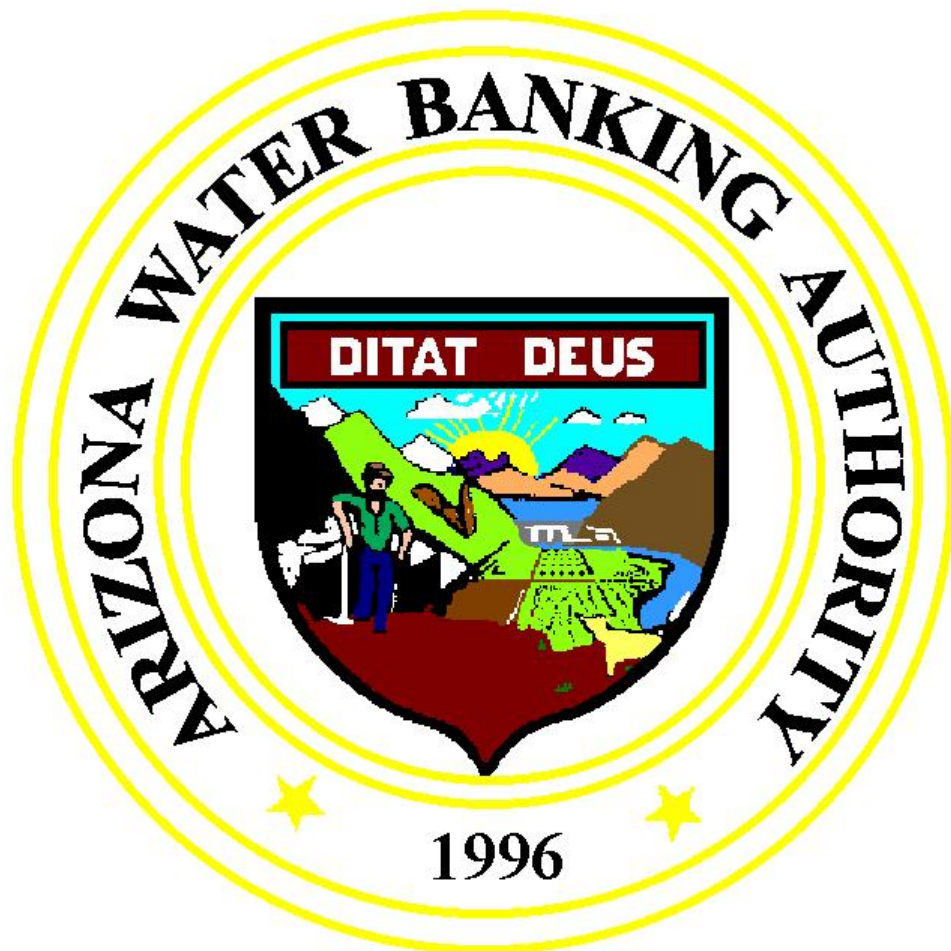


ARIZONA WATER BANKING AUTHORITY

INTERSTATE WATER BANKING REPORT
Fiscal Year 2008



Submitted

October 1, 2008

Interstate Water Banking Report Requirement

House Bill 2869, signed by Governor Napolitano on June 21, 2006, added a new section §45-2473 to Title 45, Chapter 14, Article 4 which directs the Arizona Water Banking Authority (AWBA) to submit a report for interstate water banking to the Joint Legislative Budget Committee on or before October 1 of each year for the previous fiscal year. This report submitted by October 1, 2008 contains information for fiscal year 2008.

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.

House Bill 2869 further stipulates that the AWBA can 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 Colorado River Compact is one of the components of the “Law of the River” that governs the operations of the Colorado River. 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. Together, these have resulted in a division of the waters of the Colorado River among the various users. Over the 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. Most currently, the issue facing the Basin states is drought and the potential impact to river operations and water supply. Because Arizona is a 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.

Under the 1964 decree in *Arizona v. California*, the allocation of water to the three states of the Lower Colorado River basin was recognized. This allocation was 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. The 2001 Agreement was negotiated recognizing the surplus provisions of the federal Interim Surplus Guidelines (ISG).

The ISG published on January 25, 2001 by the United States Department of the Interior, control the operation of the Lower Colorado River system through 2016. The ISG provide more liberal surpluses to allow a transition period for California to reduce its reliance on Colorado River water and to implement measures to limit its total uses of Colorado River water in the state to 4.4 million acre-feet. Consequently, at the time the 2001 Agreement was negotiated, Nevada anticipated that its water needs would be met through 2016 by surplus water made available through the ISG. After 2016, Nevada intended to utilize credits stored on its behalf by the Arizona water bank. However, in 2004, surpluses under the ISG were not available because the projected storage content of Lake Mead was below the critical threshold content established in the ISG. Consequently, Nevada began exploring alternative ways to meet their water supply needs and approached Arizona with a proposal to amend the existing agreement in such a manner that Nevada’s water supply could be made more secure in the shorter term. Nevada began negotiations regarding the amendments with AWBA and CAWCD staff.

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

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 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 to an additional sum of money 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.

A discussion paper was prepared by AWBA staff, widely distributed to the public, and discussed at various meetings throughout the Phoenix and Tucson areas. This discussion paper included pertinent background information, a review of the current agreement and proposed changes, and a description of the benefits to Arizona. 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.

The AWBA began storing water pursuant to the Amended Agreement in 2005, under a loan provision recognizing that the AWBA may store water on behalf of SNWA prior to the commencement of scheduled payments. 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. Water stored on behalf of Nevada in calendar year 2007 was stored in storage facilities located in Pinal and Pima Counties.

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.

Receipt of the \$100 million, has 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 2007 totaled 527,447 acre-feet (AWBA Annual Report 2007, Table 4) and an estimated 6,400 acre-feet of credits are forecasted to be accrued during the 2008 calendar year (AWBA Annual Plan of Operation 2008, Amended Table 2; amended in June, 2008). The AWBA will have an estimated, cumulative total of 533,847 acre-feet of credits stored on behalf of Nevada by the end of calendar year 2008. These credits amount to about 43% 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 2008; thus, the credits are estimated through the end of 2008.

Benefits to Arizona

The Amended Agreement 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 Amended Agreement also provides additional financial resources that could be used to develop alternative water supplies. In addition, 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 could help facilitate the development of recovery arrangements for Arizona water users. Most importantly, the Amended 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 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 Amended 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 Amended Agreement that are not needed to fully 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 will be paid in 10 annual payments of \$23 million scheduled to begin in 2009 and deposited into an “Operating Account”. This money will be used to pay CAWCD for the cost of water delivery and to pay facility operators for storage, as needed.

The Amended Agreement allows for some or all of the \$100 million to be “loaned” to the Operating Account and subsequently repaid to the Resource Account, with interest. This loaning provision was included in recognition of the fact that the AWBA may store water on behalf of SNWA prior to the commencement of scheduled payments into the Operating Account. Since water was available and the Operating Account payments are not scheduled to begin until 2009, it was necessary for the AWBA to call for a portion of the \$100 million, loan it to the Operating Account, and continue to contract with CAWCD to store water for SNWA.

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) between 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 2008, the AWBA did not receive any additional funds from SNWA for the delivery and storage of water pursuant to the Amended Agreement.

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.

INTERSTATE ACCOUNTING - Fiscal Year 2008

Beginning Balance FY 2008	\$ Received from NV¹	Disbursements²	Prepayment Forwarded to CAWCD³	AZ State Treasury End of FY Balance⁴	\$ Committed for AWBA CY Plan of Operation⁵
\$22,672,559	- 0 -	\$4,710,236	- 0 -	\$18,936,271	\$0

¹Initial payment of \$100 million deposited into a "Resource Account". Ten subsequent payments of \$23 million scheduled to begin annually in 2009 to be deposited into an "Operating Account".

²Monies disbursed from subaccount at Arizona State Treasurer's Office for purchase and storage of CAP water.

³Prepaid monies forwarded to CAWCD for delivery and storage of water on behalf of SNWA.

⁴End of fiscal year balance, including accrued interest, in subaccount at Arizona State Treasurer's Office.

⁵Monies committed for purchase of deliveries and storage of interstate water for remainder of the calendar year.