



IRVINE RANCH WATER DISTRICT

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July 25, 2012

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

Subject: Irvine Ranch Water District Response to the 2011/2012 Orange County Grand Jury Report, "Let There Be Light" Dragging Special Districts from the Shadows"

Dear Presiding Judge Borris:

The following represents the Irvine Ranch Water District's (IRWD) response to the findings and recommendations contained in the above referenced 2011/2012 Orange County Grand Jury Report. The responses are specific to the role and responsibilities of IRWD as a retail water supplier formed under the laws applicable to California Water Districts. The format for each section identifies each finding and recommendation followed by a specific response to the same.

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.

We disagree wholly with this finding as it applies to IRWD. Over the last 10-plus years IRWD has consolidated with five water districts. The integrated services of IRWD allow for reduced overhead and administrative costs and lower rates and charges to customers of the consolidated district. When considering consolidation requests, the District looks for increased efficiencies through economies of scale and mutual benefits from combined expertise and resources. Although consolidations differ depending upon the local agency, the basic consolidation process is generally as follows: the agency seeking consolidation provides a framework and service requirements for the specific area in question. If IRWD determines that it is both appropriate and fiscally prudent to enter into consolidation discussions, we will respond. If selected, IRWD and the agency seeking consolidation will develop and agree to the terms and conditions of the consolidation agreement and an application will be filed with the Orange County Local Agency Formation Commission. LAFCO then evaluates and makes a decision on whether or not to accept the consolidation proposal.

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.

IRWD cannot comment on this finding as it is unclear which recommendations this finding references. IRWD has a proactive record in working with other entities to promote accountable, efficient and effective local services. Please refer to IRWD response to F1.

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 smaller providers have already been absorbed by larger districts.

IRWD concurs with this finding, making note that this is a typical historical growth pattern scenario not only for enterprise special districts, but also non-enterprise special districts as well as other forms of local government that provide specialized services, including cities and counties.

F6. The sixteen enterprise special districts of Orange County founded between 1919 and 1964 have grown with the urbanization of the country. 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.

We disagree wholly with this finding as it applies to IRWD. IRWD uses the one percent property taxes received from the state, along with other voter-approved local property taxes and new connection fee revenue, to make payments on its bonds that finance the facilities it needs. This makes sense - property owners directly benefit from the water and wastewater infrastructure and services their property taxes have paid for.

These tax revenues are used by IRWD to fund the debt service on basic water and wastewater infrastructure – which includes projects like reservoirs, groundwater wells, water pipelines, water pump stations, sewage lift stations, sewage treatment and disposal capacity, and sewage collection pipelines. This enormous infrastructure serves about one fifth of Orange County and includes more than 1,100 miles of drinking water pipelines, more than 400 miles of recycled water pipelines, more than 900 miles of sewer pipes, 53 reservoirs, and two large wastewater treatment plants.

In fiscal years 2004-05 and 2005-06, the state grabbed a total of \$19.4 million of the District's one percent property tax allocation in a budget-balancing maneuver. The "temporary" taking of that property tax revenue directly resulted in an increase in new service connection fees and local property taxes. Years later, the state still owes IRWD customers \$2 million.

The Orange County Grand Jury clearly and strongly suggests it would be the responsible thing to do for the state to once again divert property tax revenue from special districts. As we have illustrated, that would be the opposite of prudent, responsible policy. Such a shift, whether temporary or permanent, would once again result in connection fee and local property tax increases. A permanent redirection of that tax revenue into state coffers could well lead to increased monthly user rates.

Even when the state takes property tax funds away from local agencies such as IRWD, our customers still continue to pay the same one percent property taxes to the state plus any additional IRWD imposed taxes and fees necessary to pay our infrastructure bond payments. In the end, this is a roundabout way for the state to quietly raise taxes by forcing IRWD to increase fees and assessments to offset the property tax revenues taken by the state.

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 wealthy 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.

We disagree wholly with this finding as it applies to IRWD. IRWD's audited financial statements reflect no unrestricted water or sewer assets (California Water District Law, Division 13 of the Water Code). Financial statements as well as the annual operating and capital budgets are adopted in a public meeting process where our customers always have an opportunity to review and comment. Once finalized, these documents are placed on the IRWD website.

IRWD "Cash and Investments" assets of approximately \$250 million as of June 30, 2010 consists primarily of funds that are restricted to pay for infrastructure replacement and refurbishment needs of the District over time as well as restricted proceeds from bond issue to finance capital infrastructure (See note 2 in the Statement of Net Assets in the IRWD 2010 Comprehensive Annual Financial Report.)

Every year IRWD evaluates its future replacement and refurbishment funding needs utilizing sophisticated planning models that currently indicate that IRWD will require an estimated \$2 billion in infrastructure and refurbishment funding in the future. IRWD believes that setting aside funds now to fund future infrastructure expenditures is prudent financial management so our customer's rates are not severely impacted by large capital expenditures in the future. This approach to financing future infrastructure needs is described on page 9 of the IRWD 2010 Comprehensive Annual Financial Report.

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.

We disagree wholly with this finding as it applies to IRWD. Please refer to IRWD response to F7.

F10. The enterprise special districts could save millions of dollars in administration costs by consolidation into regional special districts. Five or six such special districts within Orange County could save at least \$500,000 per year for each special district absorbed.

We disagree with this finding as it is not based on any criteria and is speculative in nature. Orange County already has a recognized specific local process for consolidation that takes into consideration many factors, including cost efficiencies. Please refer to IRWD response to F1.

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 customer 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.

We disagree wholly with this finding as it applies to IRWD. Please refer to IRWD response to F6.

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 public performance audits has contributed to the public's ignorance of these districts.

We disagree wholly with this finding as it applies to IRWD. IRWD utilizes independent resources to audit financial and internal control practices as well as to assess efficiency and reliability characteristics of system wide water, sewer and recycled water infrastructure and operations. Further, IRWD publishes key performance metrics in its monthly Board packages which are available on the District's website. IRWD also participates in the Orange County LAFCO Municipal Service Review process and incorporates findings and recommendations into near and long term strategic planning.

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

We disagree wholly with this finding as it applies to IRWD. Please refer to IRWD responses to F1 and F6.

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

We disagree with this finding as it is not based on any criteria and is speculative in nature. Orange County already has a recognized specific local process for consolidation that takes into consideration many factors, including cost efficiencies. Please refer to IRWD response to F1.

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)

Please refer to IRWD responses R4 and F1.

R6. Special districts should adopt "board of director's practices" for all their reserves, restricted and unrestricted. All reserves should be classified in their 2013-14 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 2012-2014 budgets. (See F7 & F9)

We disagree wholly with this recommendation as it applies to IRWD. IRWD has comprehensive financial policies and practices that are adopted and implemented by the IRWD Board of Directors. A discussion on IRWD financial planning and budgeting can be found beginning on Page 9 of the IRWD 2010 Comprehensive Annual Financial Report. For further information please refer to IRWD response F7.

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

We disagree wholly with this recommendation as it applies to IRWD. There is no definition as to what is “excessive” in terms of reserves, and having cash and investments to meet future obligations, as well as setting rates adequately to meet ongoing obligations, are both important elements in obtaining excellent ratings from the major rating agencies (Standard & Poor’s, Moody’s and Fitch). The higher the ratings, the lower the cost of debt and in turn, the lower the cost that is passed on to customers in the form of rates, fees or taxes. Please refer to IRWD response to F7.

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)

Please refer to IRWD response to F15.

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)

We disagree wholly with this recommendation. Local property taxes fund local services, including but not limited to education, public safety, roads, emergency response, water and sewer services. A clear nexus of benefit historically exists between the taxpayer and the property value improvement generated from property tax investments provided by special district.

IRWD uses the one percent property taxes received from the state, along with other local property taxes and new connection fee revenue, to make payments on general obligation bonds that are issued to finance facilities that provide water and sewer service to our customers. This makes sense - property owners directly benefit from the water and wastewater infrastructure and services their property taxes have paid for.

Additionally and as prescribed by law, IRWD provides LAFCO with a proportionate Special District LAFCO budget share to help fund LAFCO administrative activities and identified special programs. The LAFCO budget is funded in equal parts by Special Districts, Cities and by the County of Orange. Specific reorganization considerations and studies are typically funded by agencies collaboratively seeking LAFCO involvement.

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IRWD recognizes the importance of cost efficiencies and financial transparency and has a solid record of considering and implementing appropriate consolidation requests from neighboring agencies and working successfully with Orange County LAFCO throughout this process.

If you have questions or require further information, please do not hesitate to contact me at 949/453-5590.

Sincerely,

A handwritten signature in blue ink, appearing to read "Paul Cook". The signature is fluid and cursive, with a long horizontal stroke at the beginning.

Paul Cook
General Manager