Fallbrook Public Utility District

RAINBOW MUNICIPAL WATER DISTRICT
Committed to Excellence

April 6, 2021

Sandy Kerl
General Manager
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123

Dear Ms. Kerl,

While the Fallbrook Public Utility District and the Rainbow Municipal Water District have been complying with the request by San Diego LAFCO to provide a "quiet period" for Dr. Hanneman to complete his analysis without the on-going back and forth of additional correspondence, the San Diego County Water Authority (CWA) has, unfortunately, continued an on-going campaign of misinformation. Unlike CWA, which apparently has millions of public dollars to spend on disseminating incorrect information, we are not going to use our limited rate payer dollars to respond to every misleading statement CWA has made. That said, we cannot remain silent on CWA's attempt to score political points with a grossly misleading press release about its credit rating and similarly misleading statements included in CWA's most recent letter to LAFCO. We find CWA's actions in this regard quite alarming.

We had hoped that CWA would understand that issuing a press release that misrepresents its own rating agency report by implying that the potential detachment of our two small agencies would be financially devastating to CWA (even though the Districts together only represent roughly 1.5% of the population served by CWA), would not be a good strategy for CWA to maintain its long term bond rating outlook. It appears CWA decided it would disseminate a press release, and subsequent letter to LAFCO, that deflected the change in its credit outlook by taking, out of context, the language from one of the three credit rating reports, instead of focusing on addressing the main reasons identified in the rating agency report for a negative outlook.

Specifically, the language in the S&P report describing why S&P changed its outlook on CWA is as follows:

> *"The primary risk to the authority is the reduced consumption stemming from conservation, weather, economic contraction and the development of local supply by their member agencies. The reduced consumption introduces a financial challenge given that contractual water costs are increasing. Forecasted coverage is narrow relative to peers at the 'AAA' level and if rate increases are not sufficient to offset consumption declines, the rating could be lowered."*

In summary, S&P identified the main credit risks to CWA to be reduced consumption of CWA supplies due to both conservation and local supply development. The S&P report also cites to the fact that CWA has a significant amount of debt and has contracted for expensive supplies, such as desalination. The loss of approximately 17,000 water customers in the Fallbrook area was not identified as the primary concern for the change in outlook by S&P.

In addition, while S&P does describe specific concerns related to detachment, it also cites many other issues relative to the operation of CWA that resulted in the negative outlook. These include:

> *"In addition, the rating could be pressured if the authority further depletes the rate stabilization fund beyond the minimum target level established by the board or fails to implement rate increases to maintain financial metrics commensurate with a 'AAA' rating. The rating could also be pressured if the authority takes on a meaningful amount of additional leverage.*
>
> *"The authority has a higher degree of litigation and member discord than is standard in the sector, in our opinion.*
>
> *"The authority's five-year capital improvement plan is manageable, in our view. However, there is discussion of a major capital investment for a regional conveyance system. We believe a project of that magnitude could have a material impact on the authority's leverage ratios which could pressure the rating given how highly leveraged the water authority currently is."*

Some of the other secondary issues that S&P identified as drivers for the change in outlook include:

1. Potential for additional borrowing and challenges to maintain coverage ratios
2. The amount of litigation and discord between the Water Authority and its member agencies.
3. The fact that the Water Authority is spending millions of dollars on a regional conveyance project that has no possibility of being able to borrow money to actually build.

While we agree that the statement below was included in the S&P report as a secondary driver, CWA's press release and subsequent letter to LAFCO not only ignored some very specific language used by S&P, but also knowingly, to the potential detriment of CWA's financial position, failed to clarify that some of S&P noted potential financial risks are simply infeasible. Specifically, the excerpt from the S&P report set out below includes incorrect assumptions, which CWA clearly knows are incorrect, but which CWA has twisted for the singular purpose of inflating the financial impact of the proposed detachment:

> *"While we do not believe any of the aforementioned issues will have a financial effect in the near-term, we do believe ongoing litigation has associated costs and introduces potential longer term political risk -- especially if an approved detachment sets a precedent if members can easily detach from the authority. This would be further exacerbated if the two members are not required to pay for their portion of the associated debt and infrastructure costs that the authority has undertaken to provide reliable water sources."*

As CWA is well aware, the concept that if Fallbrook and Rainbow leave then other districts would follow suit is erroneous because our two districts are uniquely situated on the MWD aqueducts so that we can receive all our service directly from MWD. **<u>No other</u>** CWA member agency can now, or in the reasonably foreseeable future, obtain imported water without CWA and its infrastructure. This is not possible for other agencies and so it is clearly not something that would result in other agencies being able to "easily detach from the authority."

While CWA continues to push the narrative that other member agencies will be leaving, the next closest agency to our two districts (Valley Center Municipal Water District) has clearly indicated that it is not financially viable for it to pursue detachment, given its need for CWA infrastructure. Even though CWA appears determined to mischaracterize statements by a Valley Center Municipal Water District Board member, **in his personal capacity**, as the position of Valley Center's Board of Directors, to support its misinformation campaign (see the attached statement made by Mr. Ferro as public comment to LAFCO on April 5, 2021) the fact that Valley Center is not connected to MWD infrastructure makes detachment of Valley Center financially unviable. In addition, the San Diego Farm Bureau had to send its own letter to correct other misstatements made in the same letter (see attached). We hope the issuance of these two corrections give you some pause before you send out future correspondence.

Finally, with regard to the portion of the S&P report excerpt above that our two districts should "pay for our portion of the associated debt and infrastructure costs," we understand the statement simply as a highlight, by S&P, of the need to make sure that all appropriate costs associated with CWA providing facilities for Fallbrook and Rainbow are addressed in the process. This would necessarily need to also include the value of the infrastructure the rate payers of our two districts have funded for decades, (that will be left behind for the benefit of the remaining CWA member agencies) the overwhelming majority of which, quite notably, do not actually serve Fallbrook and Rainbow. As you are aware, although Fallbrook and Rainbow have paid tens of millions of dollars for a portion of the Emergency Storage Project (ESP), the Authority has never completed the facilities to serve all Fallbrook and Rainbow customers. In fact, an analysis conducted by London Moeder and Associates shows we have paid roughly $50 million more than we received in benefits from our past investments over the last decade.

Again, we do not plan to correct all misstatements in your recent correspondence and press release, but we are sufficiently concerned about CWA's quite alarming misstatements regarding S&P report that we felt the need to respond. CWA's actions to construe the impact of the proposed detachments of our two small districts as having any major impact on CWA's overall financial position is simply laughable.

The Fallbrook and Rainbow Boards are pursuing detaching from CWA because we believe it is in the best interest of our customers, and securing wholesale supplies through Eastern Municipal Water District is a more equitable arrangement for our customers that guarantees excellent supply reliability for our customers. We hope moving forward we can focus on providing relevant information to LAFCO in a factual manner to help facilitate the process and that the Water Authority will not continue to risk its own credit rating by continuing to politicize and mischaracterize its own rating reports.

Jack Bebee
General Manager
Fallbrook Public Utility District

Tom Kennedy
General Manager
Rainbow Municipal Water District

Enclosures

cc: SDCWA Board of Directors
Adam Wilson, Moderator – San Diego County LAFCO