



July 24, 2012

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Serrano Water District  
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Trabuco Canyon Water District  
City of Tustin  
City of Westminster  
Yorba Linda Water District

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

Dear Judge Borris,

The Municipal Water District of Orange County (MWDOC) hereby submits its required responses to the findings and recommendations in the Orange County Grand Jury report, "Let there be Light – Dragging Special Districts from the Shadows."

#### **FINDINGS**

***FI.** 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:** MWDOC disagrees. MWDOC is not aware of the need for wholesale reorganization among special districts. Special districts provide a key role in delivering of services to Orange County customers. One aspect often cited as a benefit of special districts is that of "local control" and direct accountability to the customers in the service area. Citizens tend to trust local government more than state or federal governments.

It should be noted that Orange County special districts have initiated a number of dissolutions and consolidations during the past two decades, particularly when there have been significant opportunities for ratepayer savings, operational and system efficiencies, and other benefits. Since 1995, the following consolidations, dissolutions, and mergers of Orange County special districts have occurred:

- Dissolution of the Laguna Niguel Community Service District
- Dissolution of County Service Area 25 (Aliso Viejo)
- Dissolution of the Carpenter Irrigation District
- Dissolution of the Tri-Cities Municipal Water District
- Reorganization of four special districts (South Coast reorganization)
- **Consolidation of Coastal Municipal Water District with Municipal Water District of Orange County**

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- Acquisition of Santa Ana Heights Water Company by Irvine Ranch Water District
- Merger of Los Alisos Water District with Irvine Ranch Water District
- Merger of Santiago County Water District with Irvine Ranch Water District
- Acquisition of Orange Park Acres Mutual Water Company by Irvine Ranch Water District and annexation of that territory

We note that special districts have worked seriously toward consolidations and improved efficiencies when there is a demonstrated need, desire, and opportunity. Wholesale reorganizations without the necessary level of study, analyses, and debate have not been pursued. We do not agree that special districts require independent evaluation other than that provided by LAFCO's Municipal Service Review (MSR) process.

*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:** MWDOC disagrees. We can advise that, in the development of MWDOC's responses to the Grand Jury recommendations, over the years, considerable debate and discussion of the recommendations has occurred. That is not to say that all recommendations are implemented, but they are all seriously considered. Furthermore, in certain years MWDOC has facilitated discussions and presentations directly with the Grand Jury members as part of an "educational process." MWDOC is always able and willing to collaborate with the Grand Jury in exploring issues and topics regarding water and local government issues. One of MWDOC's recommendations coming from our discussions this year is that we will proactively schedule a meeting with the 2012/13 Grand Jury shortly after it has been empanelled.

*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:** MWDOC agrees.

*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.*

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**RESPONSE:** MWDOC disagrees. While MWDOC is one of three Orange County enterprise special districts that do not receive county tax revenue, we are troubled by the suggestion that enterprise special districts should simply wean themselves from this revenue source and rely solely on fees to fund their operations and services. The loss of county tax revenue would directly impact these districts and their ratepayers. Further, the informal term “wean” understates the fiscal and legal complications that would arise from such a change.

*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:** MWDOC disagrees. The finding states that special district governing boards can spend “unrestricted” reserves “as they please.” This is not correct. Reserves are maintained to provide districts with the ability (and flexibility) to respond to events such as variations in water sales, unforeseen emergencies, lawsuits or legal challenges, the repair and replacement of infrastructure, and other issues the districts may face. The uses and restrictions on the uses of reserves are pursuant to policies set by each special district’s governing body, and the policy considerations for each district are different.

*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 a year without taxes, fees, interest, or other sources of revenue. The boards of directors have the sole discretion to spend these unrestricted reserves.*

**RESPONSE:** MWDOC agrees with the finding, but not the implication. The finding is correct. The implication, however, is that special districts have amassed inappropriate levels of financial reserves and that their boards of directors should not have the authority to spend it without some sort of additional oversight or approval. This, of course, undermines the fiduciary duty that board members are entrusted with and accept when they are sworn into office. Water infrastructure is very capital intensive and is constantly facing new regulations. Because of the safety and health issues associated with water, our industry tends to be conservative. The facilities and systems must last between 30 and 100 years depending on the structures involved, and they require ongoing investments to keep the facilities in good condition. Annual surveys conducted by many organizations (the best known are the American Water Works Association and the American Society of Civil Engineers) indicate that funding pressures are impacting the quality of our systems. The ongoing investments needed for upkeep, repair, and upgrades of water and wastewater facilities are extremely large. We are proud that planning and management within the water and wastewater community in Orange County has resulted in accumulation of these reserves for a time when they will be needed. We believe with a greater understanding of the issues facing our industry, the Grand Jury would have come to the conclusion that reserves should probably be increased for water and wastewater investments needed in the future.

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*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:** MWDOC disagrees. The savings may be estimated based on assumptions put forth, but without a very detailed analysis, identifying and quantifying potential savings would be erroneous. Further comments on the finding would require a detailed analysis of the information developed in making the Grand Jury forecast. Primary considerations would require comparison of the level of service to be provided, the costs to physically integrate water agencies, and consideration of the implication of the loss of local control.

*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:** MWDOC disagrees. We believe that the MSRs that LAFCO conducts with all special districts every five years is an effective process for evaluating performance in many of the same areas that a performance audit would cover. The MSRs are prepared and published by LAFCO and made available to the district and its board of directors, the public, the media, and others who may have an interest in assessments of local agencies. The MSRs evaluate the subject district in many areas, identifies its strengths and weaknesses, and makes recommendations as appropriate. Through the three MSR cycles that have now occurred, LAFCO has found no significant issues with special districts.

## **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.)*

**RESPONSE:** MWDOC disagrees. We believe the elimination of special districts from the county tax roll would not be in the best interest of the ratepayers due to rate increases that would be necessitated to offset the lost revenue. Also, complex new laws and procedures would be required to accomplish such a change, and a balance among local governments that has developed over many years would be threatened.

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*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:** MWDOC disagrees. The recommendation is unclear as to the source(s) of information, and the methodology and criteria that was used by the Grand Jury to determine that having six regional districts would adequately meet the needs of Orange County. Consolidations and mergers are complex processes that involve extensive study, evaluation, discussion, and costs. They cannot and should not follow a template as that fails to consider the unique aspects of each district and its customers. Further, it is not a process that can be planned and scheduled with all water and sewer districts in a matter of months even if LAFCO was fully committed to the process, which we understand is not the case.

*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:** MWDOC disagrees. See R1.

*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:** MWDOC agrees that compliance with GASB 54 with respect to classifying reserves would be useful for all agencies. However, we note that GASB 54 will not assist in setting the level of reserves. This must be accomplished based on the circumstances, risks, and policy decisions made by each special district governing body and cannot be standardized.

*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:** MWDOC disagrees. These types of decisions cannot be generalized and must be evaluated specifically on an agency-by-agency basis. We also note that the Grand Jury offers no definition of "excessive unrestricted reserves." Budgeting and long-term planning needs to be accomplished on case-by-case basis. Locally elected board members have fiscal responsibilities to their constituents that cannot be delegated by the boards or usurped by LAFCO.

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*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 have 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:** MWDOC disagrees. See our 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.)*

**RESPONSE:** MWDOC disagrees. This recommendation is not supported by any evidence or established criteria that this funding is necessary or that such a role is consistent with LAFCO's powers or its mission. We also reference LAFCO's response to the Grand Jury that indicates this recommendation is not needed. LAFCO is already funded in three equal amounts by the county, the cities, and the special districts of Orange County. LAFCO is not authorized to obtain any additional revenue from these public agency funding sources, with the exception of revenue they receive from permit application fees.

This shall conclude MWDOC's response to the Orange County Grand Jury report. Please do not hesitate to contact MWDOC General Manager Kevin Hunt at 714-593-5026 if you have any questions.

Sincerely,



Jeffery M. Thomas  
Board President