost components of the Monthly Water Purchase Price for water that is delivered. Further, if the Production Uncontrollable Event results in a price increase to the City under the DBO Contract, the District will bear its proportionate share of that increase.</p>
<p>22. District Uncontrollable Event</p>	<p>A District Uncontrollable Event means an event that causes the District to be unable to accept water from the City at the Delivery Point for any reason (including as a result of a force majeure event affecting the District’s water distribution system or the South Coast Conduit, but not including a voluntary decision by the District not to accept water).</p> <p>During a District Uncontrollable Event:</p> <p>a. The District will be relieved of its obligation to receive deliveries and the City will be relieved of its obligation to deliver water by the amount of water that the District is unable to accept because of the event. However, the District’s obligation to make payments for fixed cost components of the Monthly Water Purchase Price will not be reduced.</p> <p>b. If the City uses the water from the Plant that would have been delivered to the District during the District Uncontrollable Event, then the City will use reasonable efforts, at the City’s option, to (i) deliver an equivalent amount of water to the District at the Delivery Point over the next 12 months, or (ii) immediately deem the amount to be District Banked Water (defined below). If the City chooses to make monthly deliveries, any such water that the City is unable to deliver to the District over this 12 month period will be deemed District Banked Water.</p> <p>c. <b>“Uses the water”</b> means that the water is (i) actually used by the City for consumptive uses in its service territory and reduces the City’s draw</p>

	<p>from Lake Cachuma or other sources, or (ii) sold to as surplus to a third party outside of the City’s service territory.</p> <p>d. <b>“District Banked Water”</b> means water deemed to be delivered to the District through a debiting of the City’s balance of Lake Cachuma water (or such other location as may be mutually agreed) and a crediting of the District’s balance of Lake Cachuma water.</p> <p>e. District Banked Water will be deemed to be the District’s water and will be subject to all conveyance restrictions, losses, and costs applicable to District-owned water at Lake Cachuma (or such other location as may be mutually agreed).</p> <p>f. District will pay all costs associated with the storage and conveyance of the District Banked Water.</p> <p>g. Upon delivery of water pursuant to paragraph b., above, or delivery of District Banked Water, the District will pay the variable production costs attributable to that water.</p>
<p>23. Force Majeure or Uncontrollable Events Affecting City’s Non-Plant Core Water Supplies</p>	<p>Except as set forth in Section 24, the City shall not be relieved of its obligation to deliver the Total Annual Water Commitment because of force majeure or uncontrollable events affecting any of the City’s Non-Plant Core Water Supplies, including but not limited to, drought conditions, water emergencies, or future reductions in the City’s allocation of State Water Project water or other supplies.</p> <p><b>“City’s Non-Plant Core Water Supplies”</b> means the City’s core water supplies other than water produced by the Plant. These water supplies include groundwater, State Water Project water, Cachuma Project water, and water from the City’s water rights in the Santa Ynez River and its tributaries.</p>
<p>24. Critical Water Emergency</p>	<p>1. <u>Water Asset Failure or Contamination.</u>  The City will be excused from delivering the Total Annual Water Commitment to the extent required to meet its Basic Public Health, Safety and Sanitation Needs if:</p> <ul style="list-style-type: none"> <li>(a) the Plant is being operated at its full capacity;</li> <li>(b) except for water delivered to the District, water produced by the Plant is not being sold to a third party outside of the City’s service territory;</li> <li>(c) a breakage or failure of a water system asset or contamination of a City water supply prevents or impedes delivery of water to the City;</li> </ul> <p>and</p> <ul style="list-style-type: none"> <li>(d) as a result of such breakage or failure, the City is unable to meet its Basic Public Health, Safety and Sanitation Needs using (i) the City’s Core Water Supplies, and (ii) water produced by the Plant that is not obligated to be delivered to fulfill the Total Annual Water Commitment.</li> </ul>

	<p><b>2. Severe Drought.</b>                  The City’s obligation to deliver the Total Annual Water Commitment during a severe drought will only be excused if:</p> <ul style="list-style-type: none"> <li>(a) the Plant has a capacity of at least 7,500 AFY;</li> <li>(b) the Plant is being operated at its full capacity;</li> <li>(c) except for water delivered to the District, water produced by the Plant is not being sold to a third party outside of the City’s service territory; and</li> <li>(d) the City is unable to meet its Basic Public Health, Safety and Sanitation Needs using (i) the City’s Core Water Supplies, and (ii) water produced by the Plant that is not obligated to be delivered to fulfill the Total Annual Water Commitment.</li> </ul> <p>If the above conditions are met, the City will be excused from delivering the Total Annual Water Commitment to the extent required to meet its Basic Public Health, Safety and Sanitation Needs.</p> <p><b>“Basic Public Health, Safety and Sanitation Needs”</b> means the minimum amount of water required to meet basic needs for (i) human consumption and sanitation, and (ii) other critical services (such as fire protection, hospitals, clinical care, schools, or industry needs for employment of workers), as further defined in the WSA.</p> <p>During a period of (i) water asset failure or contamination, or (ii) severe drought as described above (each, a <b>“Critical Water Emergency”</b>), the Plant will be operated at its full capacity.</p> <p>If both parties are unable to meet their respective Basic Public Health, Safety and Sanitation Needs because of a Critical Water Emergency, the total amount of water available to the City and the District (including core water supplies and water produced by the Plant) will be evaluated when determining the amount of the City’s water delivery excuse. In such an event, (i) residential customers of both parties will receive the same amount of water per capita per day, and (ii) other critical service water demands will be apportioned equitably.</p> <p>During a Critical Water Emergency, the District will pay: (a) the fixed cost components of the Monthly Water Purchase Price (see Section 26(2)), based on the proportionate share of Plant water delivered to the District; and (b) the variable cost components of the Monthly Water Purchase Price for water that is delivered.</p>
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**PAYMENTS BY THE DISTRICT**

<p>25. Monthly Water Purchase Price</p>	<p><b>1. Components of Monthly Water Purchase Price.</b>                  From the Commencement of Deliveries and continuing through the Term of the WSA, the District shall make monthly payments (the <b>“Monthly Water</b></p>
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	<p><b>Purchase Price”)</b> to the City equal to the sum of:</p> <ul style="list-style-type: none"> <li>a. The Water Supply Charge (which is made up of seven subcomponents), as described in Section 26;</li> <li>b. The Debt Service Coverage Deposit Amount, as described in Section 35;</li> <li>c. The DSR Deposit Amount, as described in Section 36; and</li> <li>d. The Pay-As-You-Go Capital Amount, if any, as described in Section 37.</li> </ul> <p>2. <u>Fixed Cost Components of the Monthly Water Purchase Price.</u>                  Except as set forth in item 3 below, the Monthly Water Purchase Price is paid in equal amounts each month during each Contract Year.</p> <p>3. <u>Variable Cost Components of the Monthly Water Purchase Price.</u>                  The Variable O&amp;M Charge Component (see Section 30) and the TIO Payment (see Section 34), both of which are used to calculate the Water Supply Charge, are the only parts of the Monthly Water Purchase Price which will be calculated based on the amount of water delivered by the City to the District.</p> <p>4. <u>Capital Charge Allocation Percent.</u>  <b>“Capital Charge Allocation Percent”</b> is 28.6% (which is calculated by dividing the Base Volume (1,430 AFY) by Plant Capacity after the Fourth Skid is built (5,000 AFY)). However, if the City postpones construction of the Fourth Skid, then following Commencement of Deliveries and during the period of postponement until the Fourth Skid is substantially complete, the Capital Charge Allocation Percent will be 45.8%. (1,430 AFY/3,125AF = 45.8%.) The Capital Charge Allocation Percent is used to calculate the District’s share of various costs associated with the Plant.</p>
<p>26. Water Supply Charge</p>	<p>The Water Supply Charge shall be calculated monthly as the sum of the following components:</p> <ul style="list-style-type: none"> <li>a. The Plant Capital Charge Component, as described in Section 27;</li> <li>b. The Standby O&amp;M Charge Component, as described in Section 29;</li> <li>c. The Variable O&amp;M Charge Component, as described in Section 30;</li> <li>d. The Capital Maintenance Reserve Charge, as described in Section 31;</li> </ul>

	<ul style="list-style-type: none"> <li>e. The Administrative Charge, as described in Section 32;</li> <li>f. The Water Supply Development Fee Component, as described in Section 33; and</li> <li>g. The TIO Payment, as described in Section 34.</li> </ul>
<p>27. Plant Capital Charge Component</p>	<p>The Plant Capital Charge Component shall be the sum of the following annual amounts, divided by 12 and multiplied by the Capital Charge Allocation Percent:</p> <ul style="list-style-type: none"> <li>a. Annual debt service on the City’s SRF Loan financing of the City’s costs of constructing the Existing Facilities. “<b>SRF Loan</b>” means the City’s borrowing from the State Water Resources Control via the Installment Sale Agreement, dated July 21, 2015, as amended.</li> <li>b. Annual Amortization of the amount of interest during construction that was paid by the City on the SRF Loan described in subparagraph a. above. “<b>Annual Amortization</b>” means the annual debt service equivalent calculated to reflect 20-year amortization at the SRF Loan interest rate.</li> <li>c. Annual Amortization of the amount of principal that is paid by the City on the SRF Loan described in subparagraph a above prior to the date of Commencement of Deliveries.</li> <li>d. Annual debt service on the City’s debt financing of the costs of constructing the Fourth Skid. The City expects to enter into a new SRF loan agreement, or amendment of the existing SRF Loan to provide this financing. This debt service will not be included in the calculation of the Plant Capital Charge Component until operation of both the Fourth Skid and the Conveyance Pipeline has commenced.</li> <li>e. Annual debt service (including interest during construction) resulting from the City’s long-term financing of potential future Capital Modifications eligible for inclusion in this component (see Section 28).</li> </ul>
<p>28. Capital Modifications</p>	<p>The City shall have the right to finance the cost of a Capital Modification (as defined in Section 41) through issuance of additional bonds, loans, through pay-as-you-go contributions, or through a combination thereof.</p> <p>In the event that the City elects to finance the cost of a Capital Modification through issuance of additional bonds, the Capital Charge Component will be adjusted in accordance with the provisions set forth herein.</p> <p>In the event that the City elects to finance the cost of a Capital Modification through pay-as-you-go, the City shall include the District’s ratable portion in</p>

	<p>the Pay-As-You-Go Capital Amount (See Section 37).</p> <p>a. Capital Modifications associated with the Existing Plant shall be eligible for cost recovery from the District. The portion payable by the District shall be the total cost of such Capital Modification multiplied by the Capital Charge Allocation Percent. Such portion may be (i) withdrawn from the District’s portion of the Capital Maintenance Reserve Account pursuant to Section 31, (ii) charged to the District as a Pay-As-You-Go Capital Amount pursuant to Section 37, (iii) included in the Plant Capital Charge Component pursuant to Section 27(e), or (iv) some combination of these methods, as determined by the Parties.</p> <p>b. Plant Expansions shall not be eligible for cost recovery from the District.</p> <p>c. If a Capital Modification affects both the Existing Plant and the Expanded Portion of the Plant, the District shall only be responsible for costs related to the Existing Plant. The District’s cost responsibilities are calculated pursuant to item a. of this Section above.</p> <p>d. Capital modifications associated with the Conveyance Pipeline shall not be eligible for cost recovery from the District, unless such modifications are the result of a force majeure event or change in law.</p> <p><b>“Existing Plant”</b> means the Plant after completion of the Fourth Skid having an anticipated Plant Capacity of 5,000 AFY of water.</p> <p><b>“Plant Expansion”</b> means a Capital Modification that expands the capacity of the Plant greater than 5,000 AFY.</p> <p><b>“Expanded Portion of the Plant”</b> means the portions of the Plant that are only associated with a Plant Expansion.</p>
<p>29. Standby O&amp;M Charge Component</p>	<p>The Standby O&amp;M Charge shall be the annual Standby O&amp;M Costs incurred by the City, divided by 12, and multiplied by a fraction in which the numerator is the Total Annual Water Commitment and the denominator is either 5,000 AFY or the then Plant Capacity, as agreed to by the parties in the Water Supply Agreement.</p> <p><b>“Standby O&amp;M Costs”</b> mean the annual fixed amount payable by the City under the DBO Contract. These costs represent the fixed operations and maintenance costs of the Plant (as opposed to the volumetric costs of water production). These fixed costs occur independent of the volume of water produced.</p> <p>The Standby O&amp;M Costs are intended to represent the fixed costs of maintaining the Plant in a ready-to-produce state. The Variable O&amp;M Costs (see Section 30) are intended to represent costs associated with actual</p>

	<p>water production. Additional review of the cost structure under the DBO Contract is required to harmonize the definitions of Standby O&amp;M Costs and Variable O&amp;M Costs in the Water Supply Agreement with the concepts contained in the DBO Contract.</p>
<p>30. Variable O&amp;M Charge Component</p>	<p>The Variable O&amp;M Charge shall be equal to: (i) the City’s Variable O&amp;M Costs, multiplied by (ii) the Volumetric Percent.</p> <p><b>“City’s Variable O&amp;M Costs”</b> shall be determined by subtracting the annual Standby O&amp;M amount from the total O&amp;M amount as calculated under the DBO Contract, divided by the projected production output of the Plant for such Contract Year.</p> <p>If the Plant is in Curtailment Operating Mode for a billing period, the Variable O&amp;M Charge Component shall be the Variable O&amp;M Charge Component charged for the most recent billing period.</p> <p><b>“Volumetric Percent”</b> shall be equal to: (i) the amount of water delivered to the District in each month; and (ii) the annual volume of water projected to be produced by the Plant.</p>
<p>31. Capital Maintenance Reserve Charge</p>	<p>The Capital Maintenance Reserve Charge will be equal to: (i) the annual amount that the City establishes for deposit (the “Capital Maintenance Reserve Account <b>Deposit</b>”), divided by (ii) 12, multiplied by (iii) the Capital Charge Allocation Percent.</p> <p>The Water Supply Agreement will establish mutually acceptable timing and amounts for the Capital Maintenance Reserve Account Deposits. The City will credit the Capital Maintenance Reserve Charges received from the District to a reserve account for capital maintenance, renewal and replacement established and maintained by the City for the benefit of the Plant and Conveyance Pipeline (the “<b>Capital Maintenance Reserve Account</b>”). The City will fund the balance of the Capital Maintenance Reserve Account each year.</p> <p>The Capital Maintenance Reserve Account will be used to pay capital maintenance, renewal and replacement costs of the Plant and the Conveyance Pipeline. When the City determines that the Capital Maintenance Reserve Account has a prudent and reasonable balance, will be specified in the Water Supply Agreement, additional contributions shall be suspended. Deposits funded by the District, and interest earned thereon, will be tracked by the City, and may only be applied to costs allocable to the District in accordance with the Water Supply Agreement.</p>
<p>32. Administrative Charge</p>	<p>The Administrative Charge shall be equal to: (i) the City’s Administrative Costs, divided by (ii) 12, and (iii) multiplied by the Capital Charge Allocation Percent.</p>

	<p><b>“City’s Administrative Costs”</b> means the City’s costs for administration, management and oversight of the WSA, the Plant, the Conveyance Pipeline, and contracts associated therewith.</p> <p>For the first Contract Year of the WSA, the Administrative Charge will be deemed to be \$60,000. At the end of the Contract Year, the Parties will determine the actual amount paid by the City for the City’s Administrative Costs for such Contract Year. Reconciliation between this amount and the Administrative Charge paid by the District for such Contract Year will be performed as part of the annual true-up (see Section 40).</p>
<p>33. Water Supply Development Fee Component</p>	<p>The Water Supply Development Fee shall be equal to: (i) \$237,500 per annum (escalating at 3% annually), divided by (ii) 12.</p> <p>The Water Supply Development fee shall only be payable by the District for the first 20 years of the Term of the WSA.</p>
<p>34. TIO Payment</p>	<p>TIO Payment shall be equal to: (i) the TIO Unit Price, multiplied by (ii) the TIO Volume.</p> <p><b>“TIO Unit Price”</b> shall be the dollars-per-acre-foot amount equal to the sum of (i) the Plant Capital Charge Component, (ii) the Plant Standby O&amp;M Charge Component, and (iii) the Plant Variable O&amp;M Charge Component.</p>
<p>35. Debt Service Coverage Deposit Amount</p>	<p>The Parties acknowledge that the City’s SRF Loan debt covenant requires it to maintain a 1.25x debt service coverage ratio. To satisfy this covenant for water supplied to the District, the District will fund a debt service coverage deposit (the <b>“DS Coverage Deposit”</b>) in an amount equal to 0.25 times the District’s ratable portion of City debt service as determined by the calculations performed for the Plant Capital Charge Component.</p> <p>The DS Coverage Deposit shall be paid in equal monthly installments each Contract Year, provided, however, that no such monthly installments shall be due prior to seven business days following the District’s receipt of the refund from the prior year. The DS Coverage amount that was received by the City during each Contract Year shall be refunded to the District within thirty days of the end of such Contract Year.</p> <p>The DS Coverage Deposit shall be held by the City throughout each Contract Year.</p> <p>The requirement to fund a DS Coverage Deposit shall continue for the term of the SRF Loan. At final maturity of the SRF Loan, any remaining funds shall be returned to the District and the ongoing funding requirement shall cease.</p>
<p>36. DSR Deposit</p>	<p>The Parties acknowledge that the City’s SRF Loan debt covenant requires it to fund a debt service reserve (<b>“DSR”</b>) equal to two semiannual installment</p>

<p>Amount</p>	<p>payments over the first 10 years of the payment term of the SRF Loan, and to maintain the DSR at that level thereafter. To satisfy this covenant for water supplied to the District, the District will fund a DSR deposit (the “<b>DSR Deposit</b>”) in an amount equal to the debt allocated to the District pursuant to Section 27.</p> <p>The DSR shall be maintained and held in the enterprise fund established pursuant to the SRF Loan documentation, and shall be applied against the final debt service payments due on the SRF Loan. The amounts on deposit in the DSR that are provided by the District shall be applied against the final debt service payments due on the SRF Loan, thereby offsetting the Plant Capital Charge Component of the Monthly Water Purchase Price.</p> <p>Interest earned on the DSR Deposit shall be for the account of the District. Interest earned shall be calculated by the City as part of the annual true-up process, using the interest rate determined by the City as applicable to such investment.</p>
<p>37. Pay-As-You-Go Capital Amount</p>	<p>The Pay-As-You-Go Capital Amount shall be the amount determined by the City in accordance with Section 28(a).</p> <p>If the District is unable to contribute the Pay-As-You-Go Capital Amount from available District funds, the District’s portion will be added to the Plant Capital Charge Component as if it were debt financed over a 10 year period at an annual interest rate equal to the average earned by the City on its invested funds plus 0.5%.</p>
<p>38. Conveyance Pipeline Payment</p>	<p>The cost of the Conveyance Pipeline will be allocated equitably between the City and the District. In determining the appropriate equitable allocation of Conveyance Pipeline costs, the Parties have considered (i) cost estimates for the construction of a pipeline capable of carrying the full 10,000 AFY production capacity of the Plant when fully built out, and (ii) cost estimates for construction of a smaller conveyance pipeline with capacity to carry only the Base Volume of water from the Plant to the Cater Water Treatment Plant. On the basis of a cost avoidance model, the Parties have agreed that 64.6% of the cost of the Conveyance Pipeline will be allocated to the District</p> <p>On the date that is the later of (i) the Commencement of Deliveries, and (ii) substantial completion of the Fourth Skid, the District will pay the City a lump sum amount equal to the sum of:</p> <ul style="list-style-type: none"> <li>a. Interest during construction incurred by the City on its financing of the Fourth Skid, multiplied by the Capital Charge Allocation Percentage; and</li> <li>b. The amount equal to:             <ul style="list-style-type: none"> <li>(i) the City’s actual cost of constructing the Conveyance Pipeline, multiplied by the Pipeline Allocation Percentage,</li> </ul> </li> </ul>

	<p>reduced by (ii) the Allocated Grant Amount.</p> <p>The City’s actual cost of constructing the Conveyance Pipeline will be equal to: (i) the direct costs of construction determined through competitive procurement of the general contractor, and (ii) the City’s direct costs of administering the construction. The City shall provide reasonable documentation of such costs as part of its invoice to the District.</p> <p><b>“Pipeline Allocation Percent”</b> shall be 64.6%.</p> <p><b>“Allocated Grant Amount”</b> shall be \$10,000,000, which represents the grant received by the City, times the Capital Charge Allocation Percent.</p>
<p>39. SRF Loan for District’s Conveyance Pipeline Costs</p>	<p>The District is expected to secure a loan from the State Water Resources Control Board to pay for its portion of the Conveyance Pipeline costs (see Section 38).</p> <p>The City will (i) cooperate with the District to obtain this loan, and (ii) design, construct, operate, and maintain ownership of the Conveyance Pipeline in accordance with the terms of the loan as long as it remains outstanding.</p>
<p>40. Payment Mechanics</p>	<p>a. <u>Annual Budget</u> Prior to each Contract Year, (i) the City shall provide the District with an annual budget showing the estimated Monthly Water Purchase Price for such Contract Year; and (ii) the parties shall establish the monthly cost of each fixed component for such Contract Year.</p> <p>b. <u>Monthly Water Purchase Price</u> On a monthly basis, the City shall invoice, and the District shall pay, the Monthly Water Purchase Price.</p> <p>c. <u>Annual True-Up</u> The Water Supply Agreement shall specify an annual true-up provision allowing any monthly billing amounts to be reconciled with actual expenses incurred by the City.</p> <p>d. <u>Return of Debt Service Coverage Amount</u> Within thirty days of the end of each Contract Year, the DS Coverage Deposit Amount shall be returned to the District.</p>
<p>41. Capital Modifications</p>	<p>The City may from time to time undertake capital modifications to the Plant or Conveyance Pipeline.</p> <p><b>“Capital Modifications”</b> means a material change to the physical assets constituting the Plant or the Conveyance Pipeline (including the alteration, addition, demolition, removal, extension or expansion of the physical assets</p>

	<p>constituting the Plant, or the installation of new structures, equipment, systems or technology) made after the execution date of the WSA for any reason. Repairs or replacements of Plant equipment or the Plant’s structures (including replacements of membranes or other Plant equipment or Plant structures with more advanced or efficient membranes or other Plant equipment or Plant structures) shall not constitute Capital Modifications.</p> <p>The City may be required to initiate Capital Modifications of the Plant in the event that such Capital Modification is required in response to an uncontrollable circumstance (including a change in law) as defined in the DBO Contract. The City shall also have the right to direct Capital Modifications if it reasonably determines that a Capital Modification will benefit the Plant or better serve the community.</p>
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**OTHER TERMS**

<p>42. Limitation on District Payment of Capital Modification Costs</p>	<p>If the City undertakes a Capital Modification in the last 20 years of the Term of the WSA (i) for which the District would be responsible for cost-sharing pursuant Section 28, and (ii) such Capital Modification has a longer useful life than the remaining Term, then the District shall pay only the ratable portion of the cost of such Capital Modification that falls within the remaining Term.</p> <p>For example, if the City undertakes a major capital improvement in year 40 that has an expected economic life of 30 years and the City finances such capital improvement with bonds maturing in 20 years, then the District’s payment obligation with respect to such capital improvement would be determined as follows:</p> <ol style="list-style-type: none"> <li>a. The Parties would ignore the 20-year financing, and instead determine the annual debt service that would accrue on a 30-year financing the final maturity of which is coterminous with the expected economic life of the capital improvement,</li> <li>b. For the remainder of the Term of the WSA, the Parties would allocate to the District the annual debt service so determined (i.e. the first ten years of a thirty-year level debt-service repayment) in the manner set forth in Section 28.</li> </ol>
<p>43. Extension Terms</p>	<p>The Parties agree to meet and negotiate a potential extension of the Term on the 45<sup>th</sup> anniversary of the execution of the WSA.</p>
<p>44. Extension/Renewal of DBO Contract</p>	<p>The Parties acknowledge that the 5-year term of the DBO Contract is shorter than the Term of the WSA. The City shall have the right, at its sole discretion, to renew the DBO Contract with the current DBO contractor, or to replace the DBO contractor with a new third-party operator, or to self-perform Plant</p>

	<p>operations, in order to provide continued Plant operations in accordance with generally accepted operating standards.</p> <p>Certain provisions of this term sheet are formulated with reference to the DBO Contract. Such provisions include, but are not limited to, the definition of uncontrollable circumstance referred to in the definition of Production Uncontrollable Events (see Section 21), and the definitions of Standby O&amp;M Costs (see Section 29) and the City’s Variable O&amp;M Costs (see Sections 30). These provisions are expected to survive a potential termination of the DBO Contract and to apply throughout the Term of the WSA.</p>
<p>45. Dispute Resolution</p>	<p>The Parties agree to non-binding mediation to resolve disputes.</p>
<p>46. Remedies</p>	<p>Remedies will be defined in the WSA. Specific performance will be included as a non-exclusive available remedy for City’s breach of its delivery obligations. Withholding deliveries will be included as a non-exclusive available remedy for District’s breach of its take-or-pay obligations. Damages will be included as a remedy available to either party for a breach by the other.</p>