

**Board of Directors**

Margie L. Rice  
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Tyler M. Diep  
Frank A. Cobo

**General Manager**

Ken Robbins

July 12, 2012

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

Re: Response of Midway City Sanitary District to the Grand Jury Report: Let There Be Light – Dragging Special Districts from the Shadows

Dear Judge Borris:

The Midway City Sanitary District Board of Directors reviewed in its entirety at a publically held meeting the Grand Jury Report entitled “Let There Be Light – Dragging Special Districts from the Shadows” (“Report”) and submits the following comments on the findings and recommendations contained in the Report in conformity with California Penal Code Sections 933, subdivision (c), and 933.05. The comments provided below address the findings and recommendations requiring a response from Midway City Sanitary District (“MCSD” or “District”). The District’s Board of Directors has reviewed the May 9, 2012 Orange County Local Agency Formation Commission (LAFCO) and May 18, 2012 California Special Districts Association’s responses to the Report, and joins in the concerns expressed therein.

The District notes that California Penal Code section 933.05(e) provides as follows: “During an investigation, the grand jury shall meet with the subject of that investigation regarding the investigation, unless the court, either on its own determination or upon request of the foreperson of the grand jury, determines that such a meeting would be detrimental.” Regrettably, the Grand Jury chose not to meet with either members of the District’s Board of Directors or the District’s staff. The District believes that if the Grand Jury had complied with section 933.05(e), the District would have been able to provide valuable information regarding the District’s operations and efficiencies that would have cleared up certain misinformation in the report as it relates to the District and also provided an opportunity for a more balanced evaluation.

MCSD further notes that although it has previously notified the Grand Jury, both orally and in writing, on several occasions over the last few months that the MCSD’s General Manager is Kenneth Robbins, not Greg Nordbak, this change has not been made in the Grand Jury records. MCSD requests that the Grand Jury note for its records that all future correspondence be correctly addressed to General Manager, Kenneth Robbins.



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## Response to 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.**

The District first notes the overbroad nature of Finding 1 and submits that the Finding is not supported by facts referenced in the Report specific to MCSD. It is also unclear under what criteria the Finding was made. To the extent Finding 1 is applicable to MCSD; MCSD disagrees wholly with this Finding.

LAFCO, as an independent agency, is required to conduct Municipal Service Reviews (MSRs) of all agencies, including special districts, under its purview. In 2006, LAFCO prepared an MSR report which thoroughly examined the District’s governance structure and service provisions. As set forth in LAFCO’s response to the Report dated May 9, 2012, “LAFCO is finishing its third cycle of MSRs and have found no significant issues with special districts in Orange County.”

MCSD provides its constituents community focused service, that serves a specifically defined area, unlike counties, cities and regional districts that provide a wide variety of services throughout their boundaries. MCSD provides specialized sewer and solid waste services, allowing the District to concentrate on providing the best services and programs to its constituents based on what the local community needs, not competing interests. The decisions to be made on these local services should always rest with the local citizens who established and depend on MCSD.

The Midway City Sanitary District operates with a high degree of transparency and is held accountable to the public. MCSD’s infrastructure is sound and adequate for the delivery of sewer and solid waste services. The District’s expenditures are based on efficient methods of operation. Moreover the District is financially solvent.

Consolidation could jeopardize the replacement of aging infrastructure along with the high level of services already being performed because of competing interests within



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those other organizations such as public safety, economic development, street improvements and landscape and building maintenance.

- 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.**

The District notes the overbroad nature of Finding 2 and submits that the Finding is not supported by facts referenced in the Report specific to MCSD. It is unclear to which “recommendations” the Grand Jury is referring. To the extent Finding 2 is applicable to MCSD; MCSD disagrees wholly with this Finding.

MCSD has shown substantial willingness to respond to recommendations made to it. MCSD has responded to the 2010-11 Orange County Grand Jury’s recommendations for greater transparency by making compensation and benefits information for all elected officials, executive, management, and regular employees easy to access online. In addition, the General Manager’s contract and represented employees Memorandum of Understanding (MOU, union agreement) is also easily available online. As a direct result, the Midway City Sanitary District has received an “AAA” rating for accessibility and compensation cost transparency in the 2011-12 Grand Jury Report entitled “Transparency Breaking Up Compensation Fog – But Why Hide Pension Costs?” MCSD was also recognized and awarded in that same report the “2012 Gold Honor Roll” for supplying the best accessibility and compensation cost transparency for the citizens of the District. The MCSD Board of Directors and staff continually look for ways to provide easy access and easy to understand information about the District and to improve its operations and the valuable cost effective services and programs it provides.

- 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.**

MCSD agrees with this finding and suggests that this demonstrates that the local LAFCO consolidation process works well when and where deemed appropriate.



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- 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 up-on 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.**

MCSD disagrees wholly with this Finding. The District submits that the Finding is not supported by facts referenced in the Report specific to MCSD.

Property taxes help to provide a firm financial foundation for MCSD to build and maintain the infrastructure and services necessary to sustain a safe and healthy environment. Property taxes account for approximately fifteen percent of the District's revenues which tax revenues are necessary for its budget and long-term financial planning. Property tax revenue has been a critical component to the District's ability to maintain its low rates during the financial turmoil the past several years. To shift property taxes away from MCSD would impose a major hardship on the District and its constituents, forcing increases in fees, deferral of infrastructure projects and reducing or possibly eliminating some services. If property taxes are reallocated away from MCSD, MCSD's customers would be required to pay higher fees or lose core services.

MCSD's annual residential fees for solid waste and sewer service are listed on each homeowner's individual property tax bill; along with the contact information for the District should the taxpayer have any questions. Therefore, complete information is currently easily accessible to allow customers to see the true costs of MCSD services.

In the wake of the struggling economy and the State's financial crisis, MCSD has already experienced reduced property tax revenues and the shifting of property taxes to the State, resulting in less local taxpayer money that was intended for local services and programs, not to help the State solve its financial issues. Further losses and shifting of property taxes could lead to detrimental impacts on the health and safety of the local community and directly to MCSD's constituents. The property tax shift recommended by the Grand Jury would virtually guarantee that customer rates would increase.



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- 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.**

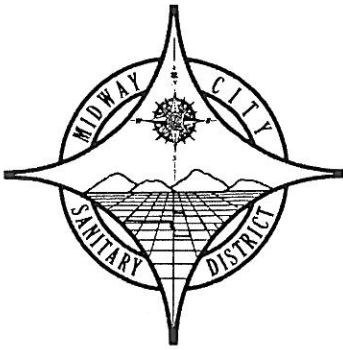
MCSDD disagrees wholly with this Finding. The District submits that the Finding is not supported by facts referenced in the Report specific to MCSDD. There is no information in the Grand Jury report indicating that accounting professionals working in the public agency area have concluded that MCSDD reserves are not fully appropriate for a sanitary district of MCSDD's size and mission, nor does the Grand Jury report provide any professional accounting analysis to indicate that other special districts' reserves are not appropriate for their size and mission.

The MCSDD Board of Directors is an elected body accountable to the taxpayers through the election process. The Board reviews the District's reserves at its public Board meetings. The Board adopts an annual budget, through an open meeting process, which budget includes funds for necessary capital improvements and infrastructure projects such as the repair and replacement of sewer lines and compliance with federal and state regulatory requirements for protection of the environment. As reflected in the LAFCO MSR Report, the District operates with a high degree of transparency and is held accountable to the public.

The District's *Direct Deposits and Invested Funds Policy* establishes and designates specific reserve accounts. The District maintains reserves as necessary to maintain appropriate levels of services, protect the health and safety of the community, and sound fiscal condition of the District. Adequate reserves are maintained for emergencies, economic uncertainties, financial hardships, and downturns in the local and national economy, local disasters, future capital obligations, and cash flow and legal requirements. The District's Policy is annually reviewed and adopted and made available on the District's website.

- 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.**





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MCSD disagrees wholly with this Finding. The District submits that the Finding is not supported by facts referenced in the Report specific to MCSD. There is no information in the Grand Jury report indicating that accounting professionals working in the public agency area have concluded that MCSD reserves are not fully appropriate for a sanitary district of MCSD's size and mission, nor does the Grand Jury provide any professional accounting analysis to indicate that other special districts' reserves are not appropriate for their size and mission.

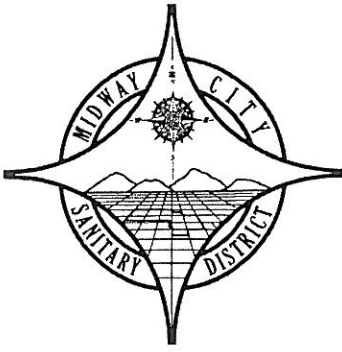
Please refer to the response to F7 above, which applies to this finding as well. The Board of Directors is responsible and accountable to its constituents for the financial health and stability of the District and operates with a high degree of transparency.

MCSD reserves are used for maintaining and replacing aging infrastructure, meeting governmental mandates, supporting operations, and unforeseen emergencies. Sanitary (sewer and solid waste) districts have very expensive infrastructure to maintain - such as sewer lines, lift stations, backflow devices, sewer vector (sewer line cleaning) trucks, solid waste (refuse) trucks, and must provide the personnel to support those services.

MCSD's reserves provide a measure of the overall fiscal health of the District's finances. As a result of MCSD's strong financial metrics, including reserves, good economic fundamentals, Standard and Poor's issued MCSD a bond rating to AAA despite the negative pressures of the housing market, employment softness and inflation.

- 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.**

MCSD disagrees wholly with this Finding. The District submits that the Finding is not supported by facts referenced in the Report specific to MCSD. It is unclear what criteria, if any, the Grand Jury utilized to estimate millions of dollars in savings by consolidating into regional special districts. Also, the Grand Jury does not identify which five or six enterprise special districts within Orange County the Grand Jury believes can save at least \$500,000 per year, so MCSD cannot adequately provide comments to this finding.



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Furthermore, MCSD believes that by keeping decision-making local and not consolidating into larger regional agencies, the citizens that the District serves are provided better access to their elected officials and provided more efficient and effective specialized services based on local need, not political boundaries.

- 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.**

MCSD disagrees wholly with this Finding. The District submits that the Finding is not supported by facts referenced in the Report specific to MCSD.

Please refer to the response to F2 and F6, which applies to this finding as well.

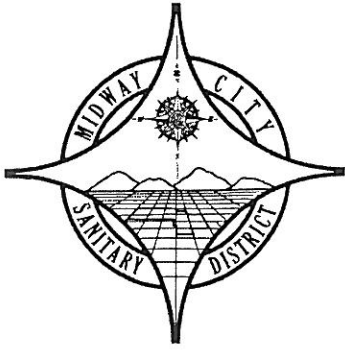
Much like private businesses, MCSD receives revenues from several resources. MCSD includes all financial resources, including property tax and fees in the annual budget process and publically identifies how those resources will be used for sanitary (sewer and solid waste) services. The budget is posted on the District's website and includes the cost of each service provided to its customers.

The MCSD Board of Directors annually holds several public meetings to prepare the District's budget through a public hearing process. The public is notified on the District's website, and with published notices, inviting the public to review and comment on the District's fees and budget adoption.

The annual residential sanitary (sewer and solid) fee applicable to individual parcels is clearly identified on the tax bill provided to each property owner, listing the amount of the fee paid along with the District's contact information number if the taxpayer has any questions.

Requiring billing on a monthly basis will not only result in a substantial increase in MCSD administrative costs, but will result in a substantially higher delinquency rate and additional collection expenses, all of which is counter-productive to providing efficient cost effective 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**



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**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.**

To the extent Finding 15 is applicable to the District; the District disagrees wholly with this Finding.

LAFCO regularly conducts Municipal Service Reviews (MSRs) of every special district. As set forth in LAFCO's response to the Report dated May 9, 2012, "LAFCO is finishing its third cycle of MSRs and has found no significant issues with special districts in Orange County."

The MCSD governing Board of Directors is fully engaged in the District's operations and implementation of long-term objectives.

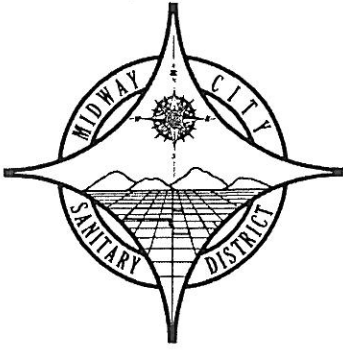
The MCSD uses the latest technology and the Board of Directors supports the training of its Directors and employees to ensure that best practices are being utilized to protect the health and safety of the residents and businesses that MCSD serves. The MCSD has an aggressive capital improvement and sewer system master plan, and has recently invested \$15.6 million dollars in the sewer system, which included projects such as refurbishing and rebuilding all four of the Districts lift stations, installing a new sewer monitoring system (SCADA), HDPE lining, Global Positioning System (GPS) each of the manholes, and the upgrading and relocating and sewer lines. The MCSD Board of Directors is currently looking at the feasibility of installing an alternative fueling station and converting its solid waste fleet to natural gas.

MCSD estimates that a performance audit may cost up to \$50,000. MCSD believes this money can be better spent preventing sanitary sewer spills and refurbishing aging infrastructure. However, MCSD will consider conducting such a performance audit in the future.

### Response to Recommendations

- 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).**





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This recommendation will not be implemented by MCSD as it is not warranted or reasonable.

While MCSD does rely, in part, on fees to provide services, MCSD does not agree that all special districts should be eliminated from the County tax rolls. Please see responses to F2, F3, F4, F5, F6 & F7, which speak to the many issues the Grand Jury raised in regard to this recommendation.

The tax funds are used for a public purpose. Diverting these tax funds to other agencies will only result in an increase in rates and therefore an increase in the overall financial burden on residents and businesses.

- 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).**

This recommendation will not be implemented by MCSD as it is not warranted or reasonable.

It is not the number of sewer districts that is significant, but the ability of a special district to deliver core local services effectively and responsibly. MCSD is sensitive and responsive to the local neighborhoods it serves and delivers its services effectively, responsibly and in a cost-effective manner to protect the health and safety of the community.

LAFCO already meets regularly with local agencies, including MCSD, and periodically prepares Municipal Services Reviews (MSRs). Recent Municipal Service Reviews confirm the effectiveness of existing special districts providing sanitary sewer services.

MCSD does not agree that consolidation into regional districts is required as it could jeopardize the health, safety, services and the maintaining and replacing of vital aging infrastructure due to competing interests within these larger organizations. MCSD further notes that it was formed as a special district by the voters within its jurisdictional area. The voters have not directed that MCSD should be consolidated with a regional or county-wide agency.



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Please see responses to F5, F6, & F10 which speak to the many issues the Grand Jury, raised in regard to this recommendation.

- 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).**

This recommendation will not be implemented by MCSD as it is not warranted or reasonable.

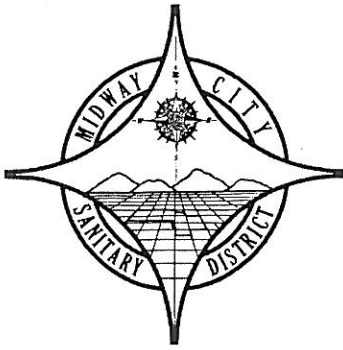
MCSD would have no alternative but to raise fees to account for the loss of revenue from property taxes. Property tax accounts for approximately 15% percent of MCSD's revenue resources that are used to maintain operations and infrastructure necessary to the community. By eliminating special districts from the tax rolls, it will not eliminate those taxes; it will only redirect them to other city, county, or state agencies, forcing MCSD to increase its rates/fees, thereby resulting in higher rates/fees to all of the customers MCSD serves. The property taxes MCSD receives are vital to keeping the rates/fees low and ensuring the protection the health and safety of the community MCSD serves.

Please see responses to F2, F5 and F6 which speak to the many issues the Grand Jury raised in regard to this recommendation.

- R6. Special districts should adopt "board of directors 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).**

The recommendation to adopt "board of directors practices" for MCSD reserves will be implemented prior to adoption of MCSD's 2013-2014 budget. MCSD notes that GASB Standard No. 54 does not apply to MCSD because MCSD is an enterprise district (sewer and solid waste). GASB Standard No. 54 applies to government general fund (non-enterprise) districts.

That being said, the MCSD Board of Directors has established and annually reviews its reserve funds to ensure that funding is available for long-term infrastructure replacement



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and refurbishment and to maintain the District's financial stability. Reserve funds are in the amounts necessary to meet these requirements.

Please see response to F7.

- 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).**

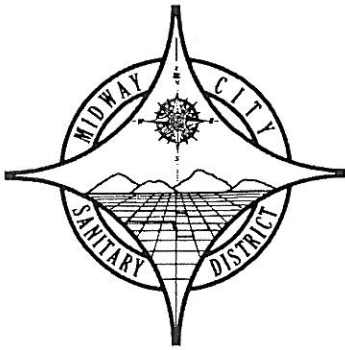
This recommendation has been implemented. MCSD funds its reserves only to the extent fiscally prudent to ensure the ability to accomplish its long-term requirements for infrastructure replacement and refurbishment, compliance with regulatory requirements and for the maintenance of fiscally sound District operations. As such, MCSD does not have excessive unrestricted reserves and revenues are already designed to maintain low rates in a fiscally responsible manner.

MCSD has very little long term debt considering its aggressive capital and sewer system master plan. In 2005, MCSD incurred approximately \$10 million dollars in long-term debt to upgrade and rebuild its four sewer lift stations, increasing their life expectancy, and protecting the health and welfare of the community MCSD serves. The MCSD Board of Directors has already implemented a plan to pay off this existing debt when it becomes eligible to be paid off in 2015.

Other than the one existing debt, MCSD finances its projects by living within its means and using existing revenues and reserves it has set aside for Board approved projects. MCSD is able to maintain its operations and aggressive capital and sewer system master plan, without incurring additional debt while keeping fees low.

See responses to F7 and F8.

- 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).**



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The recommendation has not been implemented but MCSD will consider conducting 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.)**

This recommendation will not be implemented by MCSD as it is not warranted or reasonable.

There is currently a statutory mechanism in place by which LAFCO is amply funded through monies that special districts, the county, and cities are required to pay to LAFCO. For the 2012-2013 fiscal year, MCSD is required to contribute \$13,807 to LAFCO for its operations, more than what most cities in the same County are required to pay.

The shifting of local taxpayer funds from special districts to other agencies, does not reduce the need for prudent reserves, it simply increases cost pressures on local ratepayers to maintain infrastructure and fund core services.

Please see response to F7.

In conclusion, the Midway City Sanitary District Board of Directors hopes that these comments allow for a better understanding of the Midway City Sanitary District and how it operates. Thank you for the opportunity to respond to the Grand Jury's report.

Sincerely,

Margie L. Rice  
President of the Board Directors  
Midway City Sanitary District

Kenneth J. Robbins Jr.  
General Manager  
Midway City Sanitary District  
krobbins@mcsandst.com