

SOUTH COAST



WATER DISTRICT

July 25, 2012

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

Board of Directors

Wayne Rayfield
President

Ingrid McGuire
Vice President

Bob Moore
Director

Richard Gardner
Director

Richard Runge
Director

Re: Orange County Grand Jury
2011-2012 Report
"Let There Be Light" Dragging Special Districts from the Shadows

Dear Honorable Judge Borris:

South Coast Water District would like to thank the Grand Jury for favorably citing South Coast Water District in its report, "Let There Be Light – Dragging Special Districts from the Shadows" for our consolidation efforts and performance assessments. These initiatives have worked to improve organizational effectiveness, provide cost-effective services, and, importantly, furnish excellent customer service.

However, it is extremely unfortunate that the final Grand Jury report incorporated none of the corrections to factual errors that District officials provided in writing on March 20, 2012 in Santa Ana – when we were given the opportunity to review and comment on the draft report. It is also unfortunate that our request to meet further to review the changes we provided did not receive a response from the Grand Jury.

For example, significant errors were not corrected in the Grand Jury's final published report, on Table 1a, "General Financial Data for South Coast Water District:"

- Auditor/Controller Allocations, 2010-11, \$15.5 million (vs. accurate figure of \$4 million)
- Sewer Revenue, \$9.9 million: data source/timeframe unknown (vs. accurate figure of \$10.8 million in 2010-11 Audited Financial Report)
- Water Revenue, \$11.8 million: data source/timeframe unknown (vs. accurate figure of \$13.8 in 2010-11 Audited Financial Report)

Moreover, the required budget documents and financial statements that the District originally submitted to the Grand Jury provided accurate information. Furthermore, the State Controller's Office of Local Government Reports provides the same accurate data on its website, www.sco.ca.gov. Our information was not corrected and inaccurate data was included in the published Grand Jury report.

Without accurate information, it is difficult, if not impossible, for the Grand Jury to draw meaningful conclusions and make relevant recommendations for improved local government for the citizens of Orange County. Similarly, it is difficult, if not impossible, for citizens to assess the report's findings and recommendations in an informed way.

To be specific, this cover letter will focus on two categories - reserves and property taxes - which are mischaracterized in the Grand Jury report.

Reserves. A portion of the rates and charges that the District collects is set aside as reserves (savings) in accordance with the District's Reserve Policy, which the elected Board of Directors reviews and adopts each year. The District has no "unrestricted" or "discretionary" reserve funds as alluded to in the report. The dollar amount of necessary reserves is formulated based on the Reserve Policy and reflects specific future capital projects, legal requirements, and prudent financial management as follows:

- **Restricted Reserves.** Established in accordance with laws or covenants and utilized for narrowly-defined purposes, i.e., Bond Proceed Fund; State Grant Fund; Connection Charge Fund; Accrued & Unpaid Employee Benefit Account.
- **Designated Capital Reserves.** Established by Board action and designated for specific purposes, i.e., Capital & Asset Replacement Fund; Periodic System Improvement Fund; Large Capital/Construction Projects Fund; Major General & Administrative Project Fund.
- **Operating Reserves.** Established by Board action to safeguard the financial viability and stability of the District, funded from revenues accumulated in the District's General Fund, i.e., Disaster Reserve Fund; Working Capital Reserve to cover temporary cash flow deficiencies; Rate Stabilization Reserve Fund; Contingency Reserve Fund to accommodate unexpected operational emergencies, legislative impacts or other economic events that may affect the District's operations which could not have been reasonably anticipated at the time the budget was prepared.

According to the American Water Works Association, it is a Best Management Practice for public agencies to set aside funds for disaster preparedness, unforeseeable contingencies, rehabilitation of infrastructure, and future capital improvement projects. "Reserves are not just money in the bank; they are fundamental resources for ensuring safe and reliable core services," according to the California Special Districts Association.

As an example, this District is undertaking a critical and major capital improvement project: Tunnel Stabilization and Sewer Pipeline Replacement. This five-year project will ensure 100 more years of reliable sewer service for a third of the population we serve and cost in the order of \$50 million. It is unrealistic, prohibitive, and unfair to expect current customers to foot the bill for the entire project from their current annual sewer service charges, since future customers will benefit from the rehabilitated infrastructure for years to come.

It is also important to note that our Reserve Policy signals to the financial community that there is prudent Board oversight of the District. It has helped the District to achieve its AA+ bond rating, and thereby the District has incurred lower debt service costs.

Property Tax Revenues vs. Annual Service Charges. In the Grand Jury report, there appears to be a lack of understanding or distinction between property tax revenues and the collection of annual water and sewer service charges on the County's property tax bill. As mentioned above, the report misstates that the District's property tax revenues total \$15.5 million.

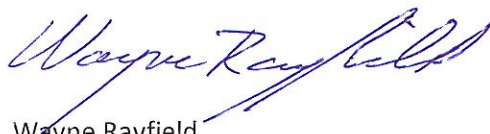
Rather, the District's annual property tax revenues are approximately \$4 million and its annual water and sewer services charges are approximately \$11.5 million.

- *Annual Service Charges.* According to state law, special districts may collect water and sewer service charges on the County's annual property tax statements in the interests of efficient and cost-effective local government operations. South Coast Water District utilizes the County's property tax bill as the collection mechanism for its water and sewer service charges. These annual charges relate to the fixed costs of providing service to each property in the District's service area, and they cover the operation, maintenance and improvement of the water and sewer system (e.g., reservoirs, pumping stations, pipelines.)
- *Property Tax Revenues.* Quite separate from the District's collecting fixed infrastructure and system charges each year on the County's property tax statements, the District receives approximately \$4 million a year in "Prop 13" property tax revenues. This is the District's share of the state's "1% Ad Valorem Property Tax" funds, which are reserved for local services. At South Coast Water District, we utilize property tax revenues for capital improvement projects and do not depend on them to fund routine operating and maintenance costs.

In addition to the examples highlighted above, there are other errors and discrepancies in the Grand Jury's Report -- both general and specific to South Coast Water District. We address these in our attached "Response to the Grand Jury's Findings & Recommendations."

We welcome discussion and meeting with any member of the Grand Jury or staff to provide further clarification in the key areas of public agency management that are addressed in the report. If you have any questions or require further information, please feel free to contact us at 949-499-4555 ext. 3112 or at mdunbar@scwd.org.

Very truly yours,



Wayne Rayfield
President, Board of Directors



Michael P. Dunbar
General Manager

Encls.

cc: Board of Directors
Betty Burnett – Assistant General Manager/District Counsel

**SOUTH COAST WATER DISTRICT'S (SCWD) RESPONSE TO THE FINDINGS AND
RECOMMENDATIONS PROVIDED IN THE 2011-12 GRAND JURY REPORT
"LET THERE BE LIGHT - DRAGGING SPECIAL DISTRICTS FROM THE SHADOWS"**

FINDINGS

CONSOLIDATION EFFORTS

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.

SCWD disagrees with this finding. South Coast Water District has undergone consolidations with other agencies throughout its history to provide vital services effectively to the community.

SCWD and its predecessor agencies have been involved in four separate consolidations since the District was formed in 1932 as follows:

- In 1976, South Coast Water District and the South Laguna Sanitary District (formed in 1947) consolidated to become a water and sewer service provider under the South Coast Water District name.
- In 1995, the Capistrano Beach Water District and the Capistrano Beach Sanitary District consolidated to become a water and sewer service provider under the Capistrano Beach Water District name.
- In 1999, the South Coast Water District, the Capistrano Beach Water District and the Dana Point Sanitary District consolidated to form today's South Coast Water District.
- In 2000, the South Coast Water District was designated as the contract operator for the former Tri-Cities Municipal Water District, following Tri-Cities' consolidation with the Coastal Municipal Water District.

COOPERATION WITH CITIES/AGENCIES

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.

SCWD disagrees with this finding. South Coast Water District has partnered with various city and county agencies throughout the years and continues to do so. Some key examples of this include:

- This District provides water and wastewater services to the community of South Laguna under contract to the **City of Laguna Beach**. This agreement is in its 12th year. The District holds quarterly meetings of the **South Laguna Water/Sewer Advisory Committee**, which consists of two Laguna Beach City Council members, two SCWD Board members, and three appointees from South Laguna.
- This District operates and maintains the **Joint Regional Water Supply System** under contract to seven cities/agencies: the City of San Clemente, the City of San Juan Capistrano, the Irvine Ranch Water District, the El Toro Water District, the Moulton Niguel Water District, the San Diego County Water Authority (Camp Pendleton, San Onofre Nuclear Generating Station, San Onofre State Park), as well as SCWD. This cooperative agreement is in its 12th year.
- This District is the lead local agency on the **South Orange Coastal Ocean Desalination project**. The Participants' Committee consists of the City of San Clemente, the City of San Juan Capistrano, the Moulton Niguel Water District, the Laguna Beach County Water District and SCWD—with the Municipal Water District of Orange County providing technical and management support for this project.
- This District is an active member of the **City of Dana Point's Ocean Water Quality Subcommittee**. The Subcommittee is chaired by a Dana Point City Council member.
- This District is a founding member of the Tri-City Water Savers, a cooperative working group consisting of SCWD, the City of Dana Point, the City of San Clemente, and the City of San Juan Capistrano. **The Tri-City Water Savers was the 2010 APWA Award Winner for Creative and Innovative Regional Partnering**. This water conservation and runoff prevention team plans and implements joint "H2O" forums and workshops for HOA board members, property managers, landscape contractors, hotels and restaurants, plumbers and nurseries in the Tri-City area.
- This District is a member and current chair of the **San Juan Basin Authority**, which consists of the City of San Juan Capistrano, Moulton Niguel Water District and Santa Margarita Water District as well as SCWD. The San Juan Basin Authority cooperatively oversees groundwater planning and management for the San Juan Basin.
- This District is a partner in the **Upper Chiquita Reservoir**. This cooperative partnership consists of the Santa Margarita Water District (lead agency), the City of San Juan Capistrano, the City of San Clemente and the Moulton Niguel Water District along with SCWD. The total reservoir capacity is 244 million gallons of emergency storage; SCWD's share is 16 million gallons.
- This District has approximately 20 cooperative agreements in place with the **City of Dana Point, the City of Laguna Beach and various homeowner associations within its service area** to divert urban runoff into the SCWD sewer system (dry weather diversions), whereby the District collects and treats nuisance water runoff during the summer months and in times of non-rain periods. This reduces, if not eliminates, nuisance water that contributes to the pollution of county and city creeks, beaches and ocean water.

- This District operates and maintains the **City of Dana Point’s Salt Creek Ozone Treatment Facility**. This cooperative agreement is in its fourth year.
- This District operates and maintains the **Poche Creek Treatment Facility on behalf of the County** and the City of San Clemente. This cooperative agreement is in its second year.
- This District cleans the private sewer collection pipelines for the **County of Orange at the Dana Point Harbor**. It also cleans the private sewer collection pipelines for **Doheny State Park** and Beach.
- This District cleans the storm drains for the **City of San Juan Capistrano**. This cooperative agreement is in its third year.
- The District regularly coordinates with the City of Dana Point, the City of San Clemente and the City of Laguna Beach on SCWD’s **in-street construction work and beach/park construction work**.
- This District participates in annual **community outreach initiatives with the City of Dana Point** (Festival of the Whales Parade and Street Fair, Emergency Expo, 12 years), **Orange County** (Ocean Awareness Day, 12 years), the **Laguna Beach County Water District** (Kelp Fest, 3 years), and the **City of San Juan Capistrano** (Earth Day, 8 years),
- This District and the City of Dana Point provide a **Grease Interceptor Rebate Program** to food service establishments to prevent sewer overflows from grease build-up that can reach the ocean. The District and the City each contribute \$25,000 per year to the initiative, which has been in place since 2006.
- This District is a member of the **Water Emergency Response of Orange County (WEROC)**, which coordinates emergency preparedness and response efforts among cities and water agencies in the county.
- This District participates on-site at the **City of Dana Point’s Emergency Operations Center** during emergencies to ensure effective coordination of efforts between SCWD and the city.
- The **City of Laguna Beach, the City of San Juan Capistrano and the Moulton Niguel Water District** tie into the SCWD Distribution System and the Joint Regional Water Supply System, operated by SCWD, for operational and emergency water supplies (**emergency interties**).
- This District and **Moulton Niguel Water District** share recycled water for irrigation of parks and golf courses. This cooperative agreement is in its eighteen year.

South Coast Water District finds that the statement “more coordination and cooperation is needed (with) city and county agencies” is not the case with this District due to its numerous agreements with its surrounding cities and the county.

SPECIAL DISTRICTS/PURPOSE

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.

SCWD disagrees partially with this finding. South Coast Water District formed in 1932 expressly to provide potable water service to a relatively undeveloped area that included the residential communities of Three Arch Bay and Capistrano-By-The-Sea. In 1947, a separate agency, the South Laguna Sanitary District, formed to provide public sewer collection, treatment and disposal to essentially the same community and consolidated into South Coast Water District in 1976.

As detailed in Response to F1, the original South Coast Water District has undergone four separate consolidations into its present size and services. It covers today an area of approximately 8.3 miles and serves a population of approximately 40,000, plus 1,000 businesses and more than two million visitors a year. It operates the Joint Regional Water Supply System under contract to two cities, three water districts and the San Diego County Water Authority.

SCWD is continually exploring options and opportunities for improvement and to provide services to its surrounding cities and the County (See Response to F2.)

PROPERTY TAX REVENUES/NEED

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.

SCWD disagrees with this finding.

- South Coast Water District receives approximately \$4.1 million in annual property tax revenues as its share of the state's "1% Ad Valorem Property Tax" (not \$15.5 million stated in the Grand Jury report). Accurate figures were provided in the District's budget document under "NON-OPERATING Revenue, GF-Water Sec-Property Tax," that the Grand Jury received in response to its original Request for Information.
- Furthermore, District officials pointed out in writing that the amount of \$15.5 million was inaccurate in the draft Grand Jury report, which we had the opportunity to review in Santa Ana on March 20, 2012. Unfortunately, the erroneous figure of \$15.5 million was not corrected in the final Grand Jury report, and, therefore, inaccurate data was published.
- The District utilizes its property tax allocation (approximately \$4.1 million per year) for capital infrastructure improvements. It is not used to cover ongoing operating and maintenance costs.

The latter costs are entirely funded by customer usage and service charges. All figures are published in the District's annual budget and are transparent. This too was pointed out to the Grand Jury in writing during the review of the draft report, but was not corrected in the final report.

- The remaining \$11.4 million in revenues (\$15.5 million less \$4.1 million) is attributable to our customers' annual payments of water and sewer service charges, which cover fixed infrastructure costs of providing service to each property. The County collects these charges on behalf of the District on its annual property tax bills. SCWD's water and sewer service charges appear as separate line items on the County tax bill, separate from the property taxes due. Our water and sewer service charges are not taxes nor are they tax deductible; SCWD utilizes the County's billing system as a cost-effective method to collect annual charges.
- According to state law, special districts may collect water and sewer service charges on county property tax statements each year in the interest of efficient and cost-effective local government operations. (This is also an example of SCWD and the County working cooperatively together for more efficient government operations).
- Unfortunately, the Grand Jury report did not distinguish between property tax revenue allocated to SCWD (\$4.1 million) and collection of SCWD's water/sewer service charges (\$11.4 million). These revenues were combined in Table 1 as \$15.5 million under the heading "tax allocations." This is inaccurate, misleading and especially unfortunate as this oversight was pointed out to the Grand Jury during this District's review of the draft report.
- Importantly, when the Grand Jury states in its report that the District did not include property tax revenues in its budget and that the actual receipt of the tax allocation was not documented, the District is mischaracterized – erroneously and negatively. The budget documents that the District submitted to the Grand Jury and the corrections to the draft report provided this information.

South Coast Water District finds this Grand Jury finding misleading and without merit. The District's budget documents show the property tax allocation separate from customers' water and sewer service charges as sources of revenue. Not only was this information submitted to the Grand Jury as part of the original request for information and on the corrected draft report, but is also posted on our website.

UNRESTRICTED RESERVES/TRANSPARENCY

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.

SCWD disagrees with this finding. The District has no "unrestricted" or "discretionary" reserve funds. The District's Board of Directors adopted a Reserve Policy in 2007, which is posted on our website. Each year, the Board sets aside (saves) a portion of customers' rates and charges that the District collects as reserves (savings). This is done in accordance with the Reserve Policy, which sets levels and criteria for

establishing reserves and spells out the various uses for which the Board may spend those reserves. For example, reserves are set aside to cover the costs of capital infrastructure replacement and major construction projects for the water and sewer systems.

Good management practice dictates that agencies set aside reserves for future capital improvements and other long-range efforts. The dollar amount of necessary reserves is formulated based on the Reserve Policy and specific future capital projects, legal requirements and prudent financial management. For example, every year, this District's Board of Directors reviews the SCWD five-year capital infrastructure budget, which supports SCWD's 10-year Infrastructure Master Plan, in order to fund and utilize reserves according to Reserve Policy.

Our Reserve Policy details three categories in which reserves may be established and funded:

- **Restricted Reserves.** Established in accordance with laws or covenants and utilized for narrowly-defined purposes, e.g., Bond Proceed Fund.
- **Designated Capital Reserves.** Established by Board action and designated for specific purposes, e.g., Capital & Asset Replacement Fund.
- **Operating Reserves.** Established by Board action to safeguard the financial visibility and stability of the District, funded from revenues accumulated in the District's General Fund, e.g., Disaster Reserve Fund; Working Capital Reserve to cover temporary cash flow deficiencies.

South Coast Water District is transparent about the criteria, purpose and level of its reserves. The following are among the financial and strategic documents posted on the SCWD website:

- **Reserve Policy**
- **Capital Budget**
- **Debt Policy**
- **Investment Policy**
- **10-Year Water/Wastewater Infrastructure Master Plan**

The District's customers are well informed in the areas of reserves and capital investments, for example.

- The District's Board of Directors discusses and establishes the annual SCWD budget over a series of public meetings and workshop, which may be viewed on Cox Cable TV and from our website (live and archived). As part of that discussion, the District's Board reviews the five-year capital infrastructure budget to utilize the reserves to cover a portion of the costs for those infrastructure improvements.

- The District presents a Quarterly Investment Report that is discussed at its Finance Committee and then at the following Board meeting. The discussions are public and may be viewed on Cox Cable TV and from our website (live and archived).
- When the District seeks a rate increase, it holds Board workshops open to the public and available to view on Cox/online. The District also holds Rate Community Forums in a central location within the service area. The forums provide a venue for customers and community members to learn more and to ask questions about the need for the rate increase, including information and updates on capital projects, reserves, investments and debt.

A copy of the District’s Reserve Policy, Capital Budget, Debt Policy and Investment Policy is provided to show that, with respect to this District, the Grand Jury opinion is without valid basis.

The District finds this Grand Jury finding inaccurate and misleading with respect to this District. These facts were pointed out to the Grand Jury in writing during the draft review, but were not reflected in the final report.

UNRESTRICTED RESERVES/AMOUNT

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 revenues.

SCWD disagrees with this finding. As pointed out in Finding F7, this District has specific criteria for the funding and use of reserves detailed in its Reserve Policy, which was adopted by the elected Board of Directors in 2007. To recap, the District’s reserves are limited to three specific categories, as follows:

- **Restricted Reserves.** Established in accordance with laws or covenants and utilized for narrowly-defined purposes, i.e., Bond Proceed Fund; State Grant Fund; Connection Charge Fund; Accrued & Unpaid Employee Benefit Account.
- **Designated Capital Reserves.** Established by Board action and designated for specific purposes, i.e., Capital & Asset Replacement Fund; Periodic System Improvement Fund; Large Capital/Construction Projects Fund; Major General & Administrative Project Fund.
- **Operating Reserves.** Established by Board action to safeguard the financial visibility and stability of the District, funded from revenues accumulated in the District’s General Fund, i.e., Disaster Reserve Fund; Working Capital Reserve to cover temporary cash flow deficiencies; Rate Stabilization Reserve Fund; Contingency Reserve Fund to accommodate unexpected operational changes, legislative impacts or other economic events that may affect the District’s operations which could not have been reasonably anticipated at the time the budget was prepared.

If this District were to “spend down” its reserves to cover operating expenses for a year, as the Grand Jury suggests, our customers might enjoy a short-term reduction of charges, but would pay a high price later for the loss of years of savings totaling millions of dollars that were earmarked for specific and vital

infrastructure replacement projects. The costs of these projects should be allocated over many years as their benefits to ratepayers will be realized over a long time.

Every single regional and national publication on the condition of the state's and nation's infrastructure has outlined its deplorable condition. This District's reserves are established to ensure that the SCWD water and wastewater infrastructure continue to be rehabilitated and replaced in a timely and effective manner for continued excellent customer service. SCWD is on track and we will continue to remain so.

PROPERTY TAX REVENUES/NEED

F9. The Orange County Auditor-Controller allocated nearly \$35,000,000 to four enterprise special districts (Costa Mesa Sanitary District, South Coast Water District, Trabuco Canyon Water District, and Yorba Linda Water District) that did not show this revenue in their budgets provided to the Grand Jury. What happened to that money is not clearly recorded. Budgeting without the allocated taxes indicates that, along with the three other enterprise special districts that do not rely on tax revenue, these enterprise special districts could function without tax revenues.

SCWD disagrees with this finding. As pointed out in Finding F6, this District receives an annual allocation of approximately \$4.1 million in Ad Valorem Property Taxes (not \$15.5 million) from the County, as do other districts and cities.

Regarding SCWD, the Grand Jury's stated in its finding, "What happened to that money is not clearly recorded." In response, this District reiterates that we show the property tax revenues we receive as a separate line item in our annual budget document under "Non Operating Revenues," as well as in our audited financial statements. This information was submitted to the Grand Jury and is posted on our website. Moreover, SCWD does not utilize property tax revenues to cover operating expenses but applies them to capital infrastructure improvements only.

The Grand Jury's statements in this finding are without valid basis and they negatively mischaracterize the District's financial management and transparency.

CONSOLIDATION/COST SAVINGS

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.

SCWD disagrees partially with this finding. As was pointed out in Finding F5, this District has undertaken and implemented several consolidations and those consolidations have already achieved significant cost savings to SCWD and its customers. As a specific example, the 1999 consolidation of three special districts into today's new, larger South Coast Water District has resulted in recurring savings of approximately \$500,000 per year, achieved through streamlined governance and management. Specifically, the total number of Board members decreased from 17 to 5 and two general manager positions were eliminated.

South Coast Water District finds the statements in this Grand Jury finding not specifically accurate or applicable to this District.

PERFORMANCE AUDITS

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.

SCWD agrees with this finding.

RECOMMENDATIONS

SPECIAL DISTRICTS: ELIMINATE USE OF PROPERTY TAX REVENUES

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 services of the surrounding governments. (See F2, F3, F4, F5 & F6)

SCWD disagrees with this recommendation.

- As described above in several of the findings, this District receives a portion of the Ad Valorem Property Taxes, along with other districts, cities, and the County. SCWD utilizes these funds for capital infrastructure improvements, not defray operating expense. Without the annual receipt of property tax revenues (which is approximately \$4.1 million per year, or 12% of SCWD's total revenues), customer charges would increase and/or necessary capital infrastructure improvements would be deferred or not implemented causing serious risks to public health and the environment.
- In addition, this District utilizes the County's annual statements as a mechanism to bill and collect its water and sewer service charges. By utilizing this cost-effective collection method, this District is able to lower operating cost. If we were unable to utilize this means of collecting annual charges, there would be upward cost pressure on customers' rates.

SPECIAL DISTRICTS: CONSOLIDATE REGIONALLY

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.)

SCWD disagrees with this recommendation.

This District does not believe feasible, nor does it advocate, the Grand Jury's recommendation to consolidate water and sewer districts in Orange County (and potentially city water agencies too) into "no more than six regional districts." The District also can find no basis for the suggestion that "5 or 6 enterprise special districts" could serve Orange County.

- All water and sewer districts, as well as city water agencies, have unique water and sewer infrastructure. There would be significant costs associated with the operational implementation of consolidating into six regional districts.
- The citizens of each individual district would give up local control and local transparency.
- There would be the risk of a decrease in customer service.
- There would be the significant risk of timely response in emergencies.

Importantly, this District brings a "coastal" mindset to its operations that non-coastal agencies may not share. Our communities place great value on ocean water quality; therefore, this District reflects that sensitivity when providing water and sewer services. For example, SCWD puts great emphasis on prevention of sanitary sewer overflows that can pollute the ocean, as well as prevention of over-irrigation and excess outdoor water use. This focus on ocean water quality is often not seen in inland areas.

Moreover, the date of October 31, 2012 (approximately three months from now) would be unrealistic for every water and sewer district throughout Orange County to develop consolidation plans and schedules with LAFCO for the formation of six new regional entities. As a specific example, this District's consolidation with two small agencies in 1999 required over 18 months to develop and to present plans to LAFCO.

SPECIAL DISTRICTS: ELIMINATE USE OF PROPERTY TAX REVENUES

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. The 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)

SCWD disagrees with this recommendation.

- As detailed above in several of our responses to findings and specifically to Recommendation R1, this District receives an estimated \$4.1 million per year from the County as an allocation from the Ad Valorem Property Taxes. This represents approximately 12% of our revenues. SCWD utilizes the allocated funds for capital infrastructure improvement and does not depend on them to defray operating expense.

- Without the \$4.1 million in annual property tax revenues, customer charges would increase to cover needed capital improvements and/or SCWD would defer or not implement necessary infrastructure replacement projects -- increasing risk of system failure and endangering public health and the environment.
- In response to the Grand Jury statement "Consideration should be given to forming non-profit agencies with ownership shared by the constituents," this District notes that this is implemented. (a) SCWD is already a "non-profit" agency; it is prohibited by state law to make a profit and may not charge customers more than the cost of their water and sewer service; (b) SCWD constituents are, in fact, the "owners" of our water and sewer facilities. Our elected Board of Directors is answerable to the owners and ratepayers of SCWD, who are their constituents.

SPECIAL DISTRICTS: ADOPT STANDARDS FOR RESERVES

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)

SCWD has implemented this recommendation. In 2007, the District's Board of Directors adopted a Reserve Policy. Each year, the Board of Directors sets aside (saves) a portion of the rates and charges that the District collects as reserves, in accordance with the Reserve Policy.

The District has no "unrestricted" or "discretionary" reserve funds. The dollar amount of necessary reserves is formulated based on the Reserve Policy and reflects specific future capital projects, legal requirements and prudent financial management in the following three categories:

- **Restricted Reserves.** Established in accordance with laws or covenants and utilized for narrowly-defined purposes, i.e., Bond Proceed Fund; State Grant Fund; Connection Charge Fund; Accrued & Unpaid Employee Benefits.
- **Designated Capital Reserves.** Established by Board action and designated for specific purposes, i.e., Capital & Asset Replacement Fund; Periodic System Improvement Fund; Large Capital/Construction Projects Fund; Major General & Administrative Project Fund.
- **Operating Reserves.** Established by Board action to safeguard the financial visibility and stability of the District, funded from revenues accumulated in the District's General Fund, i.e., Disaster Reserve Fund; Working Capital Reserve to cover temporary cash flow deficiencies; Rate Stabilization Reserve Fund; Contingency Reserve Fund to accommodate unexpected operational changes, legislative impacts or other economic events that may affect the District's operations which could not have been reasonably anticipated at the time the budget was prepared.

SCWD disagrees that "All (special district) reserves should be classified ... according to GASB Standard No. 54," which currently only applies to municipalities.

Moreover, it is unwarranted for LAFCO to set standard criteria for accumulating reserves. “One size fits all” is neither good policy nor a best management practice for enterprise districts. Each water and sewer agency has unique infrastructure needs. For example, some areas of Orange County are built out, growth is flat, and their infrastructure is basically in maintenance mode, which impacts the level and type of reserves required. Other areas are or will be experiencing growth and are entering a period of intense capital replacement; their reserve requirements would be quite different.

SPECIAL DISTRICTS: REDUCE DEBT WITH EXCESSIVE RESERVES

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

SCWD disagrees with this recommendation.

As pointed out in responses to various findings and recommendations above, this District has developed and utilizes specific criteria for the use and funding of reserves, which are detailed in its Reserve Policy adopted by the Board in 2007. The SCWD Reserve Policy does not permit the accumulation of “excessive unrestricted reserves.” Rather, the District is limited by its Reserve Policy to establishing reserve funds in the following categories for specific capital projects, legal requirements and financial management:

- **Restricted Reserves.** Bond Proceed Fund; State Grant Fund; Service Connection Charge Fund; Accrued & Unpaid Employee Benefit Account.
- **Designated Capital Reserves.** Capital & Asset Replacement Fund; Periodic System Improvement Fund; Large Capital/Construction Projects Fund; Major General & Administrative Project Fund. (The SCWD five-year capital budgeting plan informs which Designated Capital Reserves are established and spent.
- **Operating Reserves.** Disaster Reserve Fund; Working Capital Reserve Fund; Rate Stabilization Reserve Fund; Contingency Reserve Fund.

This District has issued debt to spread the costs of infrastructure replacement across past, present and future customers all of whom benefit from the public water and sewer systems. Spreading capital costs to customers across 30 years by issuing a 30-year bond, does not overly burden former and current customers financially and requires future customers to fund their share. If SCWD were to “reduce all existing debt,” as the Grand Jury recommends, using reserves, we would impose prohibitive costs upon current customers for infrastructure replacement that benefits customers for decades to come.

SPECIAL DISTRICTS: CONDUCT PERFORMANCE AUDITS EVERY THREE YEARS

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.

SCWD has implemented this recommendation. In 2011, this District conducted an independent organizational assessment to evaluate the District's performance against best management practices in administrative, financial, operational and engineering services needed to provide water and wastewater service to customers.

This District believes that a three year time frame is too frequent to conduct these performance audits, and that five years would be a more reasonable time frame. Any recommended changes in the organization not only need time to be implemented, but to see their effect. A time-frame of five years would allow the Board, management and staff to assess findings, implement recommendations, ascertain results and take corrective action, as needed. Furthermore, the District's strategic plan, like many if not most plans, covers a five-year horizon. Setting the performance audit assessment and implementation period at five years would put that initiative in sync with long-range planning efforts.

SPECIAL DISTRICTS: UNRESTRICTED RESERVES FUND LAFCO

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. The funds should be included in LAFCO's future programs and budgets until the consolidation, absorption or elimination of each special district is achieved. With additional funds, LAFCO should begin meeting with each special district before the 2014 fiscal year is budgeted for consolidation, absorption or elimination of these districts. (See F1, F2, F3, F4, F5, F6.)

SCWD disagrees with this recommendation. SCWD does not have an unrestricted reserve fund, as this District has stated in many of the responses above. Moreover, according to state law, SCWD (or any enterprise special district) is prohibited from transferring its ratepayers' reserves to fund another government agency, i.e., LAFCO, as the Grand Jury proposes.

The Grand Jury may not be aware that LAFCO already has a mechanism in place to fund consolidation studies when special districts, cities and/or the county pursue such initiatives. Simply put, the affected entities pay LAFCO directly for expenses incurred.

Moreover, an agency such as SCWD, which underwent a major consolidation as recently as 1999 (that LAFCO deems a success), would question the need to "pay into" a general LAFCO fund to support other agencies' potential consolidation efforts. It would appear to be a "gift of public funds" for SCWD to help cover the expenses of another government agency with our ratepayers' reserves.

The Grand Jury also may not be aware that one of LAFCO's mandates is to conduct Municipal Service Reviews (MSRs) every five years of the local government entities under its jurisdiction. During the MSR process, LAFCO considers the effectiveness and efficiency of services provided by each local entity to determine whether that entity should continue to provide those services – or whether another agency could better provide them.

Please refer any questions or requests for information regarding SCWD's Responses to the Grand Jury Report to Mr. Michael Dunbar, General Manager, at 949-499-4555 ext. 3112 or email at mdunbar@scwd.org.