



September 24, 2021

Keene Simonds
Executive Officer
San Diego Local Agency Formation Commission
9335 Hazard Way, Suite 200
San Diego, CA 92123

VIA EMAIL

Dear Mr. Simonds,

This letter represents the combined response of Rainbow Municipal Water District and Fallbrook Public Utility District to the September 2, 2021 letter from the San Diego County Water Authority regarding potential continuing obligation, related to our proposed reorganizations. These reorganizations would detach our agencies from the San Diego County Water Authority and concurrently annex the agencies into the Eastern Municipal Water District. We had not planned to add another letter to the record, but the content of the September 2, 2021 letter from SDCWA was such that this response was merited.

SDCWA proposed approach is fundamentally flawed

In what can only be described as an illogical method of calculation, SDCWA has asserted to LAFCO that RMWD and FPUD must pay for “obligations” SDCWA has purportedly taken on for our agencies. These “obligations” include over a billion in debt for capital projects but mostly consist of future payments for contracted water supplies and total nearly \$21 billion. In their September 2, 2021 letter to LAFCO, SDCWA calculated the combined “obligation” for FPUD and RMWD at \$1.2 Billion! This approach has significant flaws, mainly assuming that member agencies have some sort of long-term commitment of water purchases. This is certainly not reflected in the CWA Act, SDCWA policies, past practices, or rate ordinances.

The analysis put forward by SDCWA apparently assumes we have an obligation to purchase water we don't use so the remaining agencies could have it for free and then purchase our own water from EMWD. It also ignores the fact that our agencies are heavily dependent on Agricultural Water Supplies (PSAWR) which are specifically designated within SDCWA policies as MWD supplies.

In the September 2, 2021 letter, SDCWA used information from a Fitch report to define RMWD and FPUD's “share” of these obligations. The values presented here, at 3.9% for RMWD and 2.1% for FPUD are unknown in their origin, but closely resemble the percentages of total financial contributions to SDCWA that are used each year to calculate member agency voting rights. In the most recent

calculation included in the 2020 CAFR from SDCWA, RMWD’s share was calculated at 3.975% and FPUD at 2.275%. For the purposes of this document we will presume Fitch used some rounding in its analysis.

If you were to then apply this “obligation” to other member agencies based on this same calculation method, you could apportion the ~\$21 Billion across the entire group of member agencies. The table below shows the “obligation” for each member agency should SDCWA’s analysis be taken to its illogical conclusion:

Member Agency	Total Financial Contribution	Percentage		Share of "Obligation"
Carlsbad Municipal Water District	\$516,168,549	3.659%	\$	752,042,677.27
City of Del Mar	\$41,825,272	0.297%	\$	60,938,214.06
City of Escondido	\$498,188,446	3.532%	\$	725,846,186.17
Fallbrook Public Utility District	\$320,908,718	2.275%	\$	467,554,739.45
Helix Water District	\$949,520,414	6.731%	\$	1,383,423,836.35
Lakeside Water District	\$104,178,035	0.739%	\$	151,784,390.01
City of National City	\$103,527,023	0.734%	\$	150,835,884.32
City of Oceanside	\$727,331,159	5.156%	\$	1,059,700,505.06
Olivenhain Municipal Water District	\$461,113,372	3.269%	\$	671,828,873.48
Otay Water District	\$832,527,069	5.902%	\$	1,212,967,909.57
Padre Dam Municipal Water District	\$381,382,207	2.704%	\$	555,662,867.43
Pendleton Military Reservation	\$12,385,497	0.088%	\$	18,045,311.64
City of Poway	\$297,712,337	2.111%	\$	433,758,281.88
Rainbow Municipal Water District	\$560,657,964	3.975%	\$	816,862,470.78
Ramona Municipal Water District	\$208,764,732	1.480%	\$	304,164,188.76
Rincon del Diablo Municipal Water District	\$199,889,069	1.417%	\$	291,232,603.96
City of San Diego	\$5,609,355,715	39.767%	\$	8,172,669,368.98
San Dieguito Water District	\$151,126,071	1.071%	\$	220,186,323.36
Santa Fe Irrigation District	\$225,758,747	1.600%	\$	328,923,978.11
South Bay Irrigation District	\$279,214,034	1.979%	\$	406,806,788.34
Vallecitos Water District	\$406,694,371	2.883%	\$	592,541,959.77
Valley Center Municipal Water District	\$725,289,252	5.142%	\$	1,056,725,505.50
Vista Irrigation District	\$428,200,948	3.036%	\$	623,876,421.69
Yuima Municipal Water District	\$63,977,879	0.454%	\$	93,213,923.05
Total	\$14,105,696,880	100.000%	\$	20,551,593,209.00

Table 1 – SDCWA Proposed Long-term Financial Obligation by Member Agency

This table would likely come as a surprise to many member agencies. Does the City of San Diego agree that it has some sort of “obligation” in excess of \$8 Billion to SDCWA? As noted above, the fact of the matter is that within the CWA Act as well as SDCWA’s own Administrative Code and Ordinances, no member agency has any obligation to purchase any amount of water. Member agencies are only obligated to pay the set rates and charges as defined by the Board.

This point has been clarified in Open Session on several occasions at SDCWA Board meetings. The General Counsel has been asked in advance of votes on debt or other large spending items whether the vote in favor of the item by any member agency representative obligates that member agency to pay for the repayment of the debt other than through normal rates and charges should their water demands decline. The response, correctly, from the General Counsel has always been that member agencies are only obliged to pay in accordance with the rates and charges in effect at the time they purchase water from SDCWA.

Hypothetically, if we were forced to pay for some of these “obligations” for contracted supplies post detachment, SDCWA seems to think that we would not get that water delivered to us. In its communications to LAFCO and to the public SDCWA has indicated that we will need to pay for these “obligations” as well as paying for water from EMWD. There are numerous problems with this concept:

- If we pay for the water and SDCWA sells it to another agency, do we get that money?
- Paying for a service but not receiving the service is unlawful under the California Constitution.
- If we are paying for costs that are calculated on future renegotiated contracts, do we get a refund if the price goes down in the future? If the price goes up does SDCWA send us a bill?

The reality is that under SDCWA’s recently approved Urban Water Management Plan, it does not forecast a situation where its regional demands falls below its contracted supplies. The difference between SDCWA’s contracted supplies and its regional demands is water purchased from MWD. In all years in the forecast, the amount purchased from MWD is greater than the total demand from FPUD and RMWD combined.

Making the nearly \$21 Billion “obligation” figure even more surprising is the fact that in their most recent Comprehensive Annual Financial Report, SDCWA lists the total value of all of their capital assets at only \$3.444 Billion. This means that, according to SDCWA, they have obligated their member agencies to just under six times the total value of their capital assets. Such an obligation to asset ratio would generally mean that an agency’s bond rating would suffer greatly and yet SDCWA maintains very high bond ratings. This fact demonstrates the incoherence of SDCWA’s calculation of “obligations” for RMWD and FPUD.

A final point on this calculation of “obligations” is the fact that according to SDCWA each member agency has an obligation that is much higher than their total contributions to SDCWA in its history. Above you can see that the City of San Diego has contributed a total of \$5.6 Billion since 1944 and their share of the “obligation” is nearly \$8.2 Billion.

Both FPUD and RMWD have paid millions for infrastructure owned by SDCWA that will continue to benefit the remaining agencies

As the table from SDCWA’s CAFR indicates, over the years RMWD and FPUD have contributed nearly \$900 Million to SDCWA in total. While a good deal of that was for water purchases, the remaining helped pay for all of the \$3.4 Billion in capital assets that SDCWA owns. SDCWA’s rate structure was purely volumetric until about 2003 when the rate structure was “unbundled” so it is difficult to say exactly where each dollar went absent an exhaustive review of every budget over the history of SDCWA.

For the purposes of this analysis it is reasonable to make an estimation of the contributions by RMWD and FPUD ratepayers to the capital facilities that serve SDCWA (again, nearly all of which provide no service to our region). It is also important to note that prior to the huge decline in agriculture due to high water costs, RMWD and FPUD represented a higher percentage of SDCWA sales than they do today. The roughly 6% number calculated for the current time period is lower than the average over the history of our agencies. For example, RMWD used to purchase over double what it does today back in the early 2000's and our financial contributions were higher as a result. While the value may be closer to 10% on average, in order to be conservative, we will estimate our contribution to the capital assets of SDCWA to be about 7%.

This value puts the total contribution to the \$3.444 Billion in capital assets by RMWD and FPUD at about \$241 Million over the years. This number represents money from our ratepayers that built all the pipelines and facilities that serve agencies south of us, now and into the future. There are no assets that serve only RMWD and FPUD – all of these assets will continue to provide benefits to the remaining member agencies. By detaching, the remaining member agencies will continue to benefit from nearly a quarter billion dollars in investments made by the ratepayers in our region.

While there is still some debt outstanding on infrastructure owned by SDCWA, a significant amount has already been funded using FPUD and RMWD rate revenue. These investments include:

- \$1.5 billion Emergency Storage Program including pump stations and storage that will continue to serve the remaining agencies.
- Nearly 310 miles of pipelines and distribution infrastructure that were never used by FPUD and RMWD ratepayers.
- \$300 million Canal Lining Program that will continue to provide SDCWA's lowest cost water supplies to the remaining agencies into the future.

In addition to infrastructure funding there are reserves and water supplies that were funded by FPUD and RMWD ratepayers, in which FPUD and RMWD have an ownership interest, including:

- \$260 million in reserve funds (RMWD/FPUD are ~6% of SDCWA so this amounts to a net benefit of ~\$15 Million for remaining member agencies)
- Water in storage and stored water supplies.

There are also substantial CIP savings to SDCWA from our departure. SDCWA will not need to build and replace facilities associated with service to FPUD and RMWD. These facilities include:

- \$30-40 Million North County ESP Pump Stations
- Rehabilitation of flow control facilities - all of which were paid for by RMWD and FPUD when installed and ongoing payments from RMWD and FPUD generated the reserves required to perform the work.

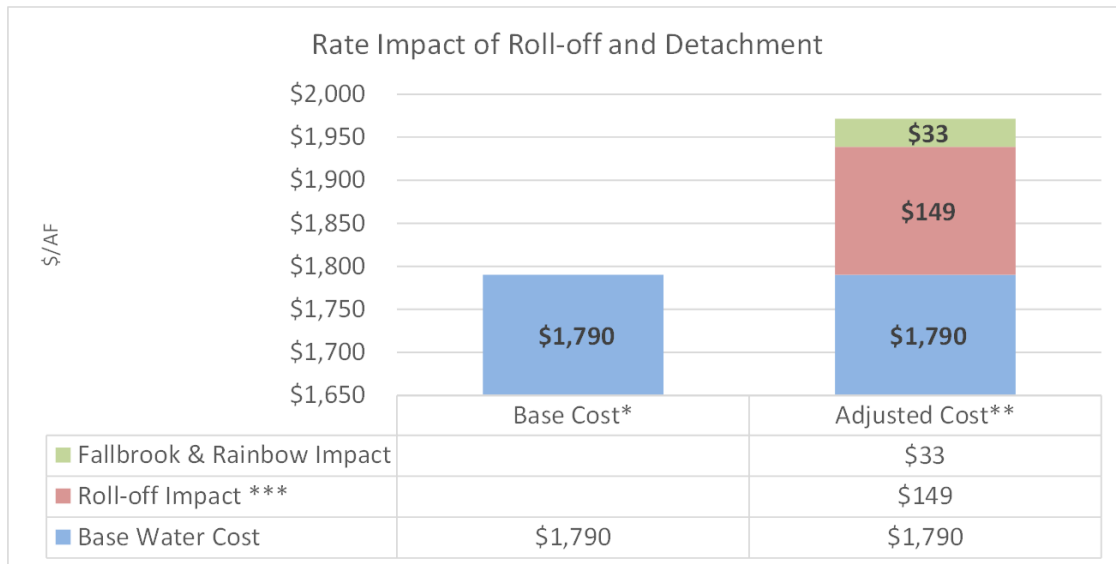
If LAFCO determines to adopt an approach looking at revenue impacts to the remaining agency it should also calculate the benefits and CIP savings received by those agencies from investments made by FPUD and RMWD ratepayers.

It is important to note that on several occasions SDCWA has asserted that there will be no O&M savings to the agency from the proposed detachments. This is false, of course, as SDCWA field staff do visit and maintain the flow control facilities in our region. There will be savings in personnel time, vehicle and fuel costs, and administrative costs to process our billing. Perhaps SDCWA means that there will be no reduction in staff related to detachment—However, this assertion by SDCWA demonstrates the minimal actual level of service that SDCWA currently provides to our two agencies.

An approach of dividing exiting SDCWA supply “obligations” among member agencies is inconsistent with SDCWA’s existing rates and past/current practice

SDCWA has developed a rate structure that allows agencies to roll-off SDCWA fixed charges over a 3-5 year time period except for the infrastructure access charge (IAC). All other fixed charges roll-off over time based on demands. If for example FPUD and RMWD contracted for local supplies from a third party similar to SDCWA’s QSA type arrangement, the only remaining costs to SDCWA and the only charge to be paid by FPUD and RMWD would be the IAC. In addition, if we contracted for supplies, SDCWA would still need to construct the ESP facilities outlined above.

While SDCWA has said that rates may change in the future to allocate more true fixed costs, there has been no progress in addressing this issue since the agencies that will be most negatively impacted hold the majority vote at SDCWA. There is no indication that some shift towards true fixed costs based on, for example, assessed valuation or population, will occur. With the upcoming roll-offs of the City of San Diego, City of Oceanside, Helix Water District and Padre Dam MWD, the existing rate structure will shift much more cost onto FPUD, RMWD, and other member agencies than our detachments would. A comparison of the rate impact of detachment versus roll-off is shown in Figure 1 below:



* Based upon CWA’s Calendar Year 2021 Cost of Service Study.
 ** Impacts calculated using continued CWA water sales of 316,000 AF.
 *** Pure Water Phase I, East County AWP, Pure Water Oceanside.

Figure 1 – Relative Impact of roll-off versus detachment

The impact of agencies rolling off SDCWA is over 4 times the impact of our detachments. For example, the City of San Diego expects to roll off about half of its purchases from SDCWA over the next decade or so. When that occurs, their “obligation” of \$8.2 Billion will, after 3-5 years, be cut in half as well. The “obligations” of each remaining member agency will then increase accordingly. If there is determined to be an “obligation” by member agency of SDCWA, it would also need to apply to agencies that either detach or roll-off. This is clearly an untenable proposition that would likely find significant opposition by SDCWA member agencies.

SDCWA has repeatedly stated that the QSA supplies are less expensive than MWD supplies

Even though LAFCO’s consultant has calculated otherwise, SDCWA has asserted on several occasions in LAFCO Ad-Hoc Committee meetings and at a recent Fallbrook Community Forum meeting that its QSA supplies are its lowest cost supplies. Since SDCWA’s very recently adopted Urban Water Management Plan shows that it will be a net purchaser of MWD water in volumes greater than FPUD and RMWD’s combined demands, then if this were the case SDCWA would be saving money should the detachments proceed. SDCWA’s conflicting messaging in this regard is difficult to reconcile. Some clarification on these contradictory statements is required.

SDCWA has the ability to adjust its supply mix to address decreasing demands due to the detachments and roll off

If SDCWA feels that its UWMP projections are incorrect and detachment could lead to a situation where its contracted supplies are greater than its demands it has options to avoid unnecessary costs. For example, SDCWA could work out an arrangement with MWD or another MWD member agency to transfer some supplies. QSA water is already transported through the MWD system and would only require only an agreement between MWD and SDCWA to adjust the supply allocation on paper. SDCWA spends approximately \$150 million a year in water cost premium versus MWD supplies purchasing Desalination supplies and IID transfer water.

In addition, under the Permanent Special Agricultural Water Rate (PSAWR) rate structure, all water deliveries under this program are defined within the SDCWA rate structure as being MWD deliveries. Currently, over half of the total supplies purchased by RMWD and starting later this year nearly all of FPUD water will be officially classified by SDCWA as part of the PSAWR program. The actual total amount that will be reduced from QSA deliveries is about 8,500 AF per year post detachment. If RMWD and FPUD are reducing SDCWA supply obligations by roughly 8,500 AFY, SDCWA could pursue options with MWD or MWD member agency to pursue an equivalent amount of water through a transfer agreement. For example, replacing 20,000 AFY of Desal with MWD supplies would save \$37.5 million a year in water supply costs. Replacing 30,000 AFY of IID transfer water with MWD water would save almost \$10 million a year and would off-set any cost impact of the detachments.

The bottom line is by adjusting the supply mix to off-set our departure SDCWA can offset any cost impact and it would simply require an agreement with MWD or another MWD member agency. Figure 2 shows the water costs impact on reducing 20,000 AFY of desalination supplies and 80,000 AFY of IID transfer supplies to offset the impacts of both detachment and roll-off. The savings from adjusting the

supply mix can off-set impacts of both roll-off by member agencies developing local supplies as well as the detachments.

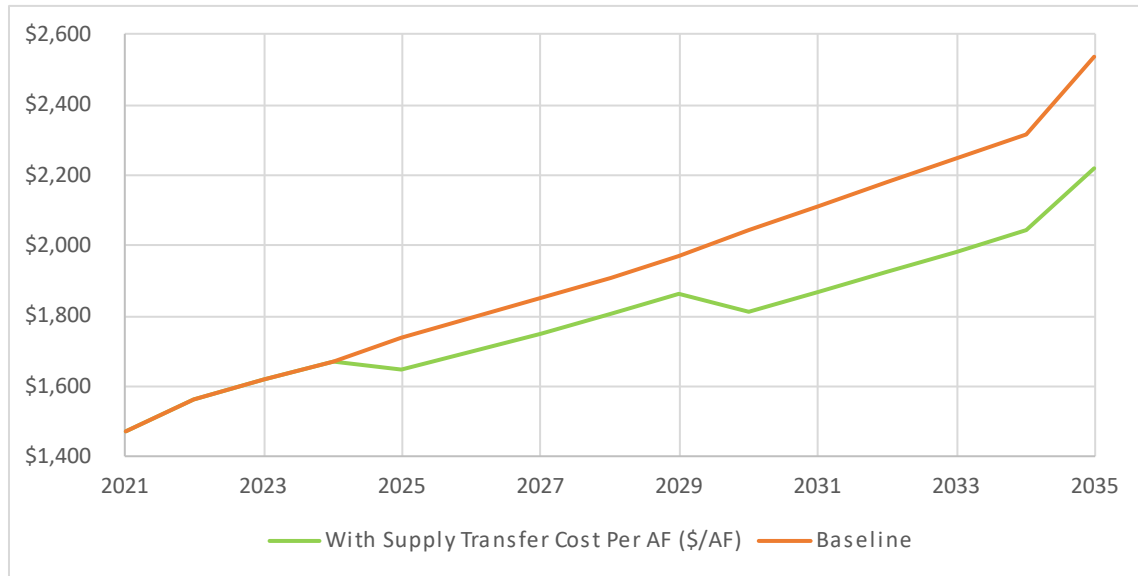


Figure 2 – SDCWA Unit Water Cost Comparing Detachment Costs with Savings in Transferring 20,000 AFY of Desalination Supply (2025) and 80,000 AFY of IID Transfer Supply (2030).

Legal Background

While we all know that LAFCO is fully aware of the relevant statutory provisions related to the financial arrangements our reorganization may require, we felt that it would be helpful to refresh the administrative record so that the information could be shared with LAFCO’s consultant, Dr. Hanemann, as well as the Ad-Hoc Committee. Attached to this letter is another letter from Rainbow Special Counsel Lloyd “Bill” Pellman that describes the relevant statutory provisions for this process. We hope that all parties find this information useful.

Conclusion

The concepts for an “exit fee” proposed by SDCWA in its September 2, 2021 letter fail to pass muster on several levels. As noted in Mr. Pellman’s letter referenced above, while LAFCO does have some discretion within the provisions of CKH, the Principal Act of SDCWA is very clear as to how continuing obligations are to be handled. The Legislature has already outlined the processes and provisions within the Exclusion of Territory sections of the CWA Act. SDCWA itself, through its Administrative Codes, Ordinances, as well as past and current practices, has set rates that allow for costs to diminish as water use diminishes. The hypothetical “exit fee” of ~\$1.2 Billion for the detachments is a crude attempt to confuse LAFCO’s consultant that is not moored in law or even common sense.

LAFCO should follow existing law and when analyzing the impact to SDCWA should recognize ability for SDCWA to adapt to our detachments, the benefits provided by our ratepayers' past investments in infrastructure, the immediate savings of \$30-\$40 million in avoided future infrastructure, and the funds paid by our ratepayers that sit in SDCWA reserves. Based on these facts, LAFCO should not impose any additional on-going payments to SDCWA apart from what is provided by statute.

LAFCO should recognize that the payments required under the CWA Act are not trivial. The ad-valorem property taxes that would be collected by SDCWA under the CWA Act could be collected until these "obligations" are satisfied. Based on the current taxes collected by SDCWA from our region, and using a very conservative 1.5% inflationary index for assessed values in the region, the total amount of money that SDCWA could collect through these taxes during the life of their water supply contracts (the QSA could, hypothetically, be extended to the year 2112), the total taxes collected over that time period would amount to roughly \$60 Million.

We do not think it is appropriate for property taxes to be collected to pay for hypothetical future water supply contracts, but these tax revenues could continue until the debt on capital facilities were retired.

However, should LAFCO desire to identify some sort of continuing obligation apart from what is outlined in State law, they need look no further than SDCWA's own system of rates and charges. As described above, were our agencies to develop or contract for supplies apart from SDCWA as a source, our fixed charges would go to zero within 5 years (apart from the IAC). Several SDCWA member agencies who are developing local supplies are counting on that as part of their financing of their projects – in fact some would be cancelled without it.

LAFCO could simply treat the detachment the way every other member agency at SDCWA is treated in a similar situation. As our demands on SDCWA go to zero when supplies from EMWD are delivered, the fixed charge components could decline in accordance with SDCWA's rate structure. Over 5 years they would go to zero as well.

There are two significant caveats to this approach that require attention. First, is the fact that the Storage Charge, which mainly recovers funds for the ESP debt payments, should not be applied in this process. While the ESP is fully functional and ready to serve every other member agency, SDCWA has not constructed the facilities to fully serve our region – despite the fact that we have paid nearly \$30 Million toward these costs to date. It has been unfair for our ratepayers to pay for a service they do not receive for the last 20 years – it would be more unfair to compel them to pay more as part of this hypothetical process.

The other caveat involves the IAC. This is SDCWA's only true fixed charge and post detachment SDCWA would lose that revenue. Together, RMWD and FPU D contribute about \$900,000 per year in IAC charges which would cease upon detachment. While this is a revenue loss for SDCWA, it is more than offset by the immediate savings of not having to build the ESP facilities (not to mention savings from ongoing O&M obligations, turnout rehabilitation, etc.). With an instant savings of \$30-\$40 Million from their CIP obligations, the savings will easily pay for any IAC charges for decades.

Should LAFCO adopt an approach that would apply SDCWA's own policies to the concept of continuing obligations, the total payments from RMWD and FPU D over that 5 year span would amount to approximately \$14 Million with the Storage charge and about \$9 Million without the Storage charge.

Finally, should LAFCO consider this approach the total amounts should include a credit for the approximately \$15 Million in RMWD/FPUD ratepayer funds that SDCWA holds in reserves. These reserves represent cash on hand at SDCWA, paid for by our ratepayers, that will be a direct benefit for other member agencies to enjoy.

We look forward to the next steps in this process.

Sincerely,



Tom Kennedy
General Manager
Rainbow Municipal Water District



Jack Bebee
General Manager
Fallbrook Public Utility District

Enclosures

cc: via email:

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