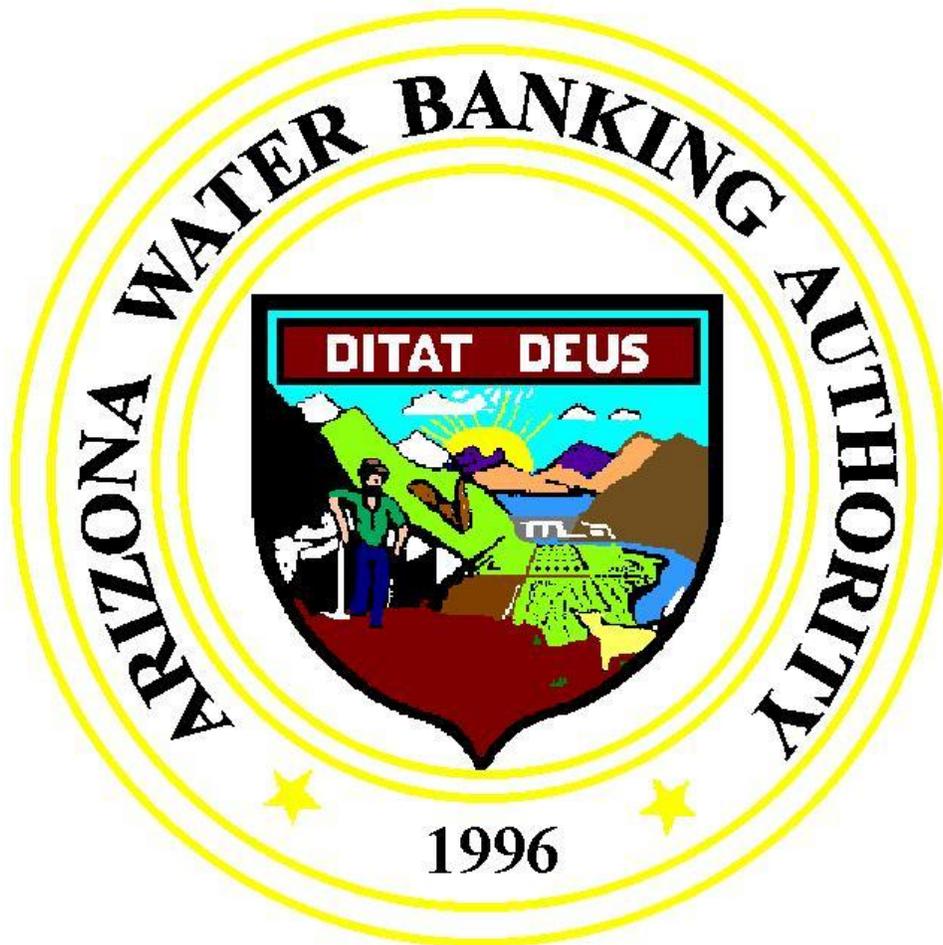


ARIZONA WATER BANKING AUTHORITY

INTERSTATE WATER BANKING REPORT
Fiscal Year 2010



Submitted

October 1, 2010

Interstate Water Banking Report Requirement

Section 2473 to Title 45, Chapter 14, Article 4 directs the Arizona Water Banking Authority (AWBA) to submit a report about interstate water banking to the Joint Legislative Budget Committee on or before October 1 of each year for the previous fiscal year. This report contains information for fiscal year 2010.

The report requires an accounting report of the AWBA's interstate water banking activities with the State of Nevada, including the Southern Nevada Water Authority (SNWA), and includes the following:

1. An accounting of all monies received through the Interstate Water Banking Agreement (Agreement) with the (SNWA).
2. An accounting of all disbursements made with interstate monies, including monies used to purchase or store water.
3. An accounting of any prepaid monies to the Central Arizona Water Conservation District (CAWCD).
4. An accounting of any monies received under the Agreement that are placed in an account with the State Treasurer.
5. Any contract that obligates the AWBA to pay or disburse monies to any other entity, including the CAWCD.

Section 2473 directs that the AWBA may only use the monies received pursuant to an interstate water banking agreement to pay the costs directly incurred in meeting the interstate water banking obligations.

BACKGROUND

The “Law of the River” is comprised of federal and state statutes, interstate compacts, court decisions and decrees, contracts with the United States, an international treaty, operating criteria and administrative decisions concerning the Colorado River. Together, these have resulted in a division of the waters of the Colorado River among the various states and their water users. Over the past several years, the seven states that utilize the Colorado River (the Basin states) have had discussions over various issues and the majority of the issues have been resolved via negotiation instead of litigation. Currently, the issue facing the Basin states is drought and the potential impact to river operations and water supply. Because Arizona is the most junior user on the river, it is important for the state to take steps to protect the Colorado River water supply for Arizona water users.

The 2006 U.S. Supreme Court Consolidated Decree in *Arizona v. California*, confirmed the allocation of water to the three states of the Lower Colorado River basin. This allocation is 4.4 million acre-feet (maf) to California, 2.8 maf to Arizona and 300,000 acre-feet to Nevada.

Agreement for Interstate Water Banking

On July 3, 2001, the Agreement for Interstate Water Banking (2001 Agreement) among the AWBA, the Southern Nevada Water Authority (SNWA) and the Colorado River Commission of Nevada (CRCN) was executed¹. In the 2001 Agreement, the AWBA agreed to use its “best efforts” to store water in Arizona in an amount sufficient to develop an aggregate total of 1.25 million acre-feet of long-term storage credits. Those credits would then be recovered to develop Intentionally Created Unused Apportionment (ICUA) for Nevada as a temporary supply of water to allow Nevada time to develop other long-term water supplies. The 2001 Agreement contained specific provisions to insure that any water stored for Nevada was water that could not be utilized by water users in Arizona. Nevada would pay the full cost of water delivery and storage in addition to all costs associated with recovery of the long-term storage credits.

In 2004, Nevada began exploring alternative ways to meet their water supply needs and approached Arizona with a proposal to amend the 2001 Agreement in such a manner that Nevada’s water supply could be made more secure in the shorter term. The AWBA began negotiations regarding amendments to the original agreement with SNWA and CAWCD staff.

Amended Agreement for Interstate Water Banking

The intent of the amendments was to assure Nevada access to the full 1.25 million acre-feet anticipated under the 2001 Agreement. For this access, Nevada would continue to bear the full cost of storing excess CAP water and later recovering that water. Nevada would also provide \$100 million to the State of Arizona to ensure that Arizona could acquire additional water resources if conditions warranted.

In summary, the amendments negotiated were as follows: (1) guaranteed Nevada a total of 1.25 million acre-feet of credits; (2) recognized that water other than Colorado River water may be the source of credits; (3) Nevada would pay the full cost of delivery, storage and recovery in addition

¹ For purposes of this discussion, the SNWA and the CRCN will be collectively referred to as “Nevada”.

to the \$100 million to mitigate the risk of the guarantee; (4) identified a set schedule for recovery of long-term storage credits; and (5) a sufficient supply of credits would be recovered to allow Nevada to use up to 340,000 acre-feet during a declared shortage on the Colorado River. The Amended Agreement for Interstate Water Banking (Amended Agreement) was approved by the AWBA Commission on December 9, 2004 and executed on February 3, 2005.

The two most significant provisions of the Amended Agreement are that Arizona has now guaranteed Nevada that a sum total of 1.25 million acre-feet of credits will be developed on their behalf. In exchange for this guarantee, Nevada agreed to pay Arizona \$100 million above the actual cost of water delivery and storage. The initial \$100 million dollar payment was made in two installments in 2005, and deposited in a Resource Account of the AWBA Fund .

The AWBA began storing water pursuant to the Amended Agreement in 2005, under a provision recognizing that the AWBA may store water on behalf of SNWA prior to the commencement of scheduled payments, using a loan from the Resource Account. The Annual Report published by the AWBA in July of each year, for the previous calendar year, details the amount of interstate water stored and long-term storage credits accrued by the AWBA. The Amended Agreement provides a temporary water supply for Nevada allowing time for development of other non-Colorado River resources and it provides Arizona additional flexibility to achieve its long-term water management goals.

The loans from the Resource Account, have allowed the AWBA to take advantage of the available water supply and store water on Nevada's behalf. Credits accrued by Nevada through the end of calendar year 2009 totaled 582,772 acre-feet (AWBA Annual Report 2009, Table 4). In January, 2009, the AWBA held a special meeting in response to a request from SNWA for the opportunity to discuss potential changes to the Amended Agreement. The type of modifications discussed focused on creating flexibility in the interstate operations and included allowing changes to the schedule dates and period, dates of water recovery, and coordination schedules in forecasting water storage and recovery. The AWBA agreed that conditions had changed since the Amended Agreement was executed and agreed to toll the performance dates for a period of 90 days to allow time for both state parties to work on permanent modifications to the Amended Agreement.

Second Amended Agreement for Interstate Water Banking

On April 1, 2009, the AWBA approved and executed the Second Amended Agreement for Interstate Water Banking (Second Amended Agreement; Interstate Agreement). While the Second Amended Agreement does provide flexibility in administering the contract, it did not change provisions requiring Nevada to pay the full cost of storage and recovery or Arizona's obligation to create 1.25 million acre-feet of long-term storage credits.

Pursuant to a letter agreement executed April 2, 2009 between the AWBA and SNWA that approved a modification to the payment schedule, the AWBA requested in August, 2009, a partial payment from Nevada to the Operating Account of \$2,685,000 to pay the cost of delivery and storage of interstate water.

At a Special AWBA meeting in November, 2009, the AWBA Annual Plan of Operation (Plan) for 2009 was amended in response to a letter dated November 4, 2009, from the Southern Nevada Water Authority notifying the AWBA of the release of Nevada's unused apportionment for storage in Arizona. The AWBA requested a partial payment from Nevada to the Operating Account of \$10,000,000 to pay the cost of delivery and storage of these new water supplies.

By the end of calendar year 2009, AWBA delivered for storage 59,024 acre-feet of interstate water on behalf of Nevada. The AWBA Annual Plan for 2010 approved in December, 2009 did not include storing water for Nevada because of limited water availability to the AWBA as a result of high water demand in Arizona. No interstate water was delivered in the first half of calendar year 2010.

Additional interstate water supplies may be available for storage by the AWBA toward the end of calendar year 2010. The AWBA will have an estimated, cumulative total of 600,442 acre-feet of credits stored on behalf of Nevada by the end of calendar year 2010. These credits amount to about 48% of the total 1.25 million acre-feet of water storage guaranteed to Nevada. Although this interstate report is based on fiscal year accounting, the AWBA operates on a calendar year. The AWBA approves a Plan of Operation for the entire year through the end of 2010; thus, the credits are estimated through the end of 2010.

Benefits to Arizona

Our Interstate Agreement with Nevada provides an opportunity for the State of Arizona to secure numerous benefits for Arizona water users. Current projections indicate excess water within Arizona's 2.8 million acre-foot entitlement will be available for storage in the future. Without interstate banking, the AWBA does not have sufficient in-state funding to store the quantities of excess CAP water currently projected to be available. Interstate water banking is a mechanism that can maximize Arizona's utilization of its 2.8 million acre-foot entitlement.

The Interstate Agreement also provides additional financial resources that could be used to develop alternative water supplies. Additionally, water stored for interstate purposes provides revenues for the Arizona Water Protection Fund, which is the sole state funding source for riparian protection in Arizona. Furthermore, the water that Nevada may recover has and will help facilitate the full development of recovery arrangements for Arizona water users. Most importantly, the Interstate Agreement helps strengthen Arizona's interstate relationship with Nevada. A strong relationship is critical as the seven Basin states continue discussions regarding the drought and shortages on the Colorado River.

INTERSTATE ACCOUNTING

Pursuant to the Second Amended Agreement, funds are to be received by the AWBA from the SNWA in two ways:

1. \$100 million will be used to guarantee that AWBA can meet the terms of the Interstate Agreement. This amount is intended to be the “insurance” payment to be used to develop alternative water resources to meet obligations to Nevada. Any alternative water supplies developed under the Second Interstate Agreement that are not needed to meet the Nevada obligation would be available for Arizona water users. This payment was made upon request in two installments in June, 2005 and October, 2005 and deposited into a “Resource Account”. If the \$100 million is not needed as “insurance” then it continues to be available to Arizona for whatever purpose deemed appropriate.
2. \$230 million was scheduled to be paid in 10 annual payments of \$23 million beginning in 2009 and deposited into an “Operating Account”. Money in the Operating Account will be used to pay CAWCD for the cost of water delivery and to pay facility operators for storage. The Second Amended Agreement now recognizes additional flexibility in operations. The AWBA and SNWA executed a letter agreement on June 15, 2010 approving a modification to the payment schedule for 2010 and 2011 given the availability of excess CAP water and economic conditions.

The total quantity of interstate storage is dynamic from year to year, but cannot exceed a quantity that would result in more than 200,000 acre-feet of long-term storage credits in any year pursuant to the Storage and Interstate Release Agreement (SIRA) among the Secretary of the Interior, the AWBA, the SNWA and CRCN. As stated above, \$100 million was received from Nevada in two installments in 2005 and deposited in a subaccount with the Arizona State Treasury. In fiscal year 2010, the AWBA received \$12,685,000 from SNWA for the delivery and storage of water pursuant to the Interstate Agreement.

On July 1, 2009, Governor Brewer signed into law SB 1188 and HB 2643¹ ("Trailer bill making revisions to SB 1188) that addressed budget reductions and transfers for FY 2009-10. The total legislative transfer from the Arizona Water Banking Fund was \$9.4 million. As a result of these bills, \$5.4 million of the total reduction was transferred from the Nevada Resource Account.

On December 23, 2009, Governor Brewer signed into law SB 1001² that addressed budget reductions and additional transfers for FY 2009-10 and transferred another \$684,700 from the Arizona Water Banking Fund. Following direction from Commission members, these monies were transferred from the Nevada Resource Account.

¹ HB 2643 (Trailer bill making revisions to SB 1188) signed July 1, 2009 identified \$9.4 million to be transferred from the Arizona Water Banking Fund [(Sec. 110) \$4 million; (Sec. 56) \$5.4 million from interest earnings on the AWB Fund].

² SB 1001 signed December 23, 2009 identified \$684,700 to be transferred from the AWB Fund (Sec. 2).

On March 18, 2010, Governor Brewer signed into law HB 2001 that addressed budget reductions and further transfers for FYs 2009-10 and 2010-11. The total legislative transfer from the Arizona Water Banking Fund was \$5.65¹ million. As a result of HB 2001, \$5 million of the total reduction was transferred from the Nevada Resource Account (see Interstate Accounting FY 2010 table).

Approximately \$47.9 million has been legislatively transferred from the Arizona Water Banking Fund from inception through calendar year 2010 as presently identified. Of this, \$19,649,616 has been transferred from the Nevada Resource Account. The \$19.65 million equates to approximately 200,000 acre-feet of water not stored by the AWBA that could assist it in meeting the State's obligation for Indian firming, interstate banking, and providing supplies to meet Arizona water users' demands during times of shortage.

It is important to note that although this report is based on fiscal year accounting, the AWBA operates on a calendar year. A.R.S. § 45-2456 requires by January 1 of each year, the AWBA shall adopt a Plan of Operation for that calendar year. Along with adoption of the annual Plan of Operation, funds are committed for the purchase, delivery, and storage of water for that calendar year.

¹ HB 2001 signed March 18, 2010 identified \$5,654,000 million to be transferred from the Arizona Water Banking Fund [(Sec.112) \$301,700; (Sec.113) \$198,200; (Sec. 113) \$154,100; (Sec. 113) \$5,000,000].

INTERSTATE ACCOUNTING - Fiscal Year 2010

| Interstate Accounts | Beginning Balance FY 2010 | \$ Received from NV¹ | Disbursements² | Prepayment Forwarded to CAWCD⁴ | AZ State Treasury End of FY Balance⁵ | \$ Committed for AWBA CY Plan of Operation⁶ |
|----------------------------|----------------------------------|--|----------------------------------|--|--|---|
| Resource | \$10,715,149 | - 0 - | \$11,084,700 ³ | - 0 - | \$5,078 | - 0 - |
| Operating | - 0 - | \$12,685,000 | \$12,673,000 | - 0 - | \$18,000 | - 0 - |

¹Initial payment of \$100 million deposited into a "Resource Account" in 2005. Ten subsequent payments of \$23 million were scheduled to begin annually in 2009 to be deposited into an "Operating Account" (see Interstate Accounting section for description of payment modification).

²Monies disbursed, including interest, from "Resource Account" at Arizona State Treasurer's Office as a consequence of SB 1188 and HB 2643 signed July 1, 2009, SB 1001 signed December 23, 2009, and HB 2001 signed March 18, 2010. Monies disbursed from "Operating Account" for purchase and storage of water.

³HB 2001, signed March 18, 2010 identified \$5M to be transferred from interstate fund; insufficient funds available (\$4,698,345.40) in interstate account to meet \$5M reduction. Pursuant to motion made at June 16, 2010 AWBA meeting, staff requested from CAWCD \$301,654.60 made available through the reconciliation of 2009 interstate deliveries and deposited same amount in the Nevada Resource Account to meet the balance of the required legislative transfer.

Legislative transfers from NV Resource Account: FY 10 = \$11,084,700. Cumulative total to date = \$19,649,616; equates to approximately 200,000 acre-feet of water not stored by the AWBA.

⁴Prepaid monies forwarded to CAWCD for delivery and storage of water on behalf of SNWA.

⁵End of fiscal year balance, including accrued interest, in subaccount at Arizona State Treasurer's Office. Balance remaining is portion of interest earned.

⁶Monies committed for purchase of deliveries and storage of interstate water for remainder of the calendar year. Monies in the Operating Account to be received from SNWA in FY 2011.