

July 24, 2012

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

Regarding: Response to 2011-12 Orange County Grand Jury Report “Let There Be Light”-
Dragging Special Districts from the Shadows

Dear Judge Borris:

Thank you for the opportunity to comment on the ***“Let There Be Light” – Dragging Special Districts from the Shadows*** report prepared by the 2011-2012 Grand Jury. Moulton Niguel Water District’s (MNWD) responses to the Findings and Recommendation presented in the Grand Jury Report are as follows:

FINDINGS/CONCLUSIONS:

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: MNWD disagrees wholly with the finding. Over the years, MNWD and surrounding agencies have worked diligently to identify ways to improve effectiveness and efficiency of each District’s respective organizations. For example, in 2002/2003, MNWD and El Toro Water District (ETWD) conducted a consolidation study, which was overseen by LAFCO. While the final report for this study did find some savings which could potentially be achieved. It was also apparent that it would be a significant cost to MNWD. MNWD believed this cost would be to the detriment of the ratepayers, and thus negotiations did not go further. As we evaluate consolidation, cost and impact to ratepayers remain forefront in determining the feasibility and value of any such consolidation. In fact, MNWD along with surrounding cities and water districts in South Orange County utilizes a regional approach for certain wastewater treatment

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and disposal facilities and water supply arrangements which are inherently a 'consolidated' approach to cooperative operations, and results in service efficiencies and cost savings to District customers.

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: MNWD disagrees wholly with this finding. MNWD values recommendations from governmental agencies and has implemented them when appropriate. As an example, MNWD's website homepage (www.mnwd.com) has a tab for "Accountability and Transparency." This tab presents salary and compensation information for each of the seven members of the Board of Directors, as well as for the General Manager. It also includes the Memoranda of Understanding with the Employees Association, Job Classification Salary Schedule, the General Manager's contract and a link to the California State Controllers website, which takes the user to salary and compensation data for all MNWD employee classifications. We continue to work with our communities and with agencies throughout the State to adopt best practices to better serve District customers and promote accountability.

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 the local smaller providers have already been absorbed by larger districts under one management.

Response: MNWD disagrees partially with this finding. This statement is not factually correct relative to MNWD and its neighbors. The borders of MNWD were established in 1960 when the District was originally formed, and the borders have not been significantly adjusted since that time. The District borders on three other special districts (El Toro Water District (ETWD), Santa Margarita Water District, and South Coast Water District (SCWD)). Other than certain boundary adjustments to provide service at less expense, MNWD has not grown because District boundaries were established by seven ranches which joined together in 1960 to create the District, with the primary mission to bring imported water into the District. Boundary adjustments between MNWD and ETWD, SCWD and the City of San Juan Capistrano, fully supported by LAFCO and the affected ratepayers, have been accomplished from time to time for the purpose of serving those ratepayers more efficiently based on the location of facilities and geography.

F6. The sixteen enterprise special districts of Orange founded between 1919 and 1964 have grown with the urbanization of the county. Thirteen of these 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 customer see the true cost of the services provided.

Response: MNWD disagrees wholly with this finding. The District has always been transparent in reporting its share of the 1% ad valorem property taxes allocated among many local agencies in the County. We report it in the Comprehensive Annual Financial Report (CAFR), the annual budget and the monthly financial reports as a line item. We have always been clear that loss of the tax subsidy would increase monthly water/sewer bills significantly. If this situation actually occurred, i.e. water bills going up, property owners should realize that their own property taxes would not go down, and that the property taxes they pay which are used to help finance the costs of service would just be allocated elsewhere.

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: MNWD disagrees wholly with this statement. The District has been proactive over the years to ensure that the rates set for potable, recycled, and wastewater treatment take into consideration all the variables required to maintain “reliable, economical, high quality water and sewer service”. The District maintains a Long Range Plan that is updated every two years, a comprehensive 10-year Capital Improvement Plan which is reviewed annually, a 10-year Cash Flow model that is updated on a regular basis, and written policies that outline the requirements of any designated reserves. The District’s reserves are maintained in both “restricted” and “designated” funds as required by GASB 54. The District also maintains a General Fund that provides for the day-to-day operating funds for the District. Designated fund reserves are only established after careful consideration of the District’s short and long-term needs. The discussion about those needs takes place during regularly scheduled public Board of Director meetings that are properly noticed, and the ratepayers are given every opportunity to provide input to the Board before any final decision is made. The District has a formal Citizens Advisory Committee, made up of local ratepayers, which meets on a regular basis and provides ongoing feedback to the Board and staff.

The Board has also adopted, during public Board Meetings, formal written policies outlining the requirements that must be met to fund any designated reserves. The District is committed to transparency and posts on its website the Annual Budget that includes a list of all Capital

Improvement Projects, along with the most recently adopted Long Range Plan that outlines how the District plans to utilize its funds, both short and long term, and the Comprehensive Annual Financial Reports. The District complies with the legal requirement to submit the budget annually to the County of Orange.

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

Response: The District agrees with the finding. Legally, a special district's restricted reserves are only those funds legally or contractually limited, such as reserve funds pledged to bondholders, or to secure State loan contracts. However, remaining reserves are still designated fund reserves as explained under F7 above, and emergency events like an earthquake as well as planned repairs and replacements for aging facilities are taken into consideration in establishing these designated reserves. The Board of Directors is elected by the public on a rotating four year schedule. Thus, while it is true that the Board has discretion on spending reserves, as authorized under the California Water Code, the Directors have a responsibility to the voters/ratepayers of the District to exercise good judgment in their approval of expenditures.

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: MNWD disagrees wholly with the finding. The Report gives no evidence or rationale for the conclusion, "Five or six such enterprise special districts within Orange County could save at least \$500,000 per year for each special district absorbed." There is no factual basis for the supposed savings in particular. The impact on overall costs resulting from consolidation would vary case by case. Depending on the state of the agencies, costs can either increase or decrease based on needs. Many reports have been completed that gives no support of consolidation, for example LAFCO's MSRs.

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 of the costs for these services without the tax subsidy will the public understand the true cost of these services and achieve financial transparency.

Response: MNWD disagrees wholly with this finding. As outlined in response to F6, the District has always been open that loss of the 1% AV property tax would increase water/sewer bills significantly. Additionally, the financial reporting shows the District's portion of the 1% AV tax as a separate line item under 'revenue.' We believe both of these actions achieve

financial transparency, so that District ratepayers can understand the financial significance to their actual water/sewer rates that would result from the loss of this tax revenue they each pay to the County.

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: MNWD disagrees partially with this finding. Performance audits can be a helpful tool for the public and the Board of Directors to understand how efficiently the District is being run. The District is currently developing a series of benchmarks and goals to assess overall performance. In addition, LAFCO conducts a Municipal Service Review (MSR) and Sphere of Influence Study on Municipal Water District of Orange County (MWDOC), that includes MWDOC's member agencies (e.g. Moulton Niguel Water District), every five years. The MSR report is available on LAFCO's website at www.oclafco.org.

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.

Response: The recommendation will not be implemented because it is not reasonable for the reasons stated above under "Findings." All this will do is increase water/sewer bills, and will have no impact- i.e. reduction- on the amount of property taxes the ratepayers pay. The tax will just be reallocated elsewhere, and the ratepayers would have to pay significantly higher fees to ensure the continued quality of service that they are accustomed to receiving from MNWD.

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.

Response: This recommendation will not be implemented because it is not reasonable. There is a lack of factual basis supporting the recommendation for six regional districts and the purported cost savings. However, MNWD and other agencies will continue to work with LAFCO to assess level of services for the public. MNWD believes that any proposed consolidations should be approached with due deliberation to fully explore the impacts such as potential cost savings, cost shifting and operational challenges.

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 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.

Response: This recommendation will not be implemented because it is not reasonable. As a public agency, we are a “non-profit agency,” and we see only disadvantages to the ratepayers if the District is removed from the County tax rolls.

R6. Special District 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.

Response: This recommendation has been implemented.

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.

Response: This recommendation has been implemented.

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.

Response: The recommendation will not be implemented because it is not warranted. MNWD performance is already reviewed by LAFCO in the MSR process. MNWD is constantly working to improve its performance and is accounted for that by its elected Board. already provides annual information to oversight agencies. In an effort to assess performance District-wide MNWD is working on developing performance goals, and measures to track progress. The need to utilize an outside consultant could be further evaluated based on needs and costs at a later time. If goals are clearly set with regular follow ups, this will allow District ratepayers to better understand and gauge the District’s performance.

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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.

Response: The recommendation will not be implemented because it is not reasonable as it is an arbitrary number without any factual basis. Agencies such as MNWD work closely and extensively with LAFCO to evaluate levels of service through MSR and Sphere of Influence processes. LAFCO develops and adopts its budget each year and assesses those charges, by which MNWD abides. Consolidation should be considered on a case by case with full understanding of cost impacts and risk/benefit assessment, and MNWD has worked diligently with surrounding agencies to assess the feasibility of consolidation. As part of any consolidation or elimination of special districts, LAFCO already has the authority to review such applications and assess impacts while placing the financial responsibility for that review on individual districts that benefit from such actions, which is fair to the ratepayers.

MNWD appreciates the opportunity to respond to the Report. Please contact the District in the event further information or explanation is required.

Respectfully submitted,

MOULTON NIGUEL WATER DISTRICT



Joone Lopez
General Manager

cc: Moulton Niguel Water District Board of Directors