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## Santa Margarita Water District

July 23, 2012

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

Subject:        **Response to the Grand Jury “*Let There Be Light – Dragging Special Districts from the Shadows*” Report**

Dear Judge Borris:

Thank you for the opportunity to review and comment on the subject report. In response to the Grand Jury report, the Santa Margarita Water District Board of Directors held a Special Meeting on July 20, 2012 and adopted the attached Resolution No. 2012-07-01.

Very truly yours,

SANTA MARGARITA WATER DISTRICT

A handwritten signature in purple ink, appearing to read 'Dan Ferons'.

Daniel R. Ferons  
General Manager

Enclosure

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RESOLUTION NO. 2012-07-01

RESOLUTION OF THE BOARD OF DIRECTORS OF SANTA MARGARITA WATER DISTRICT, ORANGE COUNTY, CALIFORNIA, ADOPTING RESPONSE TO GRAND JURY REPORT "*LET THERE BE LIGHT – DRAGGING SPECIAL DISTRICTS FROM THE SHADOWS*"

WHEREAS, the County of Orange Grand Jury issued the report "Let There Be Light – Dragging Special Districts from the Shadows" (Report) on April 27, 2012; and

WHEREAS, the Report contains specific Findings and Recommendations by the Grand Jury concerning Special Districts within Orange County; and


WHEREAS, the District has reviewed the Report, Findings and Recommendations and has prepared the attached response.

NOW, THEREFORE, BE IT RESOLVED, DETERMINED AND ORDERED that the Board of Directors of the Santa Margarita Water District does hereby approve and adopt the Santa Margarita Water District's response to the Grand Jury "*Let There Be Light – Dragging Special Districts from the Shadows*" Report.

ADOPTED, SIGNED AND APPROVED this 20<sup>TH</sup> day of JULY 2012.

  
\_\_\_\_\_  
President of the Board of Directors  
Santa Margarita Water District

ATTEST:

  
\_\_\_\_\_  
Secretary of the Board of  
Directors of Santa Margarita  
Water District

**Response to Grand Jury Report:  
“Let there Be Light – Dragging Special District 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:** SMWD disagrees. As noted by the Orange County Local Agency Formation Commission (LAFCO), since 1995 there have been at least nine reorganizations of special districts, including consolidations, dissolutions and mergers. The Report does not provide any independent analysis supporting the finding that special districts are incapable or unwilling to consolidate, or have not worked seriously toward their consolidation or demise if and when warranted (in fact the nine referenced reorganizations involved willing parties). Contrary to this Finding, LAFCO has in fact heavily focused on special districts, particularly over the last few decades, including the performance of several municipal services reviews involving special districts such as SMWD, which address the provision of services by the District.

In 1994, SMWD was the subject of and participated in a comprehensive review in connection with an application to dissolve the District and transfer the District’s assets to an investor-owned utility. The review included governance issues as well as operating and capital costs. LAFCO rejected the dissolution application on the basis that the SMWD was better suited to provide less costly and more accountable services to SMWD ratepayers and property owners.

*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:** SMWD is aware vis-à-vis its participation, for example, in the South County Issues Discussion Group (formed in 1996 in response to then-Speaker Pringle’s legislation to consolidate South Orange County special districts), and in continuing to closely work with other special districts, that special districts have in fact carefully considered recommendations made or directed by governmental agencies, including the California Legislature. If, following study or evaluation, the recommendations served the best interests of their ratepayers, they have been implemented.

*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:** SMWD was not established for purposes of providing irrigation water for agriculture but in fact as part of a comprehensive plan to prepare for and construct infrastructure in contemplation of providing water, wastewater and recycled water services in connection with urbanization.

With the second largest service area in the County, SMWD’s jurisdiction spans several cities and unincorporated communities. SMWD’s and its neighboring special districts’ service areas have not changed since their respective formations. These special districts were formed in contemplation of the very circumstances that exist today.

*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:** The following table summarizes SMWD’s current revenue breakdown:

<b>Operating Funds</b>		
<b>Water Sales</b>	\$ 27.5	52%
<b>Sanitation Sales</b>	\$ 15.6	29%
<b>Other Income</b>	\$ 4.4	8%
<b>1% General Fund Taxes</b>	\$ 5.7	11%
<b>Total</b>	\$ 53.2	100%
<b>Bond Debt Service</b>		
<b>Ad Valorem and Special Taxes to Repay Bonds Issued for Capital Construction</b>	\$ 25.3	100%

As indicated in the table, 89% of the District’s funding for operations is provided through rates established by the District and 11% is provided through the 1% General Fund taxes. The vast majority of voter-authorized ad valorem and special taxes collected by the District are to pay debt service for bonds issued to construct capital facilities. The District reports on all sources of income and costs in its monthly financial statements.

Implementing what essentially would be a tax increase on special district ratepayers to effect greater transparency if 1% property taxes were transferred to other governmental entities (which may use those tax revenues directly or indirectly to fund non-voter authorized services) may enable customers to see the true cost of service, but should be accompanied by full transparency to ratepayers with respect to the disposition and use of the transferred taxes.

*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:** SMWD disagrees because this Finding overlooks or ignores that special district governing boards are accountable to the ratepayer/voters who elect them to exercise fiduciary oversight of public funds. In this regard, these governing boards adopt deliberative policies, rules and procedures in noticed public meetings, which are subject to statutory and other governing or regulatory restrictions with respect to purpose and use.

Reserves amounts are included in monthly financial statements published on SMWD's website. The reserves are consistent with prudent and conservative fiscal practices that reflect the need to properly maintain and replace hundreds of millions of dollars of water and sewer facilities. Ratepayers are informed with respect to SMWD's financial condition, including reserves, in connection with proposed rate increase proceedings.

The SMWD Board of Directors has adopted reserve and purchasing policies which are periodically reviewed at noticed public meetings. These policies establish limits on the amount and described uses of reserves in connection with long-range capital funding and operating programs and plans. This information is updated and included on the District's website. In addition, the District is legally and contractually required to maintain debt service reserves in connection with issued capital facilities bonds.

Please note that the report incorrectly identifies that the City of Rancho Santa Margarita was formed 16 years after SMWD was incorporated (*Page 22, No. 5 in the Summary of Facts*). The City of Rancho Santa Margarita was incorporated in 1990, 36 years after the District.

**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:** While SMWD has not independently verified this Finding, it should be noted the use of special district reserves includes the replacement of extensive capital facilities collectively costing billions of dollars. Reserves are not merely for emergency or ordinary operating expense contingencies.

**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:** SMWD cannot comment on or confirm the Grand Jury's conclusion without further details on the criteria used by the Grand Jury to determine the optimal number of districts or projected cost savings. It is observed, however, that pre-supposing how consolidated special districts would be organizationally structured for purposes of projecting savings is precarious considering there are few examples of larger governmental entities recognized as operating efficiently. The proliferation of upper or middle-management positions frequently occurring in larger bureaucracies may collectively eclipse whatever cost savings may come from the elimination of a few top positions.

**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:** SMWD cannot validate the Grand Jury's reference to only one special district having completed a performance audit except that SMWD's track record over nearly the last 20 years demonstrates exemplary performance metrics consistent with the purpose of conducting performance audits. In 1994, the District eliminated dozens of positions and has maintained 1994 staffing levels while the number of service connections and population in the District has nearly doubled since then. From 1994, the District reduced rates six times and did not increase rates for 15 years.

### **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:** SMWD disagrees with this recommendation. The majority of its tax revenues are dedicated to debt service for capital improvement projects and not for operating costs. Please refer to the response to F6.

Further, considering that water and wastewater special districts are providing essential services necessary to support life, sanitation and a healthy environment through the proper treatment, disposal and reuse of wastewater, it is difficult to understand the purpose of de-funding the few governmental entities existing in California today that are in sound fiscal health, are exercising long-term fiscal planning and have accordingly adopted prudent and responsible fiscal policies.

**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:** SMWD disagrees with the recommendation. The Grand Jury has not documented or provided a basis to verify the savings for the conclusion. Please refer to the response to F10.

Further, given the current and likely ongoing scarcity of city fiscal resources, it should be recognized that needed enterprise or other revenues that are not immediately may be used by cities for other than water and wastewater operations or capital facilities. This may eventually lead to the erosion of water and wastewater facilities that would otherwise be replaced, the future cost liability for which will far eclipse whatever temporary savings may occur via consolidation.

Nonetheless, SMWD is willing to meet with LAFCO for purposes of reviewing this matter without a pre-determination of the outcome or recommendations.

**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:** SMWD does not agree with this recommendation. Please refer to the response to F6 and R1. It should be recognized that special districts operate as non-profit entities and their assets are owned by the public.

***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 2013-14 budgets. (See F7 & F9.)*

**Response:** Please refer to the response to F7. SMWD’s practice of incorporating and publishing its restricted and designated reserves will continue as part of its annual budgeting and ongoing transparency process by including all financial information on its website.

Please note, GASB No. 54 does not apply to entities such as water districts that account for their operations in the form of “enterprise” funds. Enterprise fund accounting is used where fees and charges are assessed to cover the cost of services provided.

***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:** Please refer to the response to F6 & 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.)*

**Response:** The district disagrees with the recommendation and will continue its current practices. Please refer to the 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:** SMWD disagrees with the recommendation. It is unclear as to what methodology or criteria were used in establishing the recommendation. LAFCO does not have the authority to exercise its powers without due process and, consequently, could not mandate or accept funding for the purpose of pre-determinatively mandating consolidations without following the due process procedures embodied in its enabling Act. In fact, LAFCO cannot order consolidations unless it makes findings that the consolidations were beneficial to affected ratepayers. Further, LAFCO does not have statutory authorization to establish binding standards directing the fiscal operations of special districts that would supersede the authority of special districts’ Board of Directors.

SMWD provides LAFCO with its proportionate “Special District” LAFCO budget share based upon a definitive LAFCO budget which encompasses routine LAFCO staff and Commission administrative activities and identified special efforts. The LAFCO budget is funded in equal parts by the special districts, cities and the County.

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