



## PUBLIC WORKS DEPARTMENT

CITY HALL  
10300 TORRE AVENUE • CUPERTINO, CA 95014-3255  
TELEPHONE: (408) 777-3354 • FAX: (408) 777-3333  
CUPERTINO.ORG

### CITY COUNCIL STAFF REPORT

Meeting: July 16, 2024

#### Subject

Lease agreement with San Jose Water Company for the operation of the Cupertino Municipal Water System.

#### Recommended Action

Adopt Resolution No. 24-XXXX authorizing the City Manager to execute a lease agreement with San Jose Water Company for the operation of the Cupertino Municipal Water System.

#### Reasons for Recommendation

##### *Background*

Cupertino has three water service areas as shown in Attachment A.

- The San Jose Water Company system (SJWC), pictured in orange, is owned, and operated by SJWC.
- The California Water Service Company (CWSC) system, pictured in green, is owned and operated by CWSC.
- The Cupertino Municipal Water System (System), pictured in purple, is owned by the City of Cupertino but currently operated by SJWC pursuant to the Lease Agreement with the City of Cupertino. This system is the subject of this staff report.

The System was approved for lease to SJWC by the City Council on September 2, 1997. The lease began on October 1, 1997, with a term of 25 years. As the lessee of the System, SJWC is responsible for all operations of the System including repair, maintenance, operation, customer service/billing, emergency service, and water quality testing. According to the terms of the 1997 lease, the City received an initial \$6.8 million concession fee upon the execution of the lease from SJWC and pays an annual base rental of \$1 per year for the use of the System.

This lease agreement was amended and restated in December 2019 to require SJWC to be responsible for all capital improvements with respect to the System, which includes management, design, and construction of the improvements during the term of the lease. SJWC was also responsible for expending \$5 million on capital improvements before the lease agreement expired on September 30, 2022, which was completed.

On December 14, 2021, the City issued a Request for Proposal (RFP) for the lease and operation of the System. The RFP included updated lease provisions to ensure System customers receive quality and reliable water service, and specifications that the System is operated and maintained in accordance with all applicable laws, regulations, and standards.

The City held a mandatory pre-submittal meeting on January 12, 2022, where two water retailers attended, SJWC and CWSC. Prior to the RFP due date on March 31, 2022, the City elected to cancel the RFP and extend the current lease with SJWC for another two years, expiring on September 30, 2024. As part of the extended lease term, SJWC was responsible for allocating an additional \$1.6 million for capital improvements to the System, which have been completed.

### *Discussion*

In advance of the lease expiration, an RFP for the lease and operation of the System was reissued on July 31, 2023. The City held a mandatory pre-submittal meeting on August 24, 2023, and three water retailers attended, SJWC, CWSC, and California American Water. On September 28, 2023, the City received one proposal from SJWC and a letter of concession from California American Water indicating that they decided not to submit a proposal after careful consideration. California American Water mentioned the decision was based solely on their current strategic priorities and it was not a reflection of the City's process or their ability to provide water service in Cupertino. California American Water also mentioned that they are focused on acquisitions rather than leases or concessions.

The SJWC submittal was reviewed to determine whether it complied with the requirements stated in the RFP. All requested information in the RFP was provided by SJWC. The RFP also required the respondent to offer a one-time concession fee and an annual investment rent which will be used to improve the System. SJWC included a one-time concession fee of \$22.1 million and an annual investment rent of \$1.8 million per year, with annual increases based on construction cost indices. The term for the new lease will be limited to 12 years with an option for renewal that could extend the total lease period to 20 years. The agreement has a termination for convenience clause which allows the City to terminate the lease with short notice should it find the need to do so. However, due to this termination clause, the one-time concession fee is subject to a one-twelfth per year proration, meaning that if the City terminates the lease early, it would be required to return the prorated portion of the concession fee to SJWC. For example, if the City terminated the lease in year 6, it would be responsible for returning one-half of the concession fee (six year remaining term \* 1/12 proration per year).

The SJWC has maintained and operated the System since 1997. The City has been satisfied with their performance and responsiveness to the needs of the residents in the

System. In addition to Cupertino, SJWC provides water service to customers in the City of San Jose, City of Campbell, City of Monte Sereno, City of Saratoga, Town of Los Gatos, and unincorporated portions of Santa Clara County.

The next step after the public hearing process is to execute the new lease agreement with SJWC prior to the expiration of the existing lease on September 30, 2024.

Sustainability Impact

No sustainability impacts.

Fiscal Impact

Authorization of the recommendation for a new long-term lease will result in the City receiving annual investment rent payments which will be utilized by SJWC to maintain and improve the Cupertino Water System. A one-time concession fee will be provided to the City in an amount equal to \$22.1 million dollars. Additionally, as a consideration for the City's costs to administer the lease, the City will receive an annual franchise fee which has averaged \$250,000 annually for the past three years and is consistent with similar fees established in the Cupertino Municipal Code.

California Environmental Quality Act (CEQA)

The execution of the lease is exempt under CEQA Guidelines section 15301 (operation of existing facilities).

---

Prepared by: Jimmy Tan, Assistant Director of Public Works

Reviewed by: Chad Mosley, Director of Public Works

Reviewed Approved for Submission by: Pamela Wu, City Manager

Attachments:

A – Draft Resolution

B - Water Service Map

C – Draft Lease Agreement