



Costa Mesa Sanitary District

... an Independent Special District

July 3, 2012

Board of Directors

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James Ferryman
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James Fitzpatrick
Arthur Perry

The Honorable Thomas J. Borris
Presiding Judge of Orange County Superior Court
700 Civic Center Drive West
Santa Ana, CA 92701

RE: 2011-12 ORANGE COUNTY GRAND JURY REPORT

Staff

Scott C. Carroll
General Manager

Dear Judge Borris:

In compliance with *Penal Code* §933.05(a) and (b), the following is Costa Mesa Sanitary District's response to the Orange County Grand Jury's report titled, "***Let There Be Light. Dragging Specials Districts from the Shadows***"

FINDINGS

F1. "Most Orange County special districts, with or without the assistance of the Local Agency Formation Commission (LAFCO), have been incapable or unwilling to consolidate, absorb, or eliminate these outmoded and/or redundant agencies. LAFCO typically addresses larger issues such as merging of cities and elimination of "islands" within the county. The special districts themselves have not worked seriously toward their consolidation or demise. In this regard, the enterprise special districts and the non-enterprise special districts require independent evaluation and handling."

Response: The benefit of special districts is that they provide a specialized niche service that allows the organization to focus on their performance and service levels to achieve its mission. For sanitary and water special districts, consolidating with cities and/or the county could jeopardize the replacing of aging infrastructure along with the high level of service already being performed because of competing interest within those organizations such as public safety, economic development, street improvements and landscape and building maintenance.

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In April 2012, the Costa Mesa Sanitary District (CMSD) surveyed 1,000 residents to determine the satisfactory of its services. 89% of those surveyed approved of the job CMSD is doing. 62.4% said it was important that CMSD remains an independent agency versus 21.1% who indicated it was unimportant. A 74% of residents said it is important for CMSD to remain an independent agency for the following reasons:

- good service;
- working well;
- do not want service levels to degrade;
- maintain independence; and
- avoid government bureaucracy.

To see the complete survey results, you can download the document on CMSD's website at www.cmsdca.gov. The survey results tell us that our constituents are very satisfied with their sanitary district and do not want us to work towards consolidation or demise.

F2. *“Special districts have made very little progress in complying with the recommendations made by various governmental agencies. To ensure recommendations are followed, more coordination and cooperation is needed from the city and county agencies.”*

Response: CMSD cannot comment on how this organization responded to the recommendations made by various governmental agencies in the past because CMSD had a different administration. CMSD did, however, comply with the 2010-11 Orange County Grand Jury recommendations for greater transparency by making the General Manager's contract available on the website. In addition, a compensation summary spreadsheet was added to the website that lists all types of compensation along with the name and titles of the employees and Board of Directors. The employee's total compensation is calculated and provided for the public's information.

F5. *“The sixteen enterprise districts typically started as local agricultural irrigation providers and sanitation providers for local communities. These special districts have transitioned into providers of potable water and sewerage disposal for the cities that blossomed around them after 1950. These districts grew until their boundaries met a neighboring special district that was also growing. Some of these local smaller providers have already been absorbed by larger districts under one management.”*

Response: The Costa Mesa Sanitary District was incorporated in 1944, nine years before Costa Mesa became a city, because the community did not have a legal disposal

site for its trash. Soon after incorporation the District included a sewer system because the community had many cesspools.

F6. *“The sixteen enterprise special districts of Orange County founded between 1919 and 1964 have grown with the urbanization of the county. Thirteen of these special districts rely upon taxes collected by the county while three rely on fees and other sources for their revenue. This suggests that all of these enterprise special districts could wean themselves from tax subsidies and rely on fees for their revenue. Severance from the tax subsidies would enable financial transparency and let the customers see the true cost of the services provided.”*

Response: CMSD receives little more than \$200,000 a year in property taxes, which accounts for approximately 1.53% of CMSD’s annual budget. In the last three years, no property taxes have been used to pay for CMSD services and programs. The current rate for solid waste and sewer is the true cost for providing services within CMSD. However, special districts that rely on property taxes use this revenue to keep rates stabilized. Special districts will continue to have expenditures for operations, so weaning themselves from tax subsidies would require districts to find alternative funding sources, which will most likely be in fee increases.

F7. *“The unrestricted reserves of the special districts are available to the governing boards to spend as they please. Local citizens are not openly informed of this wealth when agencies ask for fee increases, special assessments, or bond measures. Most of the special districts do not appear to have specific criteria for amassing these reserves nor do they have published long-range plans for their constructive use.”*

Response: CMSD has not had a solid waste rate increase for the last seven consecutive years and no sewer rate increase has occurred in the last three consecutive years. The solid waste unrestricted reserve fund has increased substantially over the years to more than \$5 million. CMSD has no capital expenditures for solid waste (refuse trucks, trash carts, etc.) because this service is currently being provided by a private solid waste hauler. On June 28, 2012, the Board of Directors approved use of the solid waste unrestricted reserves to temporarily lower the trash rates and reduce the unrestricted reserves. The unrestricted reserves for sewer are actually the CMSD’s Asset Management Fund that is used for long term planning for future replacement of sewer infrastructure. The Asset Management Fund will help the District replace aging pipes and avoid future sanitary sewer overflows that can contaminate the environment and risk heavy fines from the State Water Regional Quality Control Board.

F8. *“The twenty-seven special districts in Orange County have amassed unrestricted reserves of over \$866,000,000. That is enough money to fund all of these special districts for more than year without taxes, fees, interest, or other sources of revenue. The boards of directors have the sole discretion to spend these unrestricted reserves.”*

Response: Unrestricted reserves are commonly used for replacing aging infrastructure. Sewer and water districts have very expensive infrastructure such as treatment plants, pump/lift stations, manholes, pipes, backflow devices, fire hydrants, etc. that can cost hundred thousands of dollars or more. For instance, CMSD is planning on installing permanent generators and by-pass pumps at critical pumping stations to prevent sanitary sewer overflows in the event of a massive power outage. This project will cost CMSD nearly \$1 million to complete and it is funded by CMSD’s Asset Management Fund and without fee increases.

Long term financial planning using unrestricted reserves to replace aging infrastructure does not require fee increases and going into debt from bond issuance. The unrestricted reserves also pay for unforeseen or unexpected emergencies that may arise. Spending all unrestricted reserves on operations is not good business practice and can jeopardize special districts ability to properly plan and fund infrastructure replacements and/or respond to emergencies.

F9. *“The Orange County Auditor-Controller allocated nearly \$35,000,000 to four enterprise special districts (Costa Mesa Sanitary District, South Coast Water District, Trabuco Canyon Water District, and Yorba Linda Water District) that did not show this revenue in their budgets provided to the Grand Jury. What happened to that money is not clearly recorded. Budgeting without the allocated taxes indicates that, along with the three other enterprise special districts that do not rely on tax revenue, these enterprise special districts could function without tax revenues.”*

Response: Of the \$35,000,000 allocated to the four special districts indicated in the report, CMSD received only \$212,004 from the Orange County Auditor Controller, which is less than one percent (0.60%) of the \$35,000,000. CMSD did not include this allocation in the budget in anticipation that the state will raid special district property taxes to balance their own budget. The money was allocated in CMSD’s unrestricted reserves and accounted for in CMSD’s Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2011. To avoid confusion and improve transparency, CMSD will identify allocation from the Orange County Auditor-Controller in future budget documents.

F10. *“The enterprise special districts could save millions of dollars in administration costs by consolidation into regional special districts. Five or six such enterprise special*

districts within Orange County could save at least \$500,000 per year for each special district absorbed.”

Response: It is unclear what criteria was used to estimate millions of dollars in savings by consolidating into regional special districts. Also, it is not mentioned as to which five or six enterprise special districts within Orange County can save at least \$500,000 per year, so CMSD cannot adequately provide comments to this finding.

F14. *“The true cost of water and sanitary sewers in the enterprise special districts is hidden when both taxes and fees fund these districts. Only when the monthly service bills to the customers include all the costs for these services without the tax subsidy will the public understand the true cost of these services and achieve financial transparency.”*

Response: For the past three years, CMSD has not used property taxes to fund its programs and/or operations. The fees charged to CMSD residents are the true cost for providing said services.

F15. *“Only one of the special districts, the South Coast Water District, has had recent performance audits. The lack of performance audits for the remaining special districts leaves the potential for inefficiencies, poor practices, outmoded operations, etc. hidden from the governing boards and the communities they serve. The lack of published performance audits has contributed to the public’s ignorance of these districts.”*

Response: The Costa Mesa Sanitary District is one of the most efficient local governments in California. Our personnel costs is less than twenty percent compared to the average local government spending at least fifty-four percent. CMSD uses the latest technology to ensure the best practices are being utilized such as high water sensors in manholes, trenchless pipe replacement technology (e.g. pipe bursting, HDPE lining, top hat, fold and form and Cured in Place Pipe lining), GIS, computerized maintenance management system, supervisory control and data acquisition system, new inspection tools for pipeline condition analysis, etc.

CMSD estimates that a performance audit could cost between \$40,000 to \$50,000. CMSD believes this money would be better spent preventing Sanitary Sewer Overflows (SSO), however, CMSD will consider conducting such a performance audit in the future.

R1. *All special districts (except the Vector Control District and the County Cemetery District) should be eliminated from the county tax rolls and should rely solely on fees or the services of surrounding governments. (See F2, F3, F4, F5 & F6)*

Response: While CMSD does solely rely on fees to provide services, CMSD does not agree that all special districts should be eliminated from the county tax rolls, because this will require districts to significantly raise fees or drastically reduce services to make up the difference of lost revenue.

R4. *Water and sewer districts should be consolidated into no more than six regional districts. Consideration should be given to including the city water agencies in the consolidation. LAFCO should meet with the water and sewer districts before October 31, 2012 to develop plans and schedules for consolidation. (See F5, F6 & F9)*

Response: It is unclear what criteria warrants the consolidation into six regional water and sewer districts. The benefit of special districts is local control. CMSD residents do not want residents from neighboring jurisdictions to determine what is permissible. As evident in the results of a recent survey, CMSD residents prefer that their special district remains independent and cites several reasons supporting their preference such as good service, working well, don't want service levels to degrade, maintain independence, and avoid government bureaucracy.

CMSD does not agree that consolidation with cities should be considered as it could jeopardize the replacing of aging infrastructure due to competing interest within those organizations such as public safety, economic development, street improvements and landscape and building maintenance. Furthermore, many cities are facing financial uncertainty due to the economy and special districts unrestricted reserves are appealing to them. If water and sewer districts consolidate with cities, the cities will most likely borrow money from their new enterprise funds to pay for redevelopment and infrastructure improvement projects. Thus, the necessary funding to replace aging water and sewer pipes will be delayed and eventually the community will experience common pipe failures that are currently occurring in cities from around the country.

R5. *Water and sewer districts should be removed from the tax rolls and operate solely on fees and other revenues for their services. Consideration should be given to forming non-profit agencies with ownership shared by the constituents. These districts should meet with county officials before October 31, 2012 to prepare plans and schedules to remove themselves from the county tax rolls (See F2, F5 & F6)*

Response: CMSD does not agree that water and sewer districts should be removed from the tax rolls and operate solely on fees and other revenues for their services. As indicated earlier, CMSD believes that special districts will have no alternative but to raise fees and/or reduce service levels to account for the loss revenue from property taxes.

R6. *Special districts should adopt “board of director’s practices” for all their reserves, restricted and unrestricted. All reserves should be classified in their 2013-2014 budgets according to GASB Standard No. 54. LAFCO should work with the special districts to prepare standard criteria for accumulating reserves according to the new classifications by December 15, 2012. These standards should be used in preparing the 2013-2014 budgets. (See F7 & F9)*

Response: CMSD has a period of negative cash flow for the first five months of the fiscal year until such time as the annual fees have been collected and remitted to CMSD. CMSD’s Operations Code Section 4.03.020 establishes a minimum level of reserves for operating funds, which is 15% of its operating budget within the Solid Waste Fund and 10% of its operating budget within the Liquid Waste Fund. This level of operating reserves provides CMSD with the necessary liquidity and resources to cover this period of negative cash flow as well as unanticipated expenses. It is prudent for government entities to maintain operating reserves which constitutes a sound operating practice as determined by oversight bodies, professional organizations, bond rating agencies and bond insurance companies.

The Board adopted an asset management plan that requires a minimum balance of \$5 million to pay for infrastructure replacement when said infrastructure has reached the end of its life cycle. CMSD’s asset management is a long term financial plan that enables the organization to budget accordingly when sewer pipes are due for replacement without going into debt with the issuance of bonds and/or raising fees to pay for the capital costs.

GASB Standard No. 54 does not apply to CMSD because 98% of CMSD budget is from enterprise funds (solid waste and liquid waste) in which CMSD is operated like a business where customers are charged directly for the services rendered. GASB 54 applies to government general funds such as sales tax, gas tax, property tax, etc.

R7. *Excessive unrestricted reserves should be used to reduce existing debts. Future revenues should be reduced to avoid the accumulation of unallocated revenue that does not meet the adopted new standards. (See F7 & F8)*

Response: CMSD is one of the few government agencies in California that has no debt. This is due to long range fiscal planning where CMSD budgets appropriately for several consecutive years before a large capital project begins. CMSD does not agree that future revenues should be reduced because that will result in cutting service or raising fees to make up the difference in lost revenue.

R8. *Each special district should have an independent performance audit at least every three years. The executive summary of the performance audit should be distributed to all the taxpayers of each special district. Each of the special districts that has not had a performance audit within the last five years should contract with an independent outside consultant to conduct such an audit during 2012. These audits should be repeated at least every three years. (See F15)*

Response: CMSD will consider performing an independent performance audit in the future.

R9. *Each special district should contribute 1% of its unrestricted reserve fund to LAFCO to help finance preparing and directing the consolidation, absorption, or elimination, and the setting of standards for reserves for the special districts. These funds should be included in LAFCO's future programs and budgets until the consolidation, absorption or elimination of each special district is achieved. With these additional funds, LAFCO should begin meeting with each special district before the 2014 fiscal year is budgeted for consolidation, absorption and/or elimination of these districts. (See F1, F2, F3, F4, F5 & F6)*

Response: LAFCO does not have the authority to obtain an additional portion of the unrestricted revenues from special districts. In addition, allocating any portion of unrestricted reserve funds to another agency could jeopardize existing programs, capital improvements and maintenance services. Increasing rates or cutting service would need to be considered to make up the funding reduction, which is a detriment to the public.

In conclusion, CMSD hopes that these comments allow for a better understanding of CMSD and how special districts operate. Thank you for the opportunity to submit these comments.

The Honorable Thomas J. Borris
Presiding Judge of Orange County Superior Court
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Sincerely,



James Ferryman
Vice President

C: CMSD Board of Directors