



Chairman

Bill Horn
County Board of
Supervisors

September 14, 2015

8A

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Vice Chairman

Sam Abed
Mayor
City of Escondido

TO: Local Agency Formation Commission

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FROM: Executive Officer
Local Governmental Consultant

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Members

Dianne Jacob
County Board of
Supervisors

SUBJECT: Supplemental Report: Rainbow Municipal Water District
Fallbrook Public Utility District Reorganization
(SA14-04(a);SA14-04(b); MSR/SR13-66; MSR/SR13-82;
RO14-04; LPE14-04)

Andrew Vanderlaan
Public Member

Lorie Zapf
Councilmember
City of San Diego

EXECUTIVE SUMMARY

Background

Lorraine Wood
Councilmember
City of Carlsbad

Jo MacKenzie
Vista Irrigation District

Vacant
Special District

The proposed reorganization of the Rainbow Municipal Water District (MWD) and the Fallbrook Public Utility District (PUD) has been subject to an extensive and prolonged review process conducted by LAFCO staff and LAFCO's Special Districts Advisory Committee. At the request of the Rainbow MWD, a hearing was originally scheduled on July 6, 2015 in order to reach closure on this process, which Rainbow MWD has characterized as a major distraction for its staff, board, and ratepayers. The July 6th hearing was subsequently continued to September 14th. Some Commissioners suggested that during this interim time period, that LAFCO staff conduct additional research to determine if data and analysis required updating. Since July 6th, LAFCO staff has been working with both districts to collect documents and review associated data. The General Managers and staffs of the Rainbow MWD and Fallbrook PUD have cooperated with LAFCO staff during this extended research process. The byproduct of the continued hearing is the Supplemental Report.

Alternate Members

Greg Cox
County Board of
Supervisors

Chris Cate
Councilmember
City of San Diego

Racquel Vasquez
Councilmember
City of Lemon Grove

Ed Sprague
Olivenhain Municipal
Water District

The purpose of the Supplemental Report is to provide updated information and validation, as necessary -- rather than duplicating an already extensive report released for public review thirty-days prior to the July 6, 2015 LAFCO hearing. The first step involved an invitation to both districts to identify data and issue areas pertinent to the draft Consolidation Study that was prepared for the Fallbrook PUD and Rainbow MWD in 2012. Both the Fallbrook PUD and Rainbow MWD completed this first task on July 8, 2015. The result was

Harry Mathis
Public Member

Executive Officer

Michael D. Ott

Legal Counsel

Michael G. Colantuono

the formulation of a list of 24 questions covering a wide range of issues, and the identification of over 16 different pertinent documents (e.g., recent audits, Capital Improvement Plans/Budgets; organization charts, etc.). Two weeks were then given to each district to review the documents and provide additional comments, plus supporting documentation. This step was complete on July 31, 2015. Each district was given another opportunity to comment on the documents and responses received. After these series of steps, the Supplemental Report was prepared by LAFCO staff. The pertinent data, associated reports, and correspondence received from the Rainbow MWD and Fallbrook PUD can be downloaded directly from the San Diego LAFCO's website: http://www.sdlafco.org/Webpages/fallbrook_rainbow_reorg.htm.

Reorganization and LAFCO Responsibilities

In reviewing the Supplemental Report, the Commission will probably find some odd similarities with the proposed reorganization and the dialogue between the ownership of the San Diego Chargers and the City of San Diego. As with the Chargers, the Rainbow MWD objects to most every statement and cost savings projection presented by the Fallbrook PUD. The Rainbow MWD refers to the associated jurisdictional changes as a "hostile takeover". Analogous to the Chargers and voters in Carson, California, the Rainbow MWD has also been trying to influence the actions of voters and/or the Commission. The District has retained various legal, political, and public relations contractors in pursuit of these political objectives. According to filings with the Fair Political Practices Commission, the Rainbow MWD spent over \$150,000 on political activities related to opposing the reorganization since 2014.

Like the Chargers, the Fallbrook PUD believes that the reasons to move forward with reorganization are so compelling that approval from the Rainbow MWD is not necessary. The Fallbrook PUD cites cost savings estimated at \$2.7 million annually as the basis for initiating the reorganization over the objections of the Rainbow MWD. While State Law permits any affected agency to initiate a jurisdictional change involving another agency, Fallbrook PUD's decision to initiate the reorganization application may turn out to be a questionable strategy, depending on the level of protest and outcome of a possible election on this matter. For example, if LAFCO approves the reorganization and 25 percent or more of the voters or landowners register written protest, then the reorganization may be subject to an election within the territory of both Rainbow MWD and Fallbrook PUD. Per the LAFCO staff recommendation, a majority of voters in both the Rainbow MWD and Fallbrook PUD would need to favor reorganization for the proposal to become effective. The Fallbrook PUD has spent a limited amount of funds for political purposes related to the reorganization. According to filings with the Fair Political Practices Commission, the Fallbrook PUD has spent \$2,970 for political purposes since 2014.

While some observers may find that the negative dialogue between the Rainbow MWD and Fallbrook PUD is unprecedented – it is not. In terms of the nearly 200 government reorganizations that have been approved by the San Diego LAFCO – most of these proposals have been challenging and not unanimously accepted at the time by the respective staff and boards of directors of the affected agencies (e.g., Rural Fire Protection

District, Tia Juana Valley County Water District, Lower Sweetwater Fire Protection District, etc.).

The State Legislature and countless taxpayer groups are also aware of these challenges with respect to a statewide government reorganization perspective. The Legislature, in particular, believes that Local Agency Formation Commissions need to be more proactive. In 1997, these and other reasons prompted the Legislature to create the *Commission on Local Governance for the 21st Century*. This special legislative commission produced a landmark publication in 2000, called ***Growth Within Bounds***. A conclusion of this report was that the fragmentation of government services among numerous, small, inefficient, or overlapping providers should be discouraged statewide, and instead be replaced with effective, efficient, and easily understandable local governmental agencies. The outcome of this legislative report was the enactment of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (CKH Act). The CKH Act is the law that regulates LAFCOs, and among other things, instructs each commission to give consideration to the benefits of having multipurpose governmental agencies that are accountable for community service needs and financial resources. In deliberating on the proposed reorganization of the Rainbow MWD and Fallbrook PUD, the Commission will be asked to make a number of determinations related to the reorganization and the CKH Act.

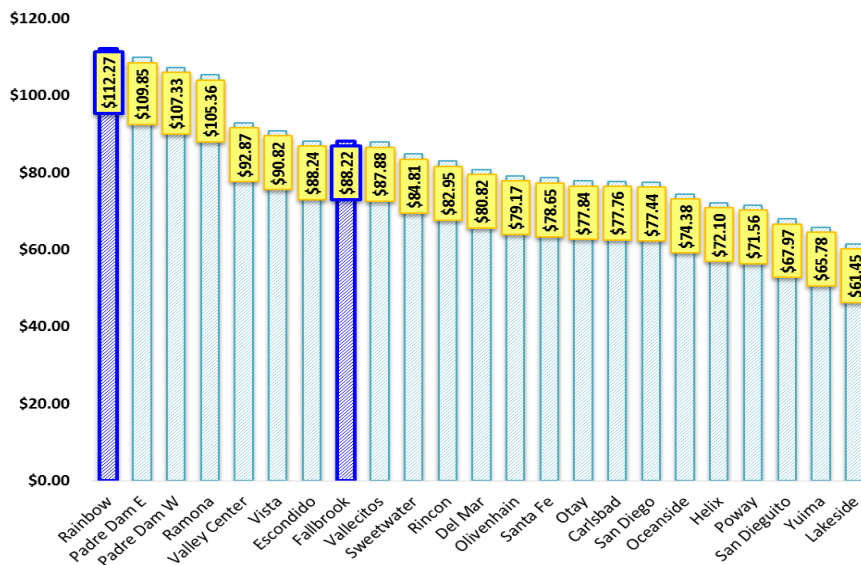
SUMMARY OF SUPPLEMENTAL REPORT AND CONCLUSIONS

As a result of conducting research for the July 6, 2015 staff report (Agenda Item Nos. 7A, 7B, and 7C) and the September 14, 2015 Supplemental Report, LAFCO staff has reaffirmed the conclusion that a reorganization of the Fallbrook PUD and Rainbow MWD makes sense from a financial and service perspective. That is not to say, however, that the reorganization should be automatically approved by the Commission. Given the history of the reorganization issue and the level of opposition, it is unlikely that the Rainbow MWD and Fallbrook PUD will ever reach concurrence on the subject of reorganization. While LAFCO staff has concluded that compelling justification exists for approval of the reorganization, it is only with the caveat that a number of modifications be made to the proposal, as recommended in the July 6, 2015 staff report. Modified approval would permit the process to move forward and allow voters and landowners to reach a decision on the reorganization—possibly terminating the proceedings. If the issues of local control and representation are as important to the Rainbow residents, ratepayers, and landowners, as claimed by the Rainbow MWD, then voters and landowners should accordingly be given an opportunity to participate, mount a protest, and with sufficient protest, cause an election to be ordered. If a majority of the voters in both the Rainbow MWD and Fallbrook PUD vote in favor of reorganization, then the reorganization would occur. On the other hand, if a majority of the voters in either district reject the ballot question of reorganization, then the process would reach closure and be terminated.

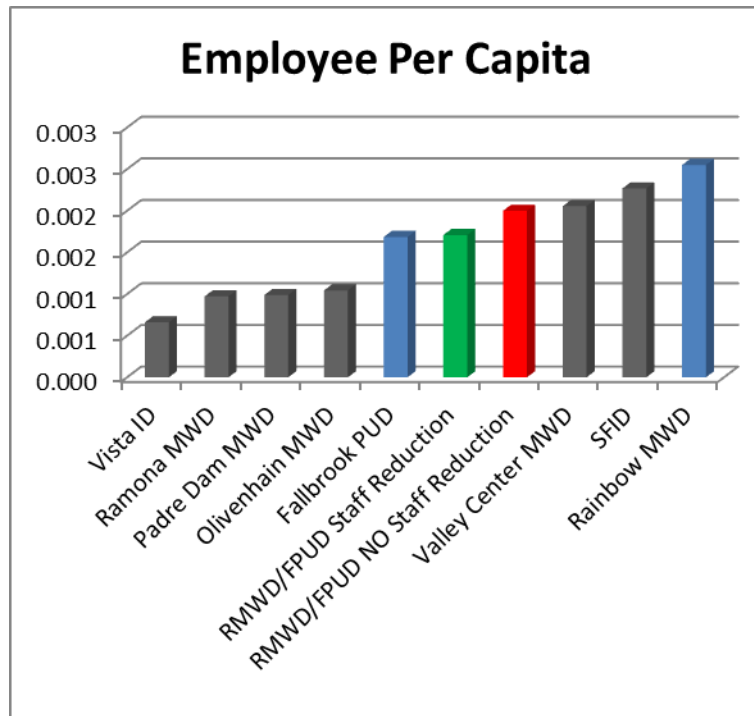
Pertinent conclusions that have been reaffirmed in the Supplemental Report include:

- Cost Savings:** The Fallbrook PUD projects that total calculated annual cost savings derived from a possible reorganization with the Rainbow MWD will total approximately \$2,715,258. This estimate includes annual salaries and benefits savings of \$2,415,258 and miscellaneous other savings of \$300,000. LAFCO staff independently reviewed these calculations and believe the cost savings may be overstated. LAFCO staff estimates that the wage and benefit cost savings may actually range from a low of \$2,162,947 to a high of \$2,371,449, annually. These totals are less than projected by the Fallbrook PUD, but still represent significant potential cost savings. The projections made by LAFCO staff exclude the miscellaneous savings forecasted by the Fallbrook PUD, because the estimates are highly generalized and difficult to quantify. However, it is conceivable that miscellaneous savings may result from reorganization and these savings may be more or less than what Fallbrook PUD has projected. LAFCO staff's lower estimate (\$2,162,947) is based on the retention of two operations positions in 2015-16 to address concerns expressed by the Rainbow MWD staff.

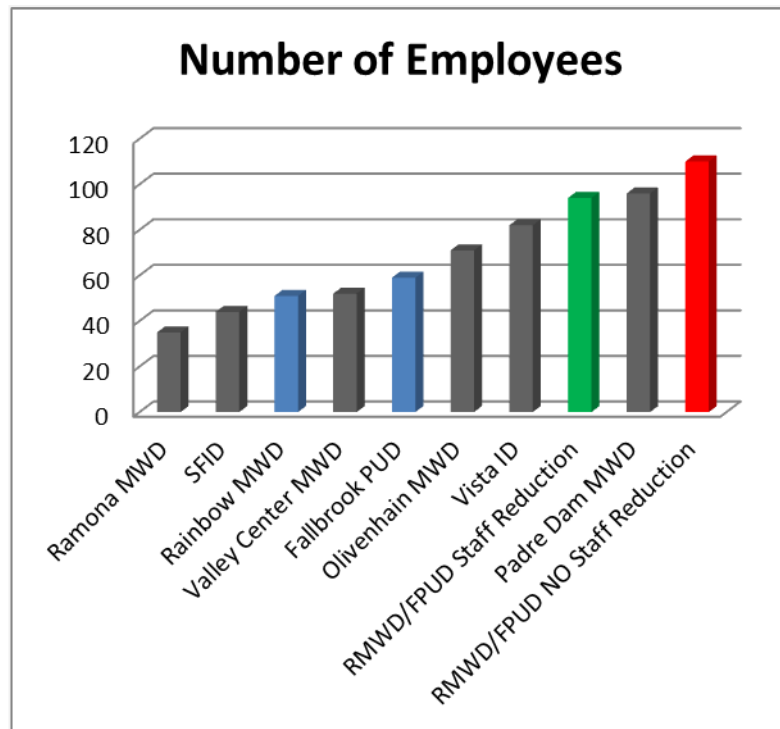
- Water Rates:** With respect to water rates charged to customers, Rainbow MWD has claimed that Fallbrook PUD's water rates are excessive and will discourage agricultural production. This contention is false and not supported by evidence. Agricultural rates appear to be lower in the Fallbrook PUD than in the Rainbow MWD. Fallbrook PUD's fixed charges (agricultural class) were estimated to be about 20 percent less than in the Rainbow MWD in 2013 at the time the two districts were exploring consolidation. In 2014, the Fallbrook PUD's water rates were about 20.50 percent less than the agricultural water rates in Rainbow MWD. In addition, based on two independent water rate surveys conducted in 2014 and 2015, water rates appear to be substantially less in Fallbrook PUD than in Rainbow MWD. According to the surveys, the Rainbow MWD had the highest water rates in San Diego County in 2014 and the Fallbrook PUD had the eighth highest rates in the County (Source: Otay WD, 2014 Water Rate Survey). In 2015, the average monthly water rates in Rainbow MWD were among the second highest in San Diego County and the Fallbrook PUD's rates were fourth highest (Source: Union-Tribune, Water Rate Survey, April 15, 2015). Below is a depiction of the 2014 water rate survey.



• **Economy of Scale:** Most local agencies can benefit from some level of reorganization to establish a more favorable relationship between operational costs and services. This relationship is sometimes referred to as Economy of Scale. It describes the reduction in average costs arising from an increase in the size of the operating unit in relation to the proportionate increase in the population served. In reviewing eight independent water districts in San Diego County, it can be concluded that a staffing reduction associated with combining the Fallbrook PUD and Rainbow MWD would potentially produce a more favorable Economy of Scale, than if the two districts remained separate. Without the reorganization, the number of employees per capita serving the Rainbow MWD would far exceed the average number of employees in other water districts in the County. The green bar in the below graph shows how the number of employees (water employees) per the combined service area of Rainbow MWD and Fallbrook PUD would be reduced to a more acceptable level if staffing reductions were made per the Fallbrook PUD proposal. The red bar shows the effect of combining the districts without staffing reductions. While retaining the status quo is an option for the Commission and ultimately a local prerogative of voters, this will result in a lost efficiency and a lost cost savings opportunity costing ratepayers approximately \$2,162,947 to \$2,371,449 annually for the same level of services as currently provided by two separate districts.



Another analytical measure would be to examine the number of employees without reference to the population base. This measure is less significant but it still illustrates that the number of employees in the combined district (Fallbrook PUD and Rainbow MWD) would be the highest among the surveyed districts unless there were employee reductions. With employee reductions, as proposed by the Fallbrook PUD, the number of employees in the combined district would decrease to a lower level compared to other water districts in San Diego County.



- Debt and Assets:** Rainbow MWD has stated that Rainbow is a low-debt, budget conscious district, while it claims Fallbrook PUD has amassed significant debt. The most recent audited financial statements from both districts, dispute this claim. Both districts have similar debt and asset levels. According to the Rainbow MWD's most recent audit for FY 2013-14, Rainbow MWD's total long-term obligations amount to \$21,282,682 (\$17,485,419 principal and \$3,797,263 interest). Expressed as a percentage of total assets, Rainbow MWD's long-term debt in relation to total assets is 18 percent. According to Fallbrook PUD's audited financial statements for FY 2013-14, the Fallbrook PUD had a total liability of \$22,732,736. Expressed as a percentage of total assets, Fallbrook PUD's long-term debt in relation to total assets is 20.6 percent.

In 1995, the Rainbow MWD adopted Ordinance No. 95-1. Per this ordinance, whenever Rainbow carries cumulative debt in excess of \$1 million, it cannot incur additional public debt unless two-thirds of the voters provide approval. An examination of the Rainbow MWD's recent audits reveals that compliance with this ordinance was either not disclosed or subject to audit testing. For example, in 2012, it appears that Rainbow MWD incurred new public debt in an amount more than \$18 million when it already had existing debt in excess of \$3.4 million (Resolution 12-12). We believe that to comply with the intent of

Ordinance No. 95-1, Rainbow MWD should have dealt with the pay-down of existing debt and new debt in two separate and independent board actions. After evidence was provided to the board that the debt had been paid down, the board should have then deliberated on incurring new debt in the amount of \$18.2 million. Instead, the Rainbow MWD board provided concurrent authorization to incur additional public debt prior to paying down existing debt, without seeking voter approval. This sequence of events should have been disclosed and tested in Rainbow MWD's audits, but disclosure and testing appears not to have occurred.

Another issue is the overall legality of Ordinance No. 95-1. A close examination of Ordinance No. 95-1 may reveal that the Ordinance is currently unlawful and/or not effective, as it pertains to the Rainbow MWD. For example, the Ordinance may amount to the equivalent of an unlawful local amendment to the Municipal Water District Act (Water Code Section 71000 et seq.), preempted by the Act itself. Analogous reasoning appears in cases arising from Proposition 218, such as *Howard Jarvis Taxpayers Assn v. San Diego* (charter amendment could not require 2/3 voter approval of general taxes which the Constitution permits with majority approval) and *Bighorn-Desert View Water Agency v. Verjil* (water district initiative could not require 2/3 voter approval of water rates which the Constitution authorizes the District Board to impose without an election).

- **Use of Collateral:** The Rainbow MWD claims that the Fallbrook PUD is pursuing the reorganization to use Rainbow's operating assets as collateral. This is an incorrect statement and not allowed under current finance practices. Both districts borrow most of their construction funds from the State of California. The State requires a pledge of revenues, not assets, to secure loans. Assets do not have value in this type of borrowing process. Lastly, divisional accounting procedures included as a term and condition, plus accounting rules would prevent cross-subsidies between both districts.

- **Reorganization Motivation:** The Rainbow MWD believes that the Fallbrook PUD is in need of additional funds and is pursuing reorganization to tap into Rainbow MWD's assets in order to incur debt. This statement is not supported by evidence. According to the most recent audit statements from both Rainbow MWD and Fallbrook PUD for the fiscal year ending on June 30, 2014, the Rainbow MWD had an excess of operating expenses over operating revenues of \$936,514. Rainbow MWD's total net position decreased by over \$1 million (\$1,045,057). The negative impact on the net financial position is the product of two new long-term notes (Rainbow MWD FY2013-14 audit, page 6). On the other hand, the most recent audit shows that Fallbrook PUD's total net position improved by \$2.4 million in 2013-14 and is attributable the District's investment in capital assets and a decrease in \$2.5 million in its unrestricted net position (Fallbrook PUD FY2013-14 audit, page 6).

- **Status of Consolidation Study:** The Rainbow MWD claims that a 2012 Consolidation Study prepared for the Rainbow MWD and Fallbrook was never adopted by the boards of the respective districts. This fact is correct, but not necessarily relevant. The 2012 Consolidation Study was instead used as a reference document and accepted by the Fallbrook PUD in its Resolution of Application to LAFCO initiating the reorganization in 2014.

- **Soundness of Data:** The data contained in the July 6, 2015 LAFCO staff report was updated six months prior to the July 6, 2015 LAFCO hearing and is now further updated as part of the September 14, 2015 Supplemental Report. To characterize the data contained in the July 6, 2015 and September 14, 2015 staff reports as outdated is not supported by facts.

- **LAFCO Standards:** Providing additional data and analysis beyond what is contained in the September 14th Supplemental Report would not comport with reasonable standards for plans for service or financial plan requirements. The July 6, 2015 and September 14, 2015 LAFCO staff reports accordingly provide sufficient information from which to begin and complete LAFCO deliberations on the possible approval, modification, or disapproval of the proposed reorganization.

- **Special Districts Advisory Committee Concurrence:** On December 19, 2014, LAFCO's Special Districts Advisory Committee concluded that the fundamental issues of operational cost savings and efficiency were valid and Rainbow MWD's objections regarding costs were not substantiated. On December 19th, the Rainbow MWD General Manager stated that the reorganization is financially feasible and the North County JPA resulted in \$570,000 of cost savings. On, August 7, 2015, the Rainbow MWD General Manager provided a different and lower estimate of cost savings (\$420,000). Besides issuing multiple cost savings statements, no reasonable basis was presented by the Rainbow MWD to explain the two different cost savings estimates. These multiple statements appear to be subjective and arbitrary. Due to these types of conflicting statements, Term and Condition No. 18 has been included in the July 6, 2015 LAFCO staff report requiring that the Fallbrook PUD conduct a final review of the finances, infrastructure, staffing, and service commitments of the Rainbow MWD prior to the recordation of the proposed reorganization, prior to recordation.

- **Resolution of Objection:** Rainbow MWD's argument that its Resolution of Objection has merit is belied by the plain language of Government Code Sections 56668.3 (b), and 56857(d)(1) and (2), as well as statements made by the Rainbow MWD. For example, the Rainbow MWD's General Manager stated that the reorganization is financially feasible and the North County JPA resulted in \$570,000 of cost savings. On August 7, 2015, Rainbow MWD General Manager reiterated this cost-savings statement, but downgraded the estimated cost savings figure to \$420,000.

In addition, an examination of the Resolution of Objection filed with LAFCO on July 23, 2014 and the most recent objections made by the Rainbow MWD on August 25, 2015 do not constitute service or financial concerns per provisions in State Law. Per Government Code Section 56668.3(b)] and 56857(d)(1) and (2), the Commission's consideration can only be based on financial or service related concerns as defined in state statute. Per Government Code Section 56857(d)(1), "financial concerns" mean that the proposed uses within the territory proposed to be annexed do not have the capacity to provide sufficient taxes, fees, and charges, including connection fees, if any, to pay for the full cost of providing services, including capital costs. Cost allocation shall be based on general accepted accounting principles and shall be subject to all constitutional and statutory

limitations on the amount of the tax, fee, or charge. Statements made by the Rainbow MWD General Manager are belied by the plain language in the above referenced statutes. Per Government Code Section 56857(d)(2), "service concerns" refer to a district's inability to provide services that are the subject of the application without imposing level of service reductions on existing or planned future uses in the district's current service area. Service concerns do not include a situation when a district has the ability to provide the services or if the services will be available prior to the time that services are required.

The finance, reorganization, and service plan documents submitted by the Fallbrook PUD were reviewed and validated by LAFCO staff as part of the July 6, 2015 and September 14, 2015 staff reports. Rainbow MWD's assertions lack merit because the assertions do not represent valid financial or service related concerns per provisions contained in State Law. Rainbow MWD's August 25, 2015 Supplemental Resolution of Objection also misleadingly referred to a LAFCO action on July 6, 2015 that never occurred. Rainbow MWD refers to direction provided by Commissioner Dianne Jacob citing conflicting information as the basis for "directing" LAFCO staff to prepare a supplemental evaluation. No such direction was ever provided by the Commission. While after the item was continued, Commissioner Jacob suggested that LAFCO staff conduct additional financial research prior to returning on September 14th, no direction as such was provided by the full Commission. Refer to the transcripts of the July 6th meeting posted on LAFCO's website for further documentation.

Rainbow MWD also states that Fallbrook PUD was unable to provide credible back-up documentation to support financial claims. This statement is also incorrect as back-up documentation has been posted on the San Diego LAFCO's website beginning in 2014 (refer to documents under the heading "supplemental documents submitted by Fallbrook PUD"). The Rainbow MWD further states that it has adequately presented financial and service related concerns because it believes that the cost benefits of reorganization are not supported by credible substantial evidence (Resolution of Objection Finding 16). Rainbow MWD also states that Fallbrook PUD has presented flawed analysis (Resolution of Objection Finding 25). These assertions made by Rainbow MWD are neither supported by evidence nor analysis contained in the July 6, 2015 and September 14, 2015 Supplemental staff reports. In particular, refer to the September 14, 2015 Supplemental LAFCO staff report pertaining to finances, assets and liabilities, water rates, and economies of scale for the associated conclusions.

The Rainbow MWD also incorrectly applies Government Code Section 56425(h) as a "finding" that LAFCO must make (Resolution of Objection 28). This provision is a "determination" and not a quasi-judicial "finding". Furthermore, the financial analysis and service plan presented by the Fallbrook PUD has been reviewed, updated, and validated as being feasible and sufficient, thus enabling the Commission to assess the feasibility of governmental reorganization and further the goals of orderly development and efficient and affordable service delivery upon approval of the reorganization. The Commission has additionally provided a wide public dissemination of these determinations and analysis through committee meetings; posting information on its website; and through public hearing notification. The Rainbow MWD also states that the Commission cannot make certain

“findings” that the reorganization will stabilize rates for agricultural and non-agricultural water users (Resolution of Objection Finding 29). Again, Government Code Section 56000 et seq., does not require that such a quasi-judicial finding be made by LAFCO. Furthermore, the financial, service, and rate analysis contained in the July 6, 2015 and September 14, 2015 LAFCO staff reports refute these unsubstantiated assertions made by the Rainbow MWD. LAFCO staff concludes that both the July 23, 2014 and August 25, 2015 Resolutions of Objection lack merit and contain no substantial evidence regarding the presence of financial or service related concerns.

LAFCO’s Special Districts Advisory Committee assisted LAFCO staff review the objections raised by the Rainbow MWD on December 19, 2014 and the committee concluded that the objections do not have merit and unsatisfactorily meet the financial and service criteria specified in Government Code Sections 56668.3(b) and 56857(d).

• **Document Authors and Other Affiliations:** The Rainbow MWD has placed considerable attention on the names of individuals and contractors that prepared the financial projections for the North County JPA. Likewise, the Fallbrook PUD General Manager has stated that 15 individuals who submitted speaker slips at the July 6, 2015 LAFCO meeting were employees or representatives of the Rainbow MWD (e.g., 4 directors; 1 lobbyist; 2 attorneys; 1 union representative; 2 consultants, 3 district appointees; 2 spouses of directors, 1 former director, 1 general manager, 4 employees). The authorship and contractors used to prepare application materials and supporting documents are not pertinent factors for LAFCO consideration. It appears that both the General Managers of the Fallbrook PUD and Rainbow MWD were fully aware of the process and preparation of the Consolidation Study and should have kept their respective boards of directors apprised.

LAFCO staff does not consider the affiliation of the authors of supporting documents or the names of individuals that provide testimony as a valid factor for the Commission to consider. However, both districts should follow applicable laws and regulations regarding utilization of district personnel and taxpayer funds to support political activities.

• **Inflammatory Statements:** A member of the Rainbow MWD board has stated that “...Rainbow is considering hiring a PR Company to encourage public outrage at the hostile takeover situation and the persons and organizations involved...” (Public Comments made to San Diego LAFCO, May 4, 2014). Public relations and political contractors were retained by the Rainbow MWD after this comment was made. Accusations, threats, and defamatory comments, or other acts of intimidation create a potentially hostile environment and should not be permitted by the subject agencies.

• **Salary Comparison:** The validity of the salary comparison conducted by the Fallbrook PUD was disputed by the Rainbow MWD. LAFCO staff obtained the respective salaries and classification data directly from each classification within both districts. Fallbrook PUD’s claim that Rainbow MWD salaries are on average 17 percent higher than the Fallbrook PUD’s salaries was correct in FY 2014-15; however, in recent months the Fallbrook PUD has adopted a new salary plan for its employees and the overall differential is now less than 10 percent.

- **Wage and Salary Detail:** The 2012 Consolidation Study was originally difficult to decipher in terms of calculated salary savings. This issue was rectified in late 2014 and in the July 6, 2015 staff report, and further clarified as part of the research effort for the September 14th Supplemental Report. Sufficient details have been provided in the July 6, 2015 report and the Supplemental Report documenting affected positions and cost saving projections.

- **Direction for Next Service Review:** If the Commission approves the reorganization, it should consider adding a provision requiring that the next Municipal Service Review conducted by LAFCO evaluate how effectively the reorganized district absorbs positions and the associated cost savings attributable within the former boundaries of both districts.

CONCLUSIONS

Based on the updated information, plus the independent evaluation conducted by LAFCO staff, the conclusions and recommendations reached in the July 6, 2015 staff report have been reaffirmed and clarified. In addition, the Commission should consider adding a provision requiring that the next Municipal Service Review conducted by LAFCO evaluate how effectively the reorganized district absorbs positions and the associated cost savings attributable within the former boundaries of both districts. If approved, a reorganization of the Rainbow MWD and Fallbrook PUD sphere and service review and reorganization (as modified) will likely accomplish the following:

- (1) Capture economies of scale and reduce administrative overhead;
- (2) Facilitate equipment and facility sharing;
- (3) Improve emergency response;
- (4) Enhance service coverage;
- (5) Integrate and consolidate duplicate management and staff positions;
- (6) Improve water resource management via use of recycled water;
- (7) Improve the ability of the combined district to utilize local water supplies;
- (8) Withstand and stabilize water rate fluctuations;
- (9) Improve governance and accountability; and
- (10) Strengthen financial capacity of both agencies.

While the proposed reorganization of the Rainbow MWD and the Fallbrook PUD may fit within the various statewide goals contained in the **Growth Within Bounds** report and the legislative priorities of the CKH Act, approval of the reorganization is not automatic. The San Diego LAFCO may disapprove the reorganization. Since the Commission is not required to approve the proposed reorganization, both approval and disapproval language was provided in the recommendations at the end of the July 6, 2015 staff report. If the Commission disapproves the reorganization, then it may cite specific reasons for rejection, or it may concur with any of the following reasons presented by the Rainbow MWD, such as:

- (1) Insufficient financial and service feasibility information;
- (2) Public and subject agency opposition;
- (3) Unresolved voting rights issues;
- (4) Inappropriate method of initiating the reorganization;
- (5) Effect on water rates;
- (6) Capitalization on Rainbow MWD's assets and growth;
- (7) Effect on Rainbow MWD's debt ordinance;
- (8) Irrelevancy of JPA Cost Savings;
- (9) Questionable validity of Reorganization Cost Savings;
- (10) Effect on agriculture; and
- (11) Lack of support from Rainbow MWD employees.

RECOMMENDATIONS

Option 1

For the reasons set forth in the Supplemental Report, plus the independent evaluation conducted by LAFCO staff, the conclusions reached in the July 6, 2015 staff report have been reaffirmed; thus justifying the approval of the Rainbow MWD and Fallbrook PUD sphere and service review and reorganization (as modified). If the Commission decides to approve the proposed reorganization, then it should follow the recommendations contained in the July 6, 2015 LAFCO staff report, plus any other recommendations made at the hearing on September 14, 2015. In addition, the Commission should consider adding a provision requiring that the next Municipal Service Review conducted by LAFCO evaluate how effectively the reorganized district absorbs positions and the associated cost savings attributable within the former boundaries of both districts.

Option 2

While justification exists for approval of the reorganization, there may be multiple interpretations and conclusions regarding certain subjects. Accordingly, the Commission may use its discretionary authority to modify or disapprove the proposed reorganization. If the Commission disapproves the reorganization, then it may cite specific reasons for rejection, or it may concur with any of the reasons presented by the Rainbow MWD. If the Commission decides to disapprove the proposed reorganization, then it should follow the recommendations contained in the July 6, 2015 LAFCO staff report, plus any other recommendations made at the hearing on September 14, 2015. It should also direct the Executive Officer to prepare a Resolution of Disapproval or return at a subsequent meeting for acceptance of the resolution.

Please refer to the following pages for a discussion of the conclusions and recommendations.

DISCUSSION

• Financial Effect on Fallbrook PUD and Water Rates

Rainbow MWD Response: The Rainbow MWD believes that the Consolidation Study depicts the Fallbrook PUD as an agency in need of additional funds. It is suggested by Rainbow that a transfer of funds from Rainbow MWD to Fallbrook PUD is the motivation for the reorganization and will improve Fallbrook PUD's financial condition. Some have speculated that this is one of the motivations for Fallbrook PUD application to LAFCO.

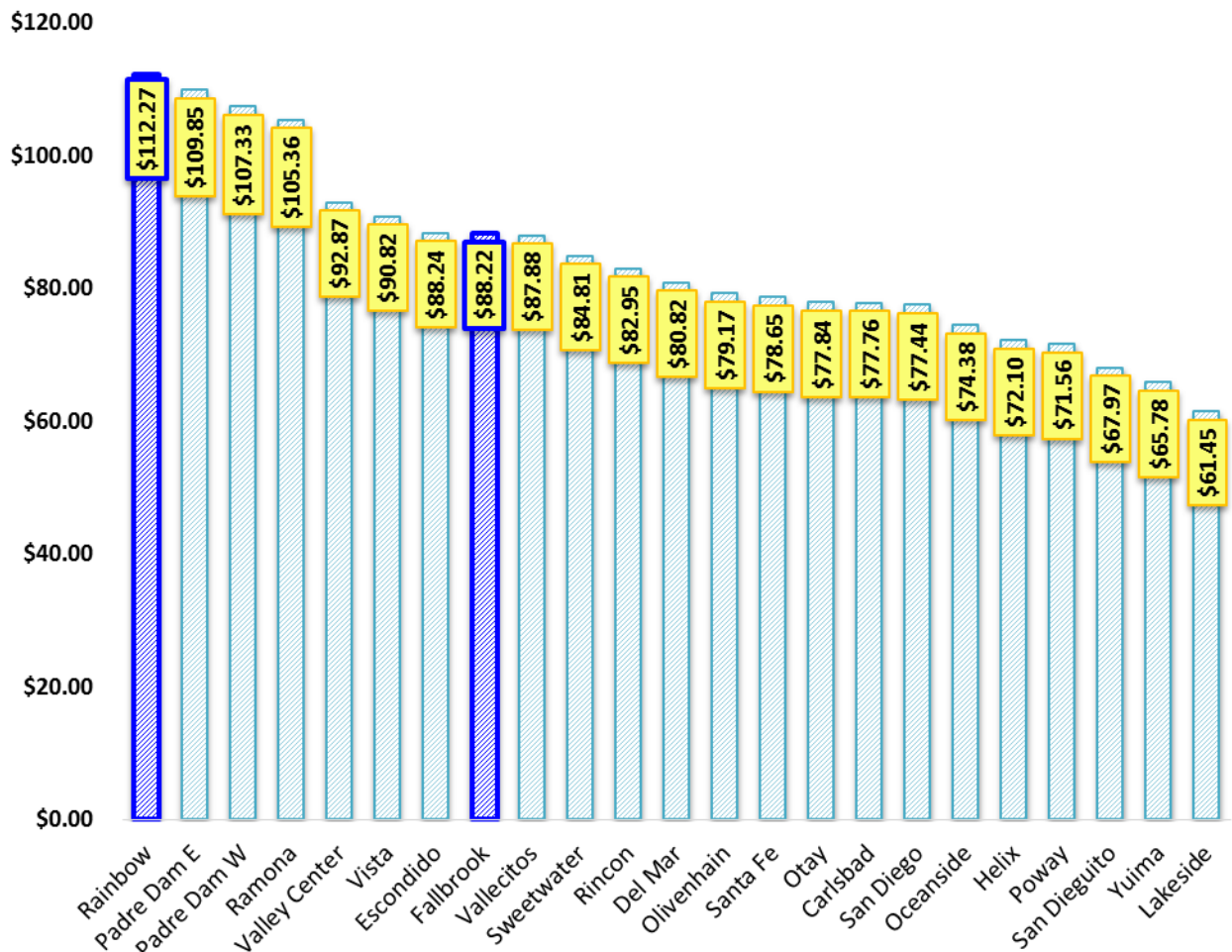
Fallbrook PUD Response: Fallbrook PUD states that non-profit water agencies like Fallbrook PUD and Rainbow set customer rates to collect enough revenue to pay the expenses of providing services. Annual budgetary planning attempts to match revenues with expenses, creating zero "profit" or "loss". The District states that as a practical matter, on a year-to-year basis, agencies do record annual losses or over-collections, which are adjusted in the next year's budget cycle. For the purposes of a common starting point for the 2012 Draft Consolidation Study, the fiscal year 2010-11 audited financial statements for Rainbow and Fallbrook PUD were used as the base period. In that fiscal year Fallbrook PUD recorded a modest negative change in net position ("loss"), while Rainbow recorded a positive change in net position ("profit"). Fallbrook states that if the base period had been developed using either fiscal year 2011-12 or 2013-14, Rainbow would have shown a negative change in net assets and Fallbrook PUD a positive change. Based upon the above, Fallbrook PUD believes there is no structural deficit for either the PUD or MWD; consequently, no transfer of funds would occur.

LAFCO Staff Response: According to the most recent audit statement from both Rainbow MWD and Fallbrook PUD for the fiscal year ending on June 30, 2014, the Rainbow MWD had an excess of operating expenses over operating revenues of \$936,514. Rainbow MWD's total net position decreased by \$1,045,057. According to Rainbow's audit, the negative financial position is the product of two new long-term notes (Rainbow MWD FY2013-14 audit, page 6). In terms of the Fallbrook PUD, the most recent audit shows that Fallbrook PUD's total net position improved by \$2.4 million in 2013-14 and is attributable the District's investment in capital assets and a decrease in \$2.5 million in its unrestricted net position due to paying off of a CalPERS side fund (Fallbrook PUD FY2013-14 audit, page 6).

With respect to water rates charged to customers, Rainbow MWD has claimed that Fallbrook PUD's water rates are excessive and will discourage agricultural production. This contention was researched and appears to be false. Agricultural rates appear to be lower in the Fallbrook PUD than in the Rainbow MWD. Fallbrook PUD's fixed charges (agricultural class) were estimated to be about 20 percent less than in the Rainbow MWD in 2013 at the time the two districts were exploring consolidation. In 2014, the Fallbrook PUD's water rates were about 20.50 percent less than the agricultural water rates in Rainbow MWD. Based on the comparison for all consumption levels, the Fallbrook PUD customer with a 2" meter has a monthly savings of 20 percent -- a range of savings for all meters sizes is 10.5 to 20.5 percent. The Rainbow MWD disputes these figures, but

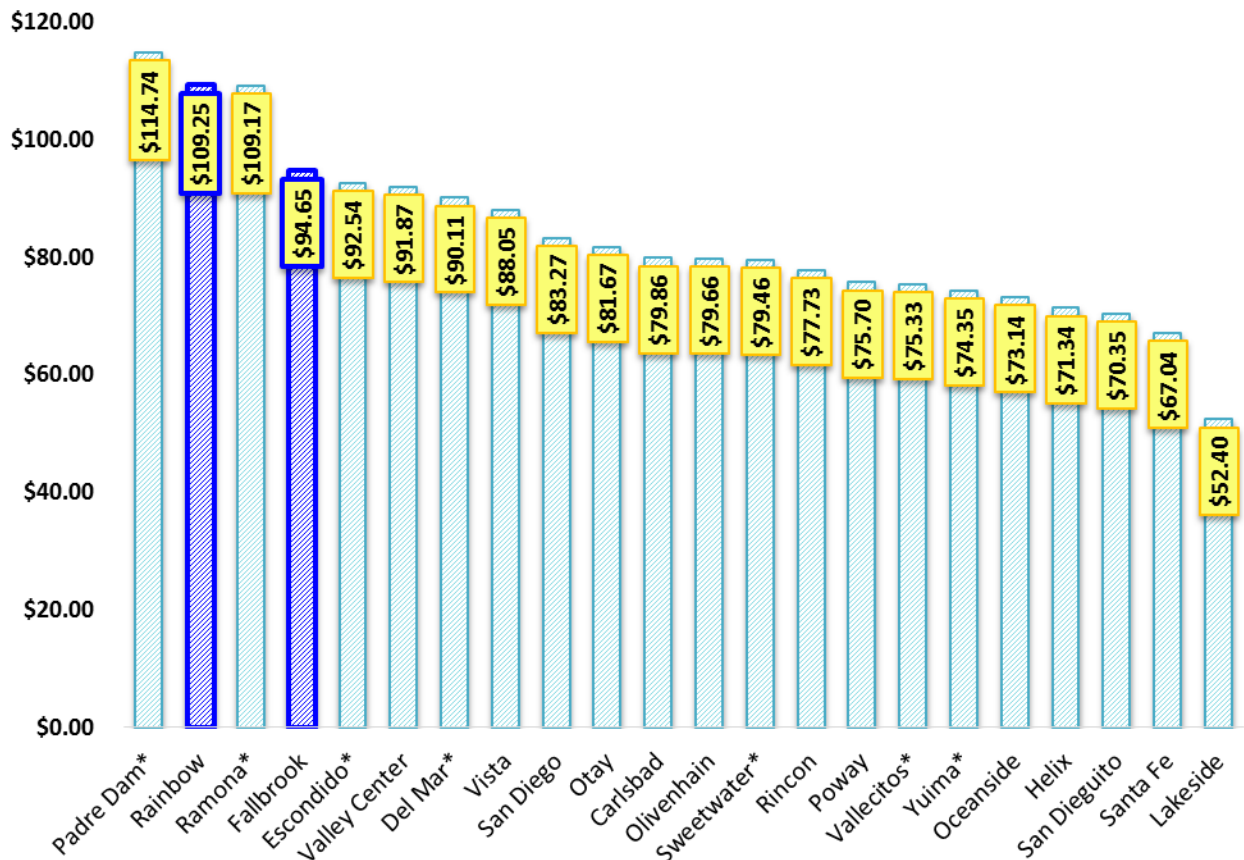
Rainbow MWD’s statements are unsubstantiated by either Rainbow MWD’s budget records or by San Diego County Water Authority documents. In addition, based on two independent water rate surveys conducted in 2014 and 2015, water rates appear to be less in Fallbrook PUD than in Rainbow MWD. There is no factual evidence to support Rainbow MWD’s assertion that the Fallbrook PUD’s water rates are excessive. According to the surveys, the Rainbow MWD had the most expensive water rates in San Diego County in 2014 and the Fallbrook PUD had the eighth most expensive rates in the County (Source: Otay WD, 2014 Water Rate Survey). In 2015, the average monthly water rates in Rainbow MWD were among the second highest in San Diego County and the Fallbrook PUD’s rates were fourth highest (Source: Union – Tribune, Water Rate Survey, April 15, 2015). Below is a depiction of these water rate surveys for 2014 and 2015.

MONTHLY WATER RATE SURVEY 2014*



*14 Units Monthly Water Use and 3/4” Residential Meter Water rates effective January 2014 (Source: Otay WD, 2014 Water Rate Survey)

MONTHLY WATER RATE SURVEY 2015*



*Charges are based on 5/8" meters because 3/4" meters are less common or not offered.
(Source: Union – Tribune, Water Rate Survey, April 15, 2015)

• San Diego CWA Water Rate Increases and the Consolidation Study

Rainbow MWD Response: Rainbow MWD states that the Fallbrook PUD should revise the associated figures in the 2012 Consolidation Study.

Fallbrook PUD Response: The Fallbrook PUD states that the November 14, 2014 updated financial pro formas contain financial model assumptions (Exhibit 11, page 20) based on SDCWA historical trends.

LAFCO Staff Response: The San Diego County Water Authority (CWA) historical trend for the past ten year period is an average of 8.3 percent annual increase for the Total Cost of Treated Water. The more recent five-year average has been 6 percent and the CWA Board approved rate increase for January 1, 2016 is 5.4 percent (Source: SDCWA website data, 2015). However, there are several significant water supply and demand issues currently under consideration by wholesale (MWD and CWA) and retail water agencies that will impact the planning for and analysis of water supply and cost projections. The recent mandatory conservation reductions for each agency will impact water sales and resulting revenues. Contact with the San Diego CWA (David Shank, Financial Planning Manager,

2015) reveals that all projections of water supply and deliveries will be under study and review later this year to update future delivery forecasts and costs. Additionally, many of the local retail water agencies have adopted “pass through” water rates whereby any increase in the CWA rate is automatically passed through to retail customers. Another data point is that the most recent Water Rate and Cost of Service Study found, for Helix Water District, prepared by RAFTELIS Financial Consultants, includes an assumption of SDCWA water rate increases for the next five years of 8 percent per year. The 7 percent projection factor used in the Rainbow MWD and Fallbrook PUD Consolidation Study is within an acceptable range according to LAFCO staff research.

• Basis for increasing "all other revenues" by 3 percent per year in the Consolidation Study

Rainbow MWD Response: Rainbow MWD requests background information on this issue.

Fallbrook PUD Response: The Fallbrook PUD states that the escalation assumption for all other revenues of 3 percent in the Draft Consolidation Study was subsequently reduced to 2% in the November 14, 2014 pro forma updates to be more conservative.

LAFCO Staff Response: The Financial planning assumptions are contained in Exhibit 11, page 20 of “Fallbrook PUD North County JPA Savings Projections, as updated on May 14, 2014 and November 14, 2014. These updated documents have been posted on the San Diego LAFCO’s website for several months. All other revenues are non-operating revenue including: property taxes, availability charges, capital improvement charges, leasing income and interest income. In the recent Helix Water District Rate and Cost of Service Study, the consultant used assumptions of 3 percent for general expenses increases and 5 percent for salaries and benefits for the next five years. The revised projection by Fallbrook PUD using a 2 percent factor is conservative, but if applied across the reorganized agency and within each agency in the comparison, the 2 percent appears to be acceptable for analytical purposes.

• Accuracy of increasing customer rates to match SDCWA rate increases

Rainbow MWD Response: Rainbow MWD believes that this rate increase assumption is inaccurate. Rainbow states that water rates at each agency are based on local financial conditions in addition to the wholesale water costs. While SDCWA costs are the largest component of our operating costs, an increase of a given percentage by SDCWA does not mean that the local agency rates increase by the same amount. Depending on local conditions, the increase could be higher, the same, or lower. Most agencies try to pass through SDCWA rate increases, but since the overall rate charged to the local customer is a combination of SDCWA costs and local costs, an increase in the SDCWA component of the rate represents only a large fraction of the actual rate.

Rainbow MWD states that a situation should be considered where the rate charged to a customer is \$1.00 per unit and it consists of 75 percent SDCWA costs and 25 percent of local costs. Rainbow MWD adds that if SDCWA increases its rate by 5 percent and the local costs stay the same, the impact of that increase on the total local rate is $\$1.00 * (.25 + (.75 * 1.05)) = \1.0375 , not \$1.05 as assumed in the Study. Rainbow MWD states that since

the nature of the cost savings projected by FPU D amounts to a percent or two of the total budgets of each agency, small errors like this can have a big impact on the outcome of the analysis.

Fallbrook PUD Response: The Fallbrook PUD states that the Consolidation Study (and subsequent updates in May 2014 and November 2014) assumed that retail water rates would generally trend with the rise in wholesale rates from the SDCWA. A historic trend of 7 percent was used.

LAFCO Staff Response: The financial planning assumptions are contained in Exhibit 11, page 20 of “Fallbrook PUD North County JPA Savings Projections”, as updated on May 14, 2014 and November 14, 2014. The setting of retail water rates must be based upon costs of service and forecasting of future rates is a function of the projection of all costs and the amount of water expected to be delivered in the studied period, established by the agency Board of Directors. The use of a historical trend of wholesale water costs and for local costs is a reasonable approach to forecasting the relative impact of costs on commodity rates. Due to the recent mandatory conservation requirements and expected continued drought conditions, the use of a 7 percent historical trend seems to be a reasonable assumption.

• **Economies of Scale**

Rainbow MWD Response: Rainbow MWD believes that service impacts will occur as a result of the reduction in the workforce caused by the proposed reorganization and that further evaluation is needed to determine if the workload managed by fewer staff can be accomplished without impacting services.

Fallbrook PUD Response: The Fallbrook PUD states among the key goals of a reorganization is for a more cost-efficient new entity to emerge that can meet service objectives with no decline in service levels, and in a manner that would result in lower overall costs.

LAFCO Staff Response: The objective of the reorganization in the Fallbrook PUD’s application to LAFCO falls within an operational concept referred to as, “Economies of Scale.” Most local agencies and private corporations can benefit from some level of reorganization to establish a more favorable Economy of Scale. Economy of Scale is a term used to describe the reduction in average costs arising from an increase in size of the operating unit. In reviewing eight independent water districts in San Diego County, it can be concluded that combining the Fallbrook PUD and Rainbow MWD would potentially a more favorable Economy of Scale. The Economy of Scale for both districts would improve if an equivalent of 13 positions were eliminated through attrition. Even with a proposed reduction of 13 position equivalents, the combined staffing of both districts would still exceed the staffing per capita amounts for other comparable districts in the County. Without the reorganization, the number of employees serving these two districts would far exceed the average number of employees per capita and most all other efficiency indicators.

While retaining the status quo is a local prerogative and decision for voters and the Commission to make, retaining the status quo may cost taxpayers about \$2,162,947 to \$2,371,449 more per year for getting the same level of service. Below is a summary of some chief characteristics of the Fallbrook PUD, Rainbow MWD, Valley Center MWD, Olivenhain MWD, Padre Dam MWD, Ramona MWD, Santa Fe ID, and Vista ID. Note that the data provided is for water services only. Sewer service was eliminated for comparison purposes, because the Rainbow MWD uses the City of Oceanside's sewer treatment facilities and does not have its own facilities. Sewage is transported to the San Luis Rey Water Pollution Control Facility (WPCF) for treatment and disposal through the Oceanside outfall. The data below was extracted from each district's website on August 17, 2015 and from their 2014 audited financial statements.

Name of Agency	Area SM/ Acres	District Population	No. of Connections	AF Sales	No. of Employees (Water)	Miles Pipe (Water)	Total Revenues
Fallbrook PUD	43.99 SM/ 28,154 AC	35,000	9,170	10,700	59	270	\$33.9 M
Rainbow MWD	79.99 SM/ 51,000 AC	20,000	7,815	20,000	51	320	\$40.6 M
Valley Center MWD	100.2 SM/ 64,153 AC	25,300	10,675	26,000	52	298	\$47.9 M
Olivenhain MWD	48.45 SM/ 30,542 AC	68,000	27,966	23,500	71	430	\$47.9 M
Padre Dam MWD	72 SM/ 46,080 AC	97,100	22,778	15,200	96	389	\$45.8 M
Ramona MWD	75 SM/ 45,800 AC	36,000	9,730	6,500	35	209	\$17.7 M
Santa Fe ID	15.9 SM/ 10,300 AC	19,400	7,200	12,000 AVG	44	155	26.1 M
Vista ID	33.3 SM/ 21,320 AC	124,000	28,272	19,128	82	473	\$49.2 M

• **Validity of Asset and Liability Data in 2012 Consolidation Study**

Rainbow MWD Response: The Rainbow MWD states that according to the LAFCO staff report, Fallbrook PUD's current liabilities are \$37 Million, and Rainbow MWD has a total liability of \$18.2 Million. Rainbow MWD states that the LAFCO staff report incorrectly states that Rainbow MWD would need to take on additional debt due to the Caltrans sewer realignment work along Highway 76. The Rainbow MWD states that the Highway 76 project's costs were much lower than previous estimates and the project was paid from current reserves. The Rainbow MWD's financial consultant (RFC) reviewed the status of liabilities for each District using each agency's FY2014 Audited Financial Statements and determined that the level of debt at Rainbow MWD is much lower than Fallbrook PUD both in terms of total assets and in terms of debt service coverage. Rainbow MWD's debt as a percentage of assets stands at about 17 percent while Fallbrook PUD's is over 28 percent.

If consolidated, Rainbow MWD claims that the new agency would have a debt to asset percentage of 22.5 percent, which is better for FPUD but significantly worse for Rainbow. Rainbow claims that since the end of FY 2014, Fallbrook PUD has taken on significantly more debt. According to the LAFCO staff report this places the total debt at the end of 2015 at \$37 Million. Rainbow MWD's total debt is not changed. When these numbers are used, the Fallbrook PUD's debt as a percentage of assets goes up to 33.6 percent, while Rainbow MWD's stays the same. The consolidated agency would have a debt to asset percentage of 24.2 percent, which Rainbow MWD believes is a massive increase.

Fallbrook PUD Response: The Fallbrook PUD indicated that asset and liability information was provided to the LAFCO staff on July 15, 2015 in the PUD's FY 2014-15 and 2015-16 Budgets. The PUD provided page numbers and document titles for the data, but did not discuss or analyze the data in its response to LAFCO.

LAFCO Staff Response: Rainbow MWD has stated that the MWD is a low-debt, budget conscious district, while Fallbrook PUD has amassed significant debt. In reviewing the most recent audited financial statements from both districts, it can be concluded that this statement is incorrect as both districts have similar debt and asset levels. According to pages 20-22 of the Rainbow MWD FY 2013-14 Financial Audit, Rainbow MWD's total long-term obligations amount to \$21,282,682 (\$17,485,419 principal and \$3,797,263 interest). Expressed as a percentage of total assets, Rainbow MWD's long-term debt in relation to total assets is 18 percent. In 1995, the Rainbow MWD adopted Ordinance No. 95-1. Per this ordinance, whenever Rainbow carries cumulative debt in excess of \$1 million, it cannot incur additional public debt unless additional public debt is first placed on the ballot. The Rainbow MWD's audits and budget documents seem to indicate that the Rainbow MWD should review its financial practices to ensure compliance with Debt Ordinance No. 95-1.

In comparison, according to pages 32-33 of Fallbrook PUD's Financial Audit for FY 2013-14, the Fallbrook PUD had a total liability of \$22,732,736 million. Expressed as a percentage of total assets, Fallbrook PUD's long-term debt in relation to total assets is 20.6 percent. The difference between the two district's debt figures is statistically insignificant.

Another issue raised by the Rainbow MWD pertains to using another district's operating assets as collateral. With respect to this issue, such a practice would be unlikely to occur as both districts borrow most of their construction funds from the State of California. The state requires a pledge of revenues, not assets, to secure loans. Assets do not have value in this type of borrowing process. In addition operating assets (pipes, pumps, reservoirs, trucks and buildings) are considered long-term liabilities because they depreciate, wear out, or become obsolete and need to be replaced. Therefore, they represent future costs, not collateral. Lastly, divisional accounting procedures included as a term and condition, plus accounting rules would prevent cross-subsidies between both districts.

• **Adoption of the 2012-13 Consolidation Study**

Rainbow MWD Response: The Rainbow MWD indicates that the Rainbow Board never considered or approved the Draft District Consolidation Study that was included with the Fallbrook PUD's 2014 application. Rainbow states that the study was a draft staff document but never came to the Rainbow board in a final version for consideration. Rainbow MWD staff also indicate that a review of the Fallbrook PUD meeting minutes from the same time period also did not reveal any evidence that the Fallbrook PUD board considered or adopted the Study.

Fallbrook PUD Response: The Fallbrook PUD states that the October 2012 Draft Consolidation Study was a collaborative effort between the general managers and finance managers of the two districts, with assistance of two outside accounting professional (Forbes and Armstrong). Fallbrook believes the study provided both boards of directors the background and economic data necessary to make the decision to move forward with the formation of the North County Joint Powers Authority (JPA) as an interim step toward a reorganization of the two districts. The Fallbrook PUD Board voted to move forward with the formation of the JPA on February 25, 2013, and the Rainbow Board took a similar action on February 26, 2013.

LAFCO Staff Response: An examination of the Fallbrook PUD's February 25, 2013 minutes (Minute Item O and P) and Rainbow MWD's minutes from February 26, 2013 (Minute Item Nos. 19 and 20) reveal that both districts formed the North County JPA and made respective appointments to the JPA after reviewing a draft JPA agreement. The minutes reference the adoption of a JPA agreement but did not specifically reference the adoption of the Consolidation Study. Rainbow MWD's claim that the Consolidation Study was not adopted by either district is correct; however, the consolidation was referenced and accepted as a source document in the Fallbrook PUD's Resolution of Application to LAFCO. Whether the Consolidation Study was actually adopted or referenced and accepted as a source document does not appear to be a relevant issue raised by the Rainbow MWD. It appears that both the General Managers of the Fallbrook PUD and Rainbow MWD were fully aware of the process and preparation of the Consolidation Study and should have kept their respective board of directors apprised.

• **Completeness of the Fallbrook PUD/Rainbow MWD Consolidation Study**

Rainbow MWD Response: The Rainbow MWD states that the study is incomplete, as the section regarding governing law is blank. Rainbow indicates that this is telling considering that governance was one of the key issues related to the decision by the Rainbow MWD board in deciding to whether to pursue consolidation. Rainbow also adds that the study should also be considered incomplete because it is a draft staff report that was not approved by either agency.

Fallbrook PUD Response: The Fallbrook PUD states that the October 2012 Consolidation Study was a draft document developed to provide enough data with which to base a decision on whether to move forward with consolidation. Fallbrook PUD states that it still remains a draft document and the main purpose of the study is to provide information to form the North County JPA. Fallbrook states that the 11-month long JPA operations produced benefits that significantly exceeded the draft study forecasts, with documented savings of nearly \$1 million.

LAFCO Staff Response: LAFCO staff confirmed that the version of the study provided with the application does not contain a governing law section. The study appears to be focused more on reorganization and consolidation than governance. While it was not a necessity that this section of the study be completed, it would have been helpful if it was. The July 31, 2015 response provided by the Fallbrook PUD does not provide an explanation for this omission of the section; however, LAFCO staff had several meetings with Fallbrook PUD and Rainbow MWD representatives to discuss and understand the varying agency positions on the governance issue.

• **Preparers of Pro Forma Budgets in the Consolidation Study**

Rainbow MWD Response: Rainbow MWD states that while Rainbow's former General Manager, Dave Seymour and former Finance Manager, Gene Buckley participated in the development of the report, nothing in Mr. Buckley's records indicate that he was the author of the pro forma budget presented on page 37 of the Study. Rainbow states that its records do indicate that Fallbrook PUD hired Mr. Phillip Forbes as a consultant to do work on the consolidation study. Rainbow also states that Mr. Forbes subcontracted work to Mr. Jeff Armstrong to do certain financial work. Rainbow adds that both Mr. Forbes and Mr. Armstrong are former colleagues of Mr. Brady from their days working at Rancho California Water District. Rainbow MWD states that the Fallbrook PUD billed Rainbow MWD for a portion of this work.

Fallbrook PUD Response: The Fallbrook PUD states that the October 2012 Draft Consolidation Study was a collaborative effort between the general managers and finance managers of the two districts, with assistance of two outside accounting professional (Forbes and Armstrong). Fallbrook believes the study provided both boards of directors the background and economic data necessary to make the decision to move forward with the formation of the North County JPA as an interim step toward a reorganization of the two districts. The Fallbrook PUD Board voted to move forward with the formation of the JPA on February 25, 2013, and the Rainbow Board took a similar action on February 26, 2013.

LAFCO Staff Response: The authorship and contractors used to prepare application materials and supporting documents is not a pertinent factor for LAFCO consideration. It appears that both the General Managers of the Fallbrook PUD and Rainbow MWD were fully aware of the process and preparation of the Consolidation Study and should have kept their respective board of directors apprised.

• Supporting Documents for Pro Forma Summaries in Consolidation Study

Rainbow MWD Response: The Rainbow MWD states that this information is in the possession of the Fallbrook PUD. Rainbow believes the pro forma budgets provided in the Study represent the basis for the financial savings claimed by Fallbrook PUD in its application. Rainbow further states that its financial consultant (RFC) reviewed the financial claims of the Study and concluded that there is insufficient information to support the conclusion that a consolidation would result in the stated annual savings.

Fallbrook PUD Response: The Fallbrook PUD states the pro forma statements presented on page 37 of the Draft Consolidation Study were updated May 12, 2014, and again six months later (November 14, 2014) based upon the progress achieved during JPA operations phase of the reorganization process. The supporting exhibits and budget assumptions are contained in the 20-page document entitled “Fallbrook PUD North County JPA Savings Projections May 12, 2014”, as updated on November 14, 2014, which has been on the San Diego LAFCO website for the past eight months and was resubmitted as an attachment to Fallbrook’s response.

LAFCO Staff Response: The associated supporting documents have been posted on LAFCO’s website and can be readily downloaded. Rainbow’s assertion is incorrect.

• Financial Impact Associated with Early Retirement

Rainbow MWD Response: The Rainbow MWD indicates that the Consolidation Study contains no information about the positions contemplated for elimination or how close the occupants of those positions are to retirement age. It is difficult or impossible to determine whether early retirements could be a viable option for workforce reduction without this information. Further, Rainbow claims that establishing a system where layoffs fall primarily on older workers could result in age discrimination claims. Finally, should layoffs be compelled through a system of retirement incentives, the magnitude of the cost of these incentives, including the ongoing post-retirement benefit costs, need to be considered in the review.

Fallbrook PUD Response: The Fallbrook PUD states that early retirement options were contemplated in the Consolidation Study and factored into the pro forma financials.

LAFCO Staff Response: Rainbow MWD assertions about early retirement is not correct; therefore, no further response to this issue is necessary. This matter was addressed per the following clarifying language distributed at the July 6, 2015 LAFCO hearing. ~~“After a minimum transition period of two years from the effective date of the reorganization, the Fallbrook PUD shall have the ability to offer early retirement incentives if the reorganization or future events not foreseen in the reorganization process result in duplication of positions~~

~~that countermand the cost effectiveness of the reorganization.~~ For a two-year period from the effective date of the reorganization, no reductions in staff shall occur, with the exception of voluntary resignations and retirements or terminations for cause.

• **Miscellaneous Staffing Updates and Projections**

Rainbow MWD Response: Rainbow MWD states that the pro forma statements in the LAFCO staff report are inaccurate and are inappropriate for providing a complete picture of the situation to the Commission. Rainbow MWD believes the basis for the cost assumptions is unsupported by facts and the projections into the future should provide a high/low estimate of costs and savings rather than a single number.

Fallbrook PUD Response: Fallbrook PUD states that the July 6, 2015 LAFCO staff report is based upon up-to-date financial analysis as of November 14, 2014. The analysis to determine the net annual benefit of merging the two districts used a “with and without” approach. Pro forma financial statements forecasting a five-year period were prepared for each district as stand-alone operations and another forecast of a merged operation. The data from this analysis show two principal drivers which create the net benefits: (1) Personnel reductions (wage and benefits savings); and (2) Other cost savings. Fallbrook states that the total number of staff reductions planned for in the reorganization is a net of 16 (after adjusting for positions already eliminated during the JPA operations phase from April 2013 to March 2014).

Current Fallbrook PUD salaries and benefits, by position, were submitted to LAFCO staff on July 15, 2014, and are shown on LAFCO’s website as “FPUD 13-14 and 14-15 Staffing by Department Number.” To calculate wage and benefit savings for a reduction in 16 positions, Fallbrook PUD actual salaries were utilized, except for the general manager and district engineer positions (which used Rainbow’s salary numbers). Using Fallbrook PUD salaries provides a more conservative savings estimate, given that Fallbrook PUD salaries for equivalent positions are lower than Rainbow, except for general manager and district engineer. Using the salary and benefit information as described above and applying a 2 percent July 1, 2015 COLA adjustment yields a \$2,415,258 annual wage and benefit savings from the planned reduction of 16 positions. Other annual cost savings with the reorganization are estimated to be between \$170,000 (worst case) and \$300,000 (most likely case). Based upon the above, current annual savings from the proposed reorganization are forecasted to be between \$2,585,258 and \$2,715,258.

LAFCO Staff Response: This issue was addressed in late 2014 and then as a part of the research effort associated with the September 14th Supplemental Report. Sufficient details were provided documenting affected positions and cost saving projections. However, the Fallbrook PUD projects that total calculated annual cost savings derived from a possible reorganization with the Rainbow MWD will total approximately \$2,715,258. This estimate includes a salaries and benefits savings of \$2,415,258 and miscellaneous other savings of \$300,000.

LAFCO staff reviewed these calculations and believes the cost savings may be somewhat lower. LAFCO staff estimates that the cost savings may range from a low of \$2,162,947 to \$2,371,449 (wage and benefit savings). The more conservative calculation takes into account the input from the Rainbow MWD regarding the need to retain two Systems and Electrical Pump Maintenance positions. This lower total also excludes the miscellaneous savings projected by the Fallbrook PUD and also bases the wage and salary savings on the mid-point of salaries. LAFCO staff eliminated the miscellaneous savings because the estimates are highly generalized and may actually be higher or lower. Below is a recalculation of estimated salaries and benefits savings, based on the conservative methodology utilized by LAFCO staff. *Note that the savings may be about \$208,502 lower if the two Systems and Electrical Pump Maintenance positions are retained.*

Recalculated Cost Savings Summary		
Reorganization Savings	Duplicate	2015-16 FPUD
<u>Duplicate RMWD Position*</u>	<u>FPUD Position</u>	<u>Total Compensation</u>
FINANCE MANAGER	ADMINISTRATIVE SERVICES MGR/TREAS.	\$ 201,335.00
HR MANAGER	HR ADMINISTRATOR	\$ 201,335.00
EXECUTIVE ASSISTANT	SECRETARY	\$ 120,869.00
SAFETY ADMINISTRATOR	SAFETY & RISK ADMINISTRATOR	\$ 94,412.00
CHIEF WATER SYSTEM OPERATOR	WATER OPERATIONS SUPERINTENDENT	\$ 157,278.00
IT TECHNICIAN	GIS TECHNICIAN	\$ 125,007.00
WASTEWATER SUPERINTENDENT	FIELD SUPERVISOR, COLLECTIONS	\$ 142,488.00
ELECTRICIAN	ELECTRONIC TECHNICIAN	\$ 104,226.00
OPERATION & MAINTENANCE MGR	AGM CONSTRUCTION & MAINT	\$ 201,335.00
DISTRICT ENGINEER*		\$ 211,523.00
GENERAL MANAGER**		\$ 290,005.00
ADMINISTRATIVE ASST	ADMIN OFFICE SPECIALIST	\$ 89,871.00
CREW LEADER	UTILITY TECH	\$ 115,040.00
SYSTEM OPERATOR	SYSTEM OPERATOR	\$ 104,276.00
CUSTOMER SERVICE REP	CUSTOMER SERVICE REP	\$ 85,547.00
	DROUGHT MGMT COORDINATOR	\$ 80,403.32
Subtotal		\$ 2,324,950.32
2% COLA		\$ 46,499.01
TOTAL		\$ 2,371,449.33

*=mid range of RMWD salary eff 8/15/14 + 2% COLA +45% benefits

• **Positions Fallbrook PUD is Proposing to Eliminate**

Rainbow MWD Response: Rainbow MWD states that this is an area of responsibility for the Fallbrook PUD to discuss. The Rainbow MWD is very interested in reviewing this response and has requested an opportunity to comment further on the PUD's response prior to the LAFCO hearing.

Fallbrook PUD Response: The Fallbrook PUD states the reorganized district will initially have 11 duplicate management and administrative positions:

- General Manager/General Manager*
- Finance Manager/Administrative Services Manager*
- HR Manager/HR Administrator*
- Executive Assistant/Board Secretary*
- Safety Administrator/Safety & Risk Administrator*
- Chief Water System Operator/Water Operations Superintendent*
- IT Technician/IS Technician*
- Waste Water Superintendent/Field Supervisor, Collections*
- Electrician/Electronic Technician*
- Operation & Maintenance Manager/AGM Construction & Maintenance*
- District Engineer/AGM Operations & Engineering*

Of the 22 individuals represented by the 11 positions above, within the two districts, the Fallbrook PUD reports that one-half are currently eligible for retirement. In addition, over a 2-3 year period, the following additional reductions are planned based upon economies of scale and improvements in use of technology:

- Administrative Assistants reduced from 3 to 2*
- Crew Leaders reduced from 9 to 8*
- System Operators reduced from 9 to 8*
- Customer Service Staff reduced from 8 to 7*
- Drought Coordinator eliminated*

The total number of positions described above is 16. According to the original 2012 Draft Consolidation Study, it was estimated that there would be a 20 position reduction. During the JPA operational phase, from April 2013 to March 2014, four positions were vacated and not replaced:

- AGM/Chief Engineer (RMWD)*
- CAD/CAM Technician (RMWD)*
- Utility Worker (FPUD)*
- Welding Technician (FPUD)*

LAFCO Staff Response: Based upon the original and supplemental information provided by the subject agencies, the number of positions proposed for elimination through attrition is generally consistent with the original estimates and is validated by associated source documents. We believe the calculations made by the Fallbrook PUD are also generally

accurate, but may overstate savings by about \$43,908 annually. LAFCO used a more conservative approach in estimating cost savings by including the mid-point of all positions in the projections. We accordingly arrived at a slightly lower cost saving amount of \$2,162,947 to \$2,371,449 annually, compared to \$2,415,257 projected by the Fallbrook PUD. Again, this \$43,908 to \$252,310 variance is attributed to LAFCO staff's methodology of using a more conservative hypothetical mid-point for projection purposes, based on Rainbow MWD's salary structure, as opposed to the method used by Fallbrook PUD, and to provide alternative to reducing the number of eliminated positions by two field personnel. The difference between the two projections is statistically insignificant. If the Commission approves the reorganization, it may want to consider adding a provision requiring that the next Municipal Service Review that is conducted address how the reorganized district absorbs the eliminated positions and the associated cost saving attributable to the former boundaries of the Rainbow MWD and Fallbrook PUD.

• **Service and Financial Impact Associated with Layoff of 20 Positions Layoff Moratorium**

Rainbow MWD Response: The Rainbow MWD believes that the monetary savings outlined in the Consolidation Study are impossible to justify, and the moratorium on layoffs defers any savings for several years. The Rainbow MWD believes the Fallbrook PUD proposal does not indicate which positions would be eliminated or which employees are nearing retirement age; therefore, the MWD believes it is not possible to determine the exact capability of the successor agency to effectively achieve staff reductions of the magnitude proposed. Further, there are union contracts that limit the ability of both agencies to arbitrarily cut positions without proper justification. The Rainbow MWD states there is insufficient justification to withstand a challenge by labor groups if and when employees are laid off.

Fallbrook PUD Response: The Fallbrook PUD states the Consolidation Study did not recommend any layoffs of personnel. Staffing reductions would be accomplished by voluntary attrition over a projected three-year period. Thirty-one individuals (26 percent) within the combined districts' ranks are currently eligible for retirement. Therefore, there is no inconsistency between the proposed LAFCO order and the business plan anticipated for the reorganization.

LAFCO Staff Response: Rainbow MWD assertions about layoffs of personnel are not correct; therefore, no further response to this issue is necessary.

• **Positions Added, eliminated, or Impacted by Reorganization**

Rainbow MWD Response: The Rainbow MWD reports that it has reduced its filled position workforce from 55 in 2011-2012 to a budgeted total of 51 for FY 2015-16. Four of the budgeted positions for Full Organizational charts were provided in our July 15th submittal. One Wastewater/Projects Superintendent position was eliminated due to a retirement; one Cross Connection Control Technician position was combined with a Water Quality Specialist position; one System Operator position was eliminated due to a retirement; one Associate/Assistant Engineer position was eliminated due to a vacancy. The Rainbow

MWD notes that as development activity increases, the need for this position may be re-evaluated.

The Rainbow MWD also notes that the Fallbrook PUD Board adopted a new Memorandum of Understanding for their employees, and as part of that action they increased the salary scale for their employees. Rainbow MWD states that the impetus for the increase was to coincide with a market survey of 13 other water agencies. The Rainbow MWD also disputes a claim that the Fallbrook PUD's salaries are lower than Rainbow MWDs based on a salary survey that was performed by Fallbrook PUD.

Rainbow MWD asks LAFCO to investigate the nature of the increase in Fallbrook PUD salary scales in their new MOU and whether the "market survey" is the same one used to claim that Rainbow MWD salaries are 17 percent higher than Fallbrook PUD's. The Rainbow MWD provided a copy of news article supporting their claims.

Fallbrook PUD Response: The Fallbrook PUD provided staffing data separately for FY 2013-14, 2014-15, and 2015-16 as follows:

- 2013-14: Fallbrook PUD eliminated one Welding Technician position after incumbent retired. Fallbrook reports that analysis revealed that there was no need for a stand-alone Welding Technician, and the associated welding duties were incorporated into existing Utility Worker and Utility Tech positions.
- 2014-15: Fallbrook did not fill an Operations Manager position after the incumbent retired; the position is being retained as an open position; one Accountant (lead) position was eliminated; one Accounting Supervisor was added with responsibility for Accounting/Customer Service Assistant, Customer Service Specialist, and Customer Service Representatives; one Utility Worker in the System Service Department was eliminated; one Plant Operator position was eliminated; one Mechanical Technician position was added to provide specific mechanical responsibilities for the rehabilitated wastewater treatment plant. Fallbrook PUD reports that it has "added" flexibility to the number of Customer Service Specialists and Customer Service Representatives for retention purposes, and "budgeted" for the unfilled position of Drought Management Coordinator.
- 2015-16: One Drought Management Coordinator position was filled.

LAFCO Staff Response: A review of the positions included in the Fallbrook PUD salary survey confirms the accuracy of the position salary comparison. At the time the Fallbrook PUD prepared the survey, Rainbow MWD salaries were about 17 percent higher than Fallbrook's; however, with the recently adopted Fallbrook salary schedule for FY 2015-16, that amount is appears to be less than 10 percent. As far as investigating the nature of the increase in Fallbrook PUD salary scales in their new MOU, and whether the "market survey" is the same one used to claim that Rainbow MWD salaries are more than Fallbrook PUD's, are not germane areas for LAFCO to investigate with respect to the proposed reorganization.

- **Staffing Change Impacts on Service Reliability and Provision**

Rainbow MWD Response: Rainbow MWD has reviewed the available information and finds that the level of cuts contemplated by the Fallbrook PUD proposal is not feasible without degrading service levels to its ratepayers. While cuts to certain administrative positions could be possible, the magnitude of the cuts proposed by FPUD will include about a dozen field personnel. Rainbow MWD states it runs very lean in its operations with no room for cuts of this magnitude without negative impacts on service provision.

Rainbow MWD asked Raftelis Financial Consultants (RFC), to review the Study and provide a report. On the topic of service provision, the RFC report concluded that "*...it is unlikely that staffing reductions could take place within the RMWD portion of the consolidated organization without compromising service levels.*"

Fallbrook PUD Response: The Fallbrook MWD reports that reductions in service personnel (i.e., customer service representatives, utility field workers, system operators, wastewater plant operators, and maintenance personnel) total only three of 85 positions as a result of the reorganization. These small staff reductions are more than offset by increased efficiencies produced by combining work groups and increasing service back-up support, particularly in "on-call" after-hour staffing. Consequently, service levels after the reorganization are expected to remain high, with opportunities for further improvement.

LAFCO Staff Response: The Rainbow MWD's assertions regarding service reliability and provision are subjective and inconclusive. While eliminating or restructuring personnel positions may have impacts on duties of specific personnel, the fact that both Fallbrook PUD and Rainbow MWD have reduced budgeted and filled positions over the past three years as part of the JPA effort, continuation of reviewing and adjusting responsibilities within both organizations should provide benefits.

- **Basis for Conclusions in Pro Forma Summary Table in Consolidation Study**

Rainbow MWD Response: The Rainbow MWD requests background information on the pro forma information.

Fallbrook PUD Response: The Fallbrook PUD states that in response to questions raised by board members of both districts, an analysis was included in the Draft Consolidation Study forecasting the impact on the future merged district's water rates if all the consolidation savings were to be applied to rate stabilization. The analysis showed a significant dampening of the year-over-year retail rate increases caused by imported water price hikes.

LAFCO Staff Response: The response from the Fallbrook PUD responds to the question and issue.

• **Consolidation Cost Savings Figures Should Provide High to Low Estimate**

Rainbow MWD Response: Rainbow MWD feels that it is important for the applicant to provide realistic projections for the Commission to consider. When presenting future outcomes using a range of assumptions, Rainbow believes it is not possible to predict any one exact outcome - yet that is what the Study does. When projecting costs forward, Rainbow indicates that SDCWA never gives a single value for future costs -they give a high and low range of values because it is impossible to know exactly what future costs will be. The difference between the high and low values increases the further in the future the estimate is made because uncertainty increases with time.

In a consolidation such as this, Rainbow MWD states that there are a number of factors that could influence the relative cost savings including, but not limited to:

- Actual costs to compel 20 people into retirement
- Loss of productivity due to staff morale
- Costs associated with Union grievances or claims
- Costs associated with retraining employees to work in other positions
- Board dysfunction that could result in financial impacts
- Excessive staff time to administer changes in regulations
- Costs associated with public outreach related to reorganization
- Costs associated with litigation, elections, etc.
- Potential citizen litigation related to Ordinance No. 95-1

Rainbow MWD states that cost projections should include a best case scenario as presented by Fallbrook PUD in the Study, as well as a worst case scenario. Rainbow MWD feels that when the best case savings are accurately portrayed (at a level well below what the Study projects), the potential worst case scenario could consume all savings and result in a net negative impact to the ratepayers. Rainbow adds that any cost cutting proposal which is based on cutting large numbers of jobs must, as a condition of being valid, include a detailed analysis of the service level impact of those job cuts.

Fallbrook PUD Response: The Fallbrook PUD states that the cost savings developed in the Consolidation Study were based upon a worst-case scenario. The general managers in fall 2012 (Brady and Seymour) estimated that the ongoing annual savings could reasonably reach \$3.5 million. However, to account for uncertainties in sustaining customer service levels in relation to taking advantage of additional economies of scale, only a small number of service-level positions were eliminated. That is why non-management and non-administrative reductions in personnel are projected to be only three out of 85 positions (3.5 percent).

LAFCO Staff Response: The response by the Fallbrook PUD adequately responds to the issues raised by the Rainbow MWD. No further response is necessary.

- **Relevance of Showing Number of Employees Per Water Account**

Rainbow MWD Response: Rainbow MWD believes this is a flawed analysis and deflects attention from the real world conditions. Rainbow believes a recitation of the number of employees per account ignores many realities associated with the actual operation of a water system. Rainbow MWD feels that having the same number of employees per meter does not mean that two agencies are equally efficient. Rainbow states there are many other factors that come into play with regard to how many employees it takes to manage a given system. Rainbow's consultant, RFC concluded that "...RMWD's operational characteristics are superior to those of FPUD as indicated by the number of connections served by each employee, miles of pipe per employee, and connections per square mile per employee."

Fallbrook PUD Response: The Fallbrook PUD states that the Customer Accounts per Employee (expressed as: total number of customer accounts/total number of employees) is a common metric in the water utility industry used to measure overall organizational efficiency.

LAFCO Staff Response: The use of comparison of the number of customer accounts per number of employees is a common metric utilized in the municipal water utility industry as well as other comparative factors as pointed out by both agencies' comments. The overarching factor is that each agency is somewhat unique by its topography, age of systems as constructed and maintained, density of customer location, miles of pipeline, number of pump stations and storage reservoirs and volume of water stored and delivered. The relative comparison of accounts per employee indicates one function of service delivery and potential contacts for field and/or administrative functions but it is only one point of comparison. Rural and highly agricultural water agencies such as Fallbrook PUD and Rainbow MWD have differing characteristics from more suburban and urban agencies with more density. These factors may influence how services are provided and organization of staff more than just the number of connections, per se. The response by the Fallbrook PUD adequately responds to the issues raised by the Rainbow MWD.

- **Quantification Other Potential Reorganization Benefits**

Rainbow MWD Response: The Rainbow MWD states there is no detail regarding these miscellaneous cost savings and that a detailed analysis would need to be done to estimate the actual costs of the consolidation.

Fallbrook PUD Response: The Fallbrook PUD provided a summary of the following from page 40 of the Consolidation Study.

<u>Cost Reduction Opportunities</u>	<u>Annual Savings</u>
<i>Reduced property and liability insurance–JPIA</i>	<i>\$20,000-\$30,000</i>
<i>Reduced vehicle fleet –heavy/specialty equipment</i>	<i>\$30,000-\$50,000</i>
<i>Reduced information technology costs.....</i>	<i>\$10,000-\$15,000</i>
<i>Banking service fee reduction</i>	<i>\$10,000-\$15,000</i>
<i>Internal training opportunities</i>	<i>\$5,000-\$10,000</i>
<i>One general counsel.</i>	<i>\$50,000-\$100,000</i>
<i>One Board of Directors.....</i>	<i>\$5,000--\$10,000</i>
<i>Combined outsource billing savings</i>	<i>\$5,000-\$10,000</i>
<i>Audit costs.....</i>	<i>\$10,000-\$20,000</i>
<i>Eliminating one office location</i>	<i>\$25,000-\$40,000</i>
<i>Optimize operations –pumping/storage facilities (capital & operating)</i>	<i>TBD</i>
<i>Potential to reduce more costly outsourcing.....</i>	<i>TBD</i>
<i>Potential to outsource existing internal functions performed by staff.....</i>	<i>TBD</i>

The upper range (totaling \$300,000) is considered very conservative and does not include a variety of smaller annual savings (e.g., association memberships, licensing fees, software costs, and so forth).

LAFCO Staff Response: The response by the Fallbrook PUD responds to the questions and issues raised by the Rainbow MWD; however, the basis for the savings has not been documented and therefore will be eliminated from the total estimated cost savings projected by LAFCO staff.

• Status of Rainbow General Manager After Reorganization

Rainbow MWD Response: Rainbow MWD requests the Fallbrook PUD to respond to whether a percentage of the Rainbow GM's salary be reallocated to the Rainbow MWD side of the accounting system. Conversely, Rainbow MWD questions whether any other Fallbrook PUD administrative staff/managers will take on additional leadership roles?

Fallbrook PUD Response: The Fallbrook PUD believes the Rainbow MWD question is unintelligible. When the Rainbow GM position is eliminated, the budget costs associated with his position are also eliminated. There will be no need to allocate the associated costs to the Rainbow division. The reorganized Fallbrook PUD management team (including former Rainbow management) will allocate their time to either the Fallbrook Division or the Rainbow Division, as appropriate.

LAFCO Staff Response: The response by the Fallbrook PUD adequately responds to the questions and issues raised by the Rainbow MWD. No further response is necessary.

• Cost Apportionment in Relation to Positions

Rainbow MWD Response: Rainbow MWD believes there are many ways to apportion costs but the 2012 Consolidation Study fails to mention any.

Fallbrook PUD Response: The Fallbrook PUD believes the Rainbow MWD question is answered on page 40 of the Consolidation Study regarding divisional accounting.

LAFCO Staff Response: The response by the Fallbrook PUD responds to the questions and issues raised by the Rainbow MWD.

• **Adopted Service Level Standards**

Rainbow MWD Response: Rainbow MWD indicates that it does not have specifically adopted service level standards outside of its after-hours standby crews. Rainbow's adopted standard for response in after-hours situations is that the employee must respond to the District boundary within 30 minutes of notification and no longer than one-hour to the incident site. During normal daily operations, high priority calls are handled as soon as possible according to Rainbow MWD, and high priority calls involve leak reports, customers out of water, or calls on possible sewer backups. Rainbow MWD states that normally, it can dispatch an employee to check on these high priority calls immediately as they will drop what they are doing and respond. Depending on the frequency of such calls, the backlogs of day to day work increase as lower priority work is set aside. Rainbow MWD has a significant backlog of lower priority work that has been deferred. Examples of this work includes meter box clearing and adjustment, locating valves that are buried, adjusting and repairing guard posts around hydrants and other facilities, and many others.

Fallbrook PUD Response: Fallbrook PUD states the following protocol for customer service emergencies and customer service calls:

Customer Service protocol for emergencies and customer service calls

- *District Wide Emergency:* Immediately notify and Call in the following order: General Manager; Assistant General Manager; Safety & Risk Administrator; Administrative Services Manager/Treasurer.

Customer Service Calls

- Immediately notify Collection Systems and call Collections in the following order: Foreman; Utility Technician; Utility Technician; Fallbrook Standby Phone.
- Emergency and no department response, Assistant General Manager.

Department 4, Construction Operations

- Call Construction Operations in the following order: Foreman; Utility Technician; Utility Technician; Fallbrook Standby Phone.
- Emergency and no department response, Assistant General Manager; If not an emergency, leave a voice mail on the Fallbrook Standby Phone with a brief description of the service order.

Department 5, System Service

- Call System Service Operations in the following order: Foreman; Utility Technician; Fallbrook Standby Phone.
- Emergency and no department response, Assistant General Manager; If not an emergency, leave a voice mail on the Fallbrook Standby Phone with a brief description of the service order.

Department 6, System Operations

- Call System Operations in the following order: Chief Systems Operator; Lead System Operator; Fallbrook Standby Phone.
- Emergency and no department response, Assistant General Manager; if not an emergency, leave a voice mail on the Fallbrook Standby Phone with a brief description of the service order.

Department 8, Wastewater Plant Operations

- Call Wastewater Plant Operations in the following order: Chief Plant Operator; Lead Plant Operator; Fallbrook Standby Phone.
- Emergency and no department response, Assistant General Manager; if not an emergency, leave a voice mail on the Fallbrook Standby Phone with a brief description of the service order.

Answering Service after hours calls are always transferred to departmental "On-Call" personnel:

"On-Call" shall mean that time in a workweek other than the scheduled work hours, during which an employee is required to be able to be contacted by telephone and be able to report to the District office building within forty-five (45) minutes.

Customer service calls of all types during regular work day hours are responded to within 30 minutes unless a system emergency has been declared.

LAFCO Staff Response: The responses are noted.

• **Rainbow MWD Resolution of Objection**

Rainbow MWD Response: On July 23, 2014, the Rainbow MWD filed with LAFCO a Resolution of Objection to the proposed reorganization. The objections encompassed the following: (1) Notice and hearing requirements; (2) Affected Agency Initiation Provisions; (3) Relevancy of water rate comparison; (4) Capitalizing on Rainbow MWD's Assets and Growth; (5) Status of Rainbow MWD's Ordinance No. 95-1; (6) Debt of Rainbow MWD and Fallbrook PUD; (7) Relevancy of JPA Cost Savings; (8) Validity of reorganization cost savings; (9) Effect on Agriculture; (10) Governance and California Voting Rights Act; (11) Rainbow MWD's Position on JPA and Governance; (12) Election Provisions; (13) Payment of Election Costs; (14) Rainbow MWD staff objections; (15) Respecting the JPA contractual process; and (16) Proposition 218 notification. On August 25, 2015, the Rainbow MWD submitted a supplemental Resolution of Objection addressing the July 6, 2015 LAFCO meeting; status and completeness of the financial and service analysis presented by the Fallbrook PUD; cost benefits of reorganization; satisfaction of provisions in Government Code Section 564235(h); and impact on water rates and employees.

Fallbrook PUD Response: The Fallbrook PUD states that the objections lack merit because they do not raise service or financial concerns per the definition of these terms in State statute.

LAFCO Staff Response: Rainbow MWD's argument that its Resolution of Objection has merit is belied by the plain language of Government Code Sections 56668.3 (b), and 56857(d)(1) and (2), as well as statements made by the Rainbow MWD. For example, the Rainbow MWD's General Manager stated that the reorganization is financially feasible and the North County JPA resulted in \$570,000 of cost savings. On August 7, 2015, Rainbow MWD General Manager reiterated this cost-savings statement, but downgraded the estimated cost savings figure to \$420,000.

In addition, an examination of the Resolution of Objection filed with LAFCO on July 23, 2014 and the most recent objections made by the Rainbow MWD on August 25, 2015 do not constitute service or financial concerns per provisions in State Law. Per Government Code Section 56668.3(b)] and 56857(d)(1) and (2), the Commission's consideration can only be based on financial or service related concerns as defined in state statute. Per Government Code Section 56857(d)(1), "financial concerns" mean that the proposed uses within the territory proposed to be annexed do not have the capacity to provide sufficient taxes, fees, and charges, including connection fees, if any, to pay for the full cost of providing services, including capital costs. Cost allocation shall be based on general accepted accounting principles and shall be subject to all constitutional and statutory limitations on the amount of the tax, fee, or charge. Statements made by the Rainbow MWD General Manager are belied by the plain language in the above referenced statutes. Per Government Code Section 56857(d)(2), "service concerns" refer to a district's inability to provide services that are the subject of the application without imposing level of service reductions on existing or planned future uses in the district's current service area. Service concerns do not include a situation when a district has the ability to provide the services or if the services will be available prior to the time that services are required.

The finance, reorganization, and service plan documents submitted by the Fallbrook PUD were reviewed and validated by LAFCO staff as part of the July 6, 2015 and September 14, 2015 staff reports. Rainbow MWD's assertions lack merit because the assertions do not represent valid financial or service related concerns per provisions contained in State Law. Rainbow MWD's August 25, 2015 Supplemental Resolution of Objection also misleadingly referred to a LAFCO action on July 6, 2015 that never occurred. Rainbow MWD refers to direction provided by Commissioner Dianne Jacob citing conflicting information as the basis for "directing" LAFCO staff to prepare a supplemental evaluation. No such direction was ever provided by the Commission. While after the item was continued, Commissioner Jacob suggested that LAFCO staff conduct additional financial research prior to returning on September 14th, no direction as such was provided by the full Commission. Refer to the transcripts of the July 6th meeting posted on LAFCO's website for further documentation.

Rainbow MWD also states that Fallbrook PUD was unable to provide credible back-up documentation to support financial claims. This statement is also incorrect as back-up documentation has been posted on the San Diego LAFCO's website beginning in 2014

(refer to documents under the heading “supplemental documents submitted by Fallbrook PUD”). The Rainbow MWD further states that it has adequately presented financial and service related concerns because it believes that the cost benefits of reorganization are not supported by credible substantial evidence (Resolution of Objection Finding 16). Rainbow MWD also states that Fallbrook PUD has presented flawed analysis (Resolution of Objection Finding 25). These assertions made by Rainbow MWD are neither supported by evidence nor analysis contained in the July 6, 2015 and September 14, 2015 Supplemental staff reports. In particular, refer to the September 14, 2015 Supplemental LAFCO staff report pertaining to finances, assets and liabilities, water rates, and economies of scale for the associated conclusions.

The Rainbow MWD also incorrectly applies Government Code Section 56425(h) as a “finding” that LAFCO must make (Resolution of Objection 28). This provision is a “determination” and not a quasi-judicial “finding”. Furthermore, the financial analysis and service plan presented by the Fallbrook PUD has been reviewed, updated, and validated as being feasible and sufficient, thus enabling the Commission to assess the feasibility of governmental reorganization and further the goals of orderly development and efficient and affordable service delivery upon approval of the reorganization. The Commission has additionally provided a wide public dissemination of these determinations and analysis through committee meetings; posting information on its website; and through public hearing notification. The Rainbow MWD also states that the Commission cannot make certain “findings” that the reorganization will stabilize rates for agricultural and non-agricultural water users (Resolution of Objection Finding 29). Again, Government Code Section 56000 et seq., does not require that such a quasi-judicial finding be made by LAFCO. Furthermore, the financial, service, and rate analysis contained in the July 6, 2015 and September 14, 2015 LAFCO staff reports refute these unsubstantiated assertions made by the Rainbow MWD. LAFCO staff concludes that both the July 23, 2014 and August 25, 2015 Resolutions of Objection lack merit and contain no substantial evidence regarding the presence of financial or service related concerns.

LAFCO’s Special Districts Advisory Committee assisted LAFCO staff review the objections raised by the Rainbow MWD on December 19, 2015 and the committee concluded that the objections do not have merit and unsatisfactorily meet the financial and service criteria specified in Government Code Sections 56668.3(b) and 56857(d).

CONCLUSION AND RECOMMENDATION

Option 1

Based on the updated information, plus the independent evaluation conducted by LAFCO staff, the conclusions and recommendations reached in the July 6, 2015 staff report have been reaffirmed, clarified, and updated as necessary. In addition, the Commission should consider adding a provision requiring that the next Municipal Service Review conducted by LAFCO evaluate how effectively the reorganized district absorbs positions and the associated cost savings attributable within the former boundaries of both districts. If approved, a reorganization of the Rainbow MWD and Fallbrook PUD sphere and service review and reorganization (as modified will likely accomplish the following:

- (1) Capture economies of scale and reduce administrative overhead;
- (2) Facilitate equipment and facility sharing;
- (3) Improve emergency response;
- (4) Enhance service coverage;
- (5) Integrate and consolidate duplicate management and staff positions;
- (6) Improve water resource management via use of recycled water;
- (7) Improve the ability of the combined district to utilize local water supplies;
- (8) Withstand and stabilize water rate fluctuations;
- (9) Improve governance and accountability; and
- (10) Strengthen financial capacity of both agencies.

If the Commission decides to approve the proposed reorganization, then it should follow the recommendations contained in the July 6, 2015 LAFCO staff report, plus any other conclusions and recommendations made at the hearing on September 14, 2015.

Option 2

While justification exists for approval of the reorganization, this is a discretionary action and approval is not automatic. If the Commission disapproves the reorganization, then it may cite specific reasons for rejection, or it may concur with any of the following reasons presented by the Rainbow MWD, such as:

- (1) Insufficient financial and service feasibility information;
- (2) Public and subject agency opposition;
- (3) Unresolved voting rights issues;
- (4) Inappropriate method of initiating the reorganization;
- (5) Effect on water rates;
- (6) Capitalization on Rainbow MWD's assets and growth;
- (7) Effect on Rainbow MWD's debt ordinance;
- (8) Irrelevancy of JPA Cost Savings;
- (9) Questionable validity of Reorganization Cost Savings;
- (10) Effect on agriculture; and
- (11) Lack of support from Rainbow MWD employees.

If the Commission decides to disapprove the proposed reorganization, then it should follow the recommendations contained in the July 6, 2015 LAFCO staff report, plus any other recommendations made at the hearing on September 14, 2015. It should also direct the Executive Officer to prepare a Resolution of Disapproval or return at a subsequent meeting for acceptance of the resolution.

Respectfully submitted,

MICHAEL D. OTT
Executive Officer

HARRY EHRLICH
Local Governmental Consultant

MDO:HE:trl

Documents reviewed in preparation of Supplemental Report

The pertinent data, associated reports, and correspondence received from the Rainbow MWD and Fallbrook PUD can be downloaded directly from the San Diego LAFCO's website: http://www.sdlafco.org/Webpages/fallbrook_rainbow_reorg.htm. Below is a list of the reviewed to prepare the Supplemental Report. These documents are extensive and can be downloaded from LAFCO's website.

- 2014-2015: Adopted Budget (forecast and actual)
- 2015-2016: Adopted Budget (forecast)
- 2013-2014 and 2014-2015: Staffing levels by department (budgeted and actual)
- 2015-2016: Staffing levels by department
- 2014-2015 and 2015-2016: Organization charts
- Most recent audited financial statements and Comprehensive Annual Financial Reports
- Recent financial reports: District Net Position; unrestricted funds; and balance sheet
- 2015-2016 to 2020 Capital Improvement Program
- List of approved debt
- Assumptions used in developing the 2015-16 Budget for water sales
- Cost of service studies completed for water and/or sewer rates
- Contract amounts entered into within the past year for professional services
- Pending legal claims or judgments and estimated financial responsibility of the district
- Notices of violation from the RWQCB or Department of Public Health
- Copies of FPUD's salary surveys and associated supporting documents

Attachments

- (1) RMWD Response to FPUD Supplemental Financial Analysis, August 7, 2015
- (2) FPUD Response to RMWD Supplement Financial Analysis, August 7, 2015
- (3) FPUD Response to RMWD's August 7, 2015 letter, August 18, 2015
- (4) RMWD Supplemental Resolution of Objection, August 25, 2015



August 7, 2015

Mr. Mike Ott
Executive Officer
San Diego LAFCO
9335 Hazard Way, Suite 200
San Diego, CA 92123

VIA EMAIL AND US MAIL

Subject: Response to FPUD Submittal on Financial Analysis

Dear Mike:

Thank you for the opportunity to review and comment on the Fallbrook Public Utility District (FPUD) submittal to LAFCO on Financial Analysis. While we have had an abbreviated time to review the information, we were able to draw some conclusions from the information. The following is RMWD's response to the FPUD submittal on a point by point basis.

1. While FPUD attempts to skirt the question here, the actual answer is that neither Board adopted the Draft Consolidation Study.
2. We agree with FPUD that the Draft Consolidation Study is an incomplete draft document. On that basis alone it is an inappropriate document to serve as the justification for the dissolution of a public agency, especially in the face of the opposition of the RMWD Board of Directors and ratepayers. In this response, the "documented savings" are stated as being nearly \$1 Million but our records show a nine-month savings during FY14 of about \$420K. There were also serious negative service impacts within RMWD during this time period, especially in the areas of executive leadership and customer service.
3. There are a number of issues with this response:
 - a. The first list mischaracterizes a number of field positions as "management and administrative" positions, including:
 - i. Chief Water Systems Operator
 - ii. It Technician
 - iii. Wastewater Superintendent
 - iv. Electrician

- b. The response from FPUD indicates that all reductions will be handled due to retirements – no layoffs – yet this response indicates that only half of the individuals who occupy the targeted positions are eligible for retirement. We are not quite sure how the desired reductions would take place through retirements in this situation. The response to Question 9 indicates that there are others in the organization who occupy different positions that could be eligible for retirement, but those positions are not part of the targeted job cuts and are to be refilled. Does FPUD contemplate moving non-retirement age individuals in these targeted positions into other roles that might be vacated by retirements? This ignores the reality of pay rates, skill sets, and employee morale which is a recipe for failure.
- c. Once again, the contemplated cuts in positions fail to take into account the impact on services. While it is clear that executive management positions can be eliminated without major issues (GM, department heads), any positions below those need to be evaluated to determine if the workload formerly managed by two individuals could be handled by one. For instance, RMWD has one electrician who is stretched thin by our current workload keeping pumps and motors running among many other tasks. There is no way possible that one individual could take over responsibility for all of FPUD's pumps and motors (or vice versa). The same applies to IT technicians and a number of the other targeted positions.

As a reasonableness check, a comparison could be made to another highly efficient local agency, Olivenhain MWD. With 85 employees covering water and wastewater services, Olivenhain could be considered a slightly smaller analogue to the proposed combined RMWD/FPUD agency. A review of the OMWD organization chart (found here <http://www.olivenhain.com/files/docs/hr/org%20chart.pdf>) shows that one position is not sufficient to manage the pumps and motors, nor the IT services. OMWD has two individuals in each of these areas – how does FPUD propose to manage the workload of two with a single person?

This is just an example of why the Draft Consolidation Study and FPUD's response to LAFCO questions fail entirely to consider what sort of service impacts would occur should the proposed cuts be made by FPUD. They cannot simply state that no service impacts will occur – they need to demonstrate that the workload now handled by two employees can be handled by one.

d. The response indicates that additional positions can be eliminated “..based on economies of scale..” and “..technology.” Without an analysis of the current workloads of the positions indicated, it is impossible to draw such conclusions. For instance, cutting three Administrative Assistants down to two increases the workload of each of the remaining individuals by 50%. This proposal assumes that each of the remaining individuals has about 20 hours per week of idle time. Compounding this issue is that administrative assistants generally work within specific departments and perform tasks specific to those departments. It is very difficult to “split” administrative assistants across departmental lines without significant performance impacts. The response provided by FPUD is insufficient to justify these reductions in workforce.

4. No Comment

5. This response is not supported by any factual information. FPUD claims in this response that “only three” positions will be eliminated from a variety of positions but in the response to Question 3 above, they call out a total of nine reductions of non-management staff. Once again, FPUD fails to provide any backup information to demonstrate that these cuts will not have a service level impact. It is not enough to just say there will be no service impacts – some form of analysis needs to be done that identifies current workloads and evaluates the impact of lost productive hours from employees. No such analysis has been provided so it is impossible to determine that there will be no service level impacts.

The reality of the FPUD proposal is that over 90% of the projected savings will come from individuals losing their jobs. These job cuts will not reduce rates but will leave customers with lower levels of service.

6. We agree that outside consultants retained by FPUD developed the vast majority of the pro-forma budgets included in the Draft Consolidation Study.

7. The information in the “NCJPA Savings Projection” document provided by FPUD to LAFCO is in error. Specifically, the table on Page 2 of Attachment A which describes the relative costs and savings is inaccurate. Figure 1 below is an excerpt of a tracking spreadsheet of JPA costs maintained by RMWD Finance Manager Gene Buckley (now retired) that clearly shows that the net monthly cost of employee leasing for RMWD was over \$26,000. The table provided by FPUD's analysis shows just over \$21,000 for the entire year. This is barely enough to cover the monthly cost of the GM position, not to mention all the others. RMWD's net savings drops from the incorrect

number of over \$721,000 down to just over \$420,000. The "savings" identified by FPUD are incorrect.

RAINBOW MWD SUMMARY OF SHARED COST RELATING TO CONSOLIDATION ACTIVITIES		Leased Employee (Cost) Savings
POSITIONS NOT REPLACED		
Employee Wages & Benefits		
General Manager	\$	(14,735)
District Engineer/AGM		
Maint./Operations Mgr.		
Accounting Tech		
Utility Workers (2 positions)		
TOTALS - POSITIONS NOT REPLACED		\$ (14,735)
EMPLOYEE LEASING		
Employee Wages & Benefits		
Safety Administration		966
Engineer		(12,665)
Engineering Tech		(1,420)
Engineering Inspector		(3,756)
Cost Recovery - Developers		3,756
Welding Crew		1,405
Sewer - CCTV		
Construction-Utility Worker		
Customer Service Supervisor		
TOTALS - EMPLOYEE LEASING		(11,714)
TOTALS - SAVINGS / (COST) EMPLOYEE-RELA		(26,449)

Figure 1: Excerpt from JPA Cost Tracking

8. No Comment
9. No Comment
10. This response refers to a business plan "anticipated" for the reorganization. We are not aware of this business plan –is this the same as the Draft Consolidation Study? Further, as noted in 3(b) above, there are not enough

retirement age individuals within the selected positions to accomplish the job cuts proposed by FPUD. The statement that there are other individuals who may retire could be true, but this does not explain how the job duties will be rotated around to meet operational needs.

11. Since the two-year restriction on layoffs was put into place by LAFCO in its most recent staff report, it is impossible for the pro-forma budgets that were developed several years earlier to have included this requirement. The pro-forma budgets had a set time table for staffing reductions that was not the same as the limitations established by LAFCO. FPUD has not answered this question with any information that could allow LAFCO to determine what the financial impact of the delay on layoffs would have. Clearly, this delay in job cuts would reduce the amount of savings from the forced merger.
12. FPUD's answer here does not respond to the question. The question was about the basis for the projected increases of revenues but FPUD replies by saying that the projection has changed from 3% to 2%. Apparently inflation is the cause of these increases, however, it is unlikely that all sources of non-operating revenue will increase at exactly the same rate.
13. FPUD again misses the intent of the question which inquired as to whether the assumption made in the Draft Consolidation Study was accurate or not. As documented in our letter of July 31, 2015, increases in wholesale rates do not equate to increases in retail rates.
14. Here FPUD merely reiterates the content of the Draft Consolidation Study rather than responding to the question which was looking for the basis for the conclusions made in the Draft Consolidation Study. This question remains unanswered.
15. This response is another example of wild assumptions for savings being made without any substantiation with facts. Even the most optimistic of FPUD's savings projections never got close to the value of \$3.5 Million as stated in this response. FPUD never contemplates any of the real risks to cost savings, many of which were identified in our letter of July 31, 2015. Simply stated, these cost projections are not supported by factual evidence and FPUD continues to avoid any discussion of downside risks that would reduce savings.
16. FPUD is relying on an oversimplified metric that cannot be used in a vacuum to justify staffing levels. If using this metric, the City of San Diego water department, with over 280,000 meters would have over 1400 employees – double their current amount. Local conditions and other factors must be

taken into account when considering staffing levels.

17. There are a number of these items that we believe are inaccurate but the one that stands out is legal costs - the largest contributor to these "cost savings". FPUD is claiming to be able to save \$100,000 in legal fees through consolidation, but the reality is that the only cost savings will come from attending Board meetings. All other legal realities such as contracts, claims, lawsuits and others that water agencies deal with on a day-to-day basis will continue from both agencies. While there will be fewer total meetings with only one agency, with a larger board and more items on the agenda, it would be expected that the meetings will be longer. Thus this savings on legal costs is more likely a small fraction of what FPUD is claiming.
18. For some reason, FPUD chose not to read the question and understand it's meaning, which is readily apparent even through an obvious typographical error. An appropriate action on their part – if they did not understand the question – would be to contact LAFCO for clarification rather than provide this dismissive reply.

The allocation question is important as it is a critical part of any financial analysis. Without a thorough understanding of how shared costs are allocated among the divisional accounting entities, it is impossible to determine what the cost impacts are to the ratepayers responsible for each agency.

19. As noted above, the precise method of allocating shared costs (and revenues) must be clearly defined in order to perform even a basic financial analysis of the proposed merger. In this reply, FPUD dismisses the question and simply refers to the Draft Consolidation Study. Had the Draft Consolidation Study provided this information, this question would not need to be asked, but the reality is that it does not.

FPUD's Attachment B puts forth the relevant content of the Draft Consolidation Study, but does not reply to the question. The recommendation of the Draft Consolidation Study is to split up general and administrative expenses based on "...an appropriate method, such as, labor." It is unclear what this means exactly. What is the appropriate method? Further, the Draft Consolidation Study puts forth an example of how customer service costs could be allocated which is by the numbers of accounts.

In order to perform an accurate financial analysis showing the relative distribution of cost savings among the four primary financial entities (two water and two sewer each), a detailed description on how the allocations will

be handled is mandatory. Absent this information, the financial analysis is incomplete at best, or, more likely, completely unusable.

20. FPUD's reply confirms that the pro-forma budgets show a transfer of funds that is net positive to FPUD via the reorganization.
21. No Comment
22. Once again, FPUD utterly fails to even attempt to demonstrate that there will be no negative service level impacts by the loss of 16 jobs as part of this merger. They reiterate the false statement that only three positions will be "service personnel". FPUD feels that service levels "...are expected to remain high.." without giving a single bit of evidence as to whether this will be the case. As noted in our letter of July 31, 2015, unless an actual study of workloads and backlogs in each functional group is performed, any projections about service levels is pure speculation.
23. The response to this question is a reiteration of the earlier pro-forma budgets rather than a restatement. There are a number of factors included in the LAFCO proposal, such as delayed staffing reductions, that will have a material impact on the pro-forma budgets. FPUD has failed to address these realities and as such the earlier pro-forma budgets, which were flawed to begin with, are now nearly useless in evaluating the real financial impact of the proposed merger.

In summary, the financial analysis provided to LAFCO by FPUD to support their application for the annexation of the RMWD service area is deeply flawed. This analysis is unsuitable to be used as the basis for the Commission to make the following findings that are included in Exhibit E the LAFCO staff report:

Finding 16 – FPUD has not demonstrated that the cost benefits identified in this Finding are true and correct.

Finding 25 – RMWD's Resolution of Objection contains financial and service related concerns which have been shown to have merit through this review of the flawed financial analysis. The Commission cannot use this flawed analysis as the basis of rejecting RMWD's Resolution of Objection.

Finding 28 – The Commission cannot find that the provisions of 56425(h) have been satisfied as FPUD has not demonstrated that the proposed reorganization will result in "efficient and affordable" service delivery. The financial analysis is missing key features to allow any conclusion to be drawn as to the exact financial impact to RMWD ratepayers, and thus no determination about efficiency or affordability can be

Mike Ott
SD LAFCO
August 7, 2015
Page 8

made. Further, FPUD has only provided speculation about service delivery rather than appropriate studies of actual current and projected service levels.

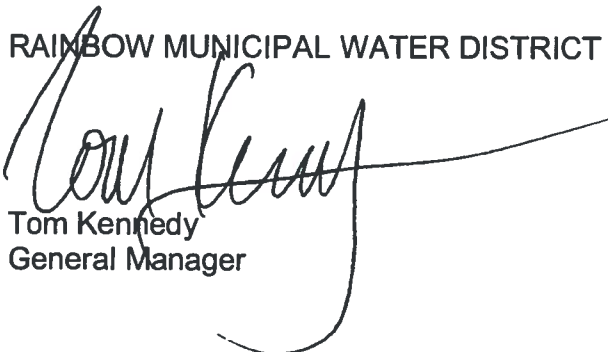
Finding 29 – the Commission cannot find that the reorganization will “stabilize rates for agricultural and non-agricultural water users” because the financial analysis is inaccurate and incomplete. It is impossible to determine what the actual cost impacts to RMWD ratepayers would be due to shortcomings in the financial analysis, and thus no determination about rate impacts could be made. Also, due to dilution in agricultural representation in a combined agency, it is more likely than not that agricultural interests will have less influence over rate design in the future.

Based on the above as well as statutory requirements under the Cortese-Knox-Hertzberg Local Government Reorganization Act, the Commission must give **great weight** to the Resolution of Objection of the Rainbow Municipal Water District because the objections based on financial and service level concerns are justified by the inadequacy of the financial and service level analysis provided by FPUD.

Thank you for the opportunity to participate in this financial analysis process.

Sincerely,

RAINBOW MUNICIPAL WATER DISTRICT

A handwritten signature in black ink, appearing to read 'Tom Kennedy', is written over the printed name and title. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Tom Kennedy
General Manager

cc: Adriana Ochoa, General Counsel
RMWD LAFCO Ad-Hoc Committee



990 East Mission Road
P. O. Box 2290
Fallbrook, California
92088-2290

(760) 728-1125
Fax (760) 728-5943

Board of Directors:

Milt Davies
Al Gebhart
Bert Hayden
Don McDougal
Charley Wolk

Staff:

Brian J. Brady
General Manager

Jack Bebee
Assistant General Manager

Marcie Eilers
Admin Services Manager

Robert H. James
Legal Counsel

Mary Lou Boultinghouse
Board Secretary

August 7, 2015

VIA ELECTRONIC MAIL AND USPS

Mr. Michael Ott
Executive Officer
San Diego Local Agency Formation Commission
9335 Hazard Way, Suite 200
San Diego, CA 92123

Subject: Comments on Kennedy Letter to San Diego LAFCO dated July 30, 2015

Dear Mike:

We have reviewed the subject July 30, 2015 letter by Mr. Kennedy to you, with attachments. We believe that our submittal of the same date adequately addresses the objections raised by Mr. Kennedy regarding the 23 questions posed by LAFCO staff.

We do need to comment on the relevance of the nine-page Raftelis Financial Consultants ("RFC") report attached to Mr. Kennedy's letter. According to RFC, the report "documents the findings of RFC's independent review of the October 2012, Draft District Consolidation Study."

As you will recall, the Draft Consolidation Study ("the Study") was prepared by Rainbow General Manager Dave Seymour and myself, with the assistance of both FPUD and Rainbow finance staffs during the early exploration stages of consolidation.

The Study was prepared as a resource for both FPUD and Rainbow boards' deliberations on whether to move ahead with forming a Joint Powers Authority ("JPA") to manage both Districts as an interim step toward full consolidation.

There was no need for either board to “approve” the Study. However, the Study information was a part of their decision-making process, and, in fact, was posted on both Districts’ websites.

With practically no analysis, RFC’s review draws the following conclusions:

- There is insufficient information to support the conclusion that a consolidation would result in the stated annual savings.

Comment: That is precisely why the two boards decided to form a joint powers authority. During the 11-month JPA operation, many of the anticipated savings were verified (and documented in a November 14, 2014 analysis).

- RFC was unable to validate the statement that the proposed savings would be captured primarily through retirement and attrition.

Comment: In just 11 months of JPA operations, combined staffing levels were reduced to 114 from the original 123 referred to in the October 2012 Study.

- The analysis contained in the report did not evaluate whether or not additional efficiencies could actually be realized and therefore did not adequately consider the feasibility of the proposed staff reductions.

Comment: Same as comment above.

- Cost savings to the RMWD side of the divisional accounting proposed in the consolidation will be minimized.

Comment: During the 11-month JPA operational phase, nearly \$1 million in savings were realized by the two districts. Using divisional accounting procedures, over 70% of the savings accrued to Rainbow.

- The report fails to identify what method for apportioning costs would be used, so it is not possible to evaluate the impact of the consolidation on each agency.

Comment: Chapter VI (pages 15-20) of the Draft Consolidation Study explains divisional accounting concepts.

- It is likely that expanding the recycled water system to serve RMWD customers may not be economically viable.

Comment: There is absolutely no basis given (technical or financial) for this statement.

Mr. Michael Ott
August 7, 2015
Page 3

- It appears that FPUD is financially weaker and consolidation from that aspect would strengthen FPUD customers to the detriment of RMWD customers.

Comment: This statement is perhaps the most irresponsible of all. There is no sound basis for the conclusion, and it reflects either a lack of knowledge of, or a disregard for, the thousands of pages of financial and analytical materials developed over the past three years as part of LAFCO's deliberative process. The information is easily sourced on LAFCO's website.

Thank you for the opportunity to submit our comments.

Sincerely,



Brian J. Brady, P.E.
General Manager

C: Paula de Sousa



August 18, 2015

990 East Mission Road
P. O. Box 2290
Fallbrook, California
92088-2290

(760) 728-1125
Fax (760) 728-5943

Board of Directors:

Milt Davies
Al Gebhart
Bert Hayden
Don McDougal
Charley Wolk

Staff:

Brian J. Brady
General Manager

Jack Bebee
Assistant General Manager

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Legal Counsel

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Board Secretary

VIA ELECTRONIC MAIL AND PERSONAL DELIVERY

Mr. Michael Ott
Executive Officer
San Diego Local Agency Formation Commission
9335 Hazard Way, Suite 200
San Diego, CA 92123

Subject: Response to Kennedy Letter of August 7, 2015

Dear Mike:

We have reviewed Mr. Kennedy's letter of August 7, 2015. In many cases, we find quite a few disjointed conclusions in their critique of merger financial benefits. We find their responses regarding items 2, 3, 5, 6, 7, 11, 16, and 20 particularly misleading, and respond to them below.

2. The October 2012 Draft Consolidation Study ("the Study") served as the basis for the Rainbow and FPUD boards' decision to form a joint powers authority to prove up study forecasts over a one-year test period. Recorded savings from the JPA operation were documented in "Fallbrook PUD NCJPA Savings Projections" (updated in November 2014) report submitted to LAFCO staff.

Rainbow claims to have independent records of JPA savings but only references the "Fallbrook PUD NCJPA Savings Projections" document. We agree that the documented savings from the JPA operation were developed by now retired Rainbow finance manager, Gene Buckley, and are contained as Exhibits 1 – 4 in the "Fallbrook PUD NCJPA Savings Projections (updated November 14, 2014)." The answer to item no. 7 below addresses Rainbow's computational errors in reviewing this report.

Rainbow makes a new claim of "serious negative service impacts within RMWD during this (JPA operational) period, especially in the areas of executive leadership and customer service." It is more than curious that nearly 16 months into LAFCO staffs' deliberative process, Rainbow decides to voice these new concerns. No mention was made during two separate Special District Advisory Committee meetings. And no data are presented to back up the claims.

3. Chief Water Systems Operator and Wastewater Superintendent are both middle management positions duplicated in the two districts.

Rainbow currently has not one, but two electrical/electronic technicians. FPUD has one maintenance electrician. Functional work group reviews during the JPA operations phase, showed opportunities for rebalancing workloads to free up the equivalent of one "electrician" duties.

While shown as a newly budgeted position for 2015-16, Rainbow doesn't have an IT Technician currently on staff. For many years the work has been contracted out. During the JPA operation, many of the technical details of combining the two districts' IT operations were finalized and integrated. There is a clear sense of IT staffing requirements, and that equates to one technician position.

It is a mistake to use the Olivenhain MWD organization for staffing comparisons. Olivenhain MWD services 60% more customer accounts than a combined FPUD/Rainbow operation. Olivenhain also delivers as much as three times the reclaimed water as FPUD and operates a water treatment plant supplying 34 million gallons per day to their customers. Olivenhain's technical support requirements (i.e., electricians, IT technicians) may well exceed a less complex FPUD/Rainbow agency.

Of the 22 employees filling the 11 management and administrative positions duplicated by the two districts, one-half are currently eligible to retire. And, within the next three years, nine of the targeted 11 duplicate positions will have one or both of the incumbents of retirement age or eligible for a retirement incentive.

Currently, both districts have an administrative assistant within their engineering departments. During the one-year JPA operation phase, the two engineering departments were combined. One administrative assistant proved adequate to support the integrated department, allowing the other assistant to support other department integration efforts.

5. Day in and day out, service levels (response to emergencies, billing inquiries, meter services, etc.) are most impacted by staff that directly interface with the customer. These include customer service representatives, utility field workers, systems operators, wastewater plant operators, and the like. Of those categories one crew leader position (out of 9), one customer service staff position (out of 8), and one system operator (out of 9) are forecasted to be reduced out of a total combined service personnel staffing of 85.
6. Until March 2014, all consultants working on the merger proposal were retained by both FPUD and Rainbow.
7. The summary table on page 2 of "NCJPA Savings Projections" is correct, reflecting the 12-month savings developed by Mr. Buckley and taken from Exhibits 1-4 in the report. Figure 1 in Mr. Kennedy's letter is taken from Exhibit 2. In Figure 1, the two categories:

POSITIONS NOT REPLACED and EMPLOYEE LEASING are treated as separate calculations and are displayed as two different line items on the table on page 2 of the report. Therefore, the monthly cost to Rainbow of leasing a general manager (\$14,735) is contained within Exhibit 2, Jan-June 2013 savings/(cost) Positions not Replaced total of \$448,975. The remaining \$11,714 in Figure 1 reflects all other employee leasing activities from January-June 2013.

Figure 1 incorrectly tries to combine a monthly leasing charge of \$14,735 with a six-month summary of other employee leasing charges and represent the sum as an ongoing monthly leasing obligation. A careful review of Exhibit 2 clears up the misunderstanding.

11. Discussions with LAFCO staff in 2014 included the likelihood of a multi-year restriction on forced staff reductions and the "NCJPA Savings Projections, Updated November 14, 2014" reflected those conditions in the three-year merger strategy. Furthermore, the overarching assumption in every merger analysis going back to 2012 was that staff reductions would be by attrition, not layoffs or filled position eliminations.
16. Rainbow, in their response, makes the valid argument that a larger, combined agency enjoys economies of scale without reducing service levels.
20. There is no transfer of funds from Rainbow to FPUD under the merger proposal. Both districts benefit from the shared savings in administrative and other operating costs.

Thank you for the opportunity to submit our comments.

Sincerely,



Brian J. Brady, P.E.
General Manager

C: Paula de Sousa, Special Legal Counsel

RESOLUTION NO. 15-14

**RESOLUTION OF OBJECTION
OF THE BOARD OF DIRECTORS OF THE RAINBOW MUNICIPAL WATER DISTRICT
TO THE FALLBROOK PUBLIC UTILITY DISTRICT'S
RESOLUTION AND APPLICATION FOR REORGANIZATION
TO THE SAN DIEGO COUNTY LOCAL AGENCY FORMATION COMMISSION**

BE IT RESOLVED by the Board of Directors of the RAINBOW MUNICIPAL WATER DISTRICT ("Rainbow"):

WHEREAS, on March 10, 2014, the Fallbrook Public Utility District ("FPUD") passed Resolution No. 4813, which purported to be a Resolution of Application by the Fallbrook Public Utility District Requesting the San Diego County Local Agency Formation Commission to Take Proceedings for a Reorganization with the Rainbow Municipal Water District and Making Certain Findings Under the California Environmental Quality Act, in violation of the notice and hearing requirements of law, and thereafter improperly submitted said resolution together with an Application for Reorganization to the San Diego Local Agency Formation Commission ("LAFCO") on March 11, 2014;

WHEREAS, FPUD thereafter noticed a public hearing pursuant to Government Code § 56824.12, and on April 28, 2014, passed Resolution No. 4815, which amended Resolution No. 4813. Resolution No. 4815, Amended Resolution of Application by the Fallbrook Public Utility District Requesting the San Diego County Local Agency Formation Commission to Take Proceedings for a Reorganization with the Rainbow Municipal Water District and Making Certain Findings Under the California Environmental Quality Act (the "FPUD Resolution"), was submitted to LAFCO together with an Application for Reorganization ("Application for Reorganization") on April 29, 2014;

WHEREAS, the FPUD Resolution and Application for Reorganization seek the dissolution of Rainbow, a district annexation of Rainbow territory to FPUD, a reduction of Rainbow's sphere of influence to a zero sphere, and an expansion of FPUD's latent sewer powers to include Rainbow territory, and is not a special reorganization as defined by Government Code § 56075.5;

WHEREAS, Rainbow received notice of FPUD's Application for Reorganization on May 28, 2014, and was asked to submit comments on any aspects or possible effects of the Application for Reorganization by July 11, 2014, which deadline was extended by the LAFCO Executive Director to August 1, 2014;

WHEREAS, the Board of Directors of the Rainbow Municipal Water District passed and submitted Resolution 14-13, a Resolution of Objection to FPUD's Resolution and Application for Reorganization, in response to FPUD's Application for Reorganization; specifically, Rainbow passed and submitted Resolution 14-13 for the purpose noting RMWD's strong objection to the FPUD Resolution and Application for Reorganization;

WHEREAS, RMWD's Resolution 14-13 contained a variety of objections to the FPUD Application based largely on financial and service related concerns, in addition to concerns over negative impacts to agriculture, voting rights, and employees;

WHEREAS, after nearly a year of evaluation of the FPUD application, LAFCO staff released its Staff Report regarding the FPUD application on June 5, 2015 to be considered at the July 6, 2015 LAFCO Commission meeting;

WHEREAS, during the course of the period of evaluation by LAFCO, RMWD staff had made several attempts to convince LAFCO staff that the financial analyses submitted by FPUD as part of its application were seriously flawed and did not provide substantial evidence sufficient to support FPUD's claims either for financial savings or their assertion that no service-related impacts would result from the reorganization;

WHEREAS, LAFCO staff had made it very clear that they would not fully review the financial analyses provided by FPUD and based this position on the misleading claim of FPUD that RMWD had adopted the Draft Consolidation Study provided by FPUD to support their application despite the Study being an incomplete, untested draft presented for illustrative purposes and discussion only;

WHEREAS, at the July 6, 2015 LAFCO Commission meeting, Commissioner Dianne Jacob directed LAFCO staff to evaluate the financial claims made by FPUD in its application, citing conflicting information as the basis for the evaluation;

WHEREAS, neither RMWD nor FPUD ever adopted the Draft Consolidation Study, or even affirmed its contents since the report used by FPUD was a draft staff document, was never approved, and did not ever become an official approved action of either agency;

WHEREAS, through a series of information gathering efforts by LAFCO staff, FPUD was unable to and has continued to be unable to provide credible, substantial evidence in the form of backup documentation to support the financial claims made in their application;

WHEREAS, Rainbow is an affected local agency and an affected district as defined by Government Code sections 56014 & 56013, respectively;

WHEREAS, this resolution is made pursuant to the Cortese/Knox/Hertzberg Local Government Reorganization Act of 2000, with specific reference to Sections 56668.3(a)(4) and 56668.3(b) of the California Government Code, which sections permit the filing of a resolution raising objection by an affected agency, and by a district;

WHEREAS, this supplemental resolution is submitted in light of the misleading information contained in the FPUD application, the supplemental information provided at LAFCO's request by both FPUD and RMWD, and the continuing lack of credible substantial information before LAFCO to support the determination of cost benefits or the improvement of public services of the proposed reorganization;

WHEREAS, this resolution is made as a supplement to Resolution 14-13 and serves to add to the content of that resolution rather than replace it;

NOW, THEREFORE, Rainbow raises the following objections to the FPUD Application:

1. RAINBOW OBJECTS to the FPUD Resolution and Application for Reorganization because the Draft Consolidation Study that FPUD has included in its Application is deeply flawed, does not contain demonstrably accurate information and data, and, lacking in substantial evidence to support the necessary determinations, is unsuitable to support the findings that are outlined in Exhibit E of the July 6, 2015 LAFCO Staff Report. Specifically, the following findings are not supported by the FPUD application:

- a. **Finding 16** – FPUD has not demonstrated with the presentation of credible substantial evidence that the cost benefits identified in this Finding are true and correct.
 - b. **Finding 25** – RMWD's Resolution of Objection 14-13 contains financial and service related concerns which have been shown to have merit through this review of the flawed financial analysis. The Commission cannot use this flawed analysis as presented by FPUD and incorporated by LAFCO staff as the basis of rejecting RMWD's Resolution of Objection 14-03.
 - c. **Finding 28** – The Commission cannot find that the provisions of 56425(h) have been satisfied as FPUD has not demonstrated through the presentation of credible substantial evidence that the proposed reorganization will result in "efficient and affordable" service delivery. The financial analysis is missing key features to allow any conclusion to be drawn as to the exact financial impact to RMWD ratepayers, and thus no credible determination about efficiency or affordability can be made in the absence of substantial evidence even after the invited supplement of additional data in light of the original misleading information included in the application. Further, FPUD has only provided speculation about service delivery rather than appropriate studies of actual current and projected service levels.
 - d. **Finding 29** – the Commission cannot find that the reorganization will "stabilize rates for agricultural and non-agricultural water users" because the financial analysis lacking in credible substantial evidence and therefore is inaccurate and incomplete. It is impossible to determine what the actual cost impacts to RMWD ratepayers would be due to shortcomings in the financial analysis, and thus no determination about rate impacts could be made. Also, due to dilution in agricultural representation in a combined agency, it is more likely than not that agricultural interests will have less influence over rate design in the future.
2. RAINBOW OBJECTS to the FPUD Resolution and Application for Reorganization because the claims made by FPUD related to financial savings are not supported by the Draft Consolidation Study, nor by additional information provided to LAFCO staff by FPUD since July 6, 2015. No credible substantial evidence has been provided by FPUD to LAFCO to support FPUD's claims.
 3. RAINBOW OBJECTS to the FPUD Resolution and Application for Reorganization because the only credible evidence demonstrates that proposed job cuts which would result from the proposed reorganization will cause immediate disruption of service delivery to the Rainbow ratepayers. FPUD's supplemental information failed to demonstrate through any credible substantial evidence that there would not be degradation in service to the ratepayers as a result of the proposed job cuts. In fact, the cuts proposed would have immediate and perhaps long term negative impacts on service to ratepayers.
 4. RAINBOW OBJECTS to the FPUD Resolution and Application for Reorganization because the overwhelming majority of public comments in response to the FPUD Application for Reorganization opposed the reorganization. **LAFCO received well over 600 letters in opposition to the reorganization**, and only about 30 letters in support of the reorganization. In accordance with Government Code Section 56668(m), the Commissioners must take into account the input from affected stakeholders.

NOW, THEREFORE, this Resolution of Objection is hereby approved and adopted by the Board of Directors of the Rainbow Municipal Water District. The San Diego County Local Agency Formation Commission is hereby **requested to take notice of this second Resolution of Objection and to give great weight to the objections raised in this Resolution,** as mandated by the Cortese/Knox/Hertzberg Local Government Reorganization Act of 2000. (Government Code §§ 56668.3(a)(4) and (b).)

PASSED, APPROVED, AND ADOPTED by the Board of Directors of the Rainbow Municipal Water District at a regular meeting thereof held on August 25, 2015, by the following vote:

AYES: Directors Brazier, Griffiths, Lucy, Sanford, and Walker
NOES: None
ABSTAIN: None
ABSENT: None


Dennis Sanford, Board President

ATTEST:

Dawn M. Washburn, Board Secretary

8B

8C

8D

**SAN DIEGO LOCAL AGENCY FORMATION COMMISSION
SEPTEMBER 14, 2015
CONTINUED PUBLIC HEARING
AGENDA ITEM NOS. 8B, 8C AND 8D**

**(RELATED TO THE PREVIOUS JULY 6, 2015
AGENDA ITEM NOS. 7A, 7B and 7C)**

**MUNICIPAL SERVICE REVIEW AND SPHERE OF INFLUENCE
OF WATER AND WASTEWATER SERVICES WITHIN THE
FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER DISTRICT
(MSR13-66; SR13-66; MSR13-82; SR13-82)**

**ADOPTION OF AMENDMENT TO THE SPHERES OF INFLUENCE FOR THE
FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER DISTRICT
(SA14-04A; SA14-04B)**

**PROPOSED “FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER
DISTRICT REORGANIZATION” (FALLBROOK PUBLIC UTILITY DISTRICT; RAINBOW
MUNICIPAL WATER DISTRICT): DISSOLUTION OF THE RAINBOW MUNICIPAL WATER
DISTRICT; ANNEXATION OF TERRITORY FORMERLY WITHIN THE RAINBOW MUNICIPAL
WATER DISTRICT TO THE FALLBROOK PUBLIC UTILITY DISTRICT; AND EXPANSION OF
FALLBROOK PUBLIC UTILITY DISTRICT’S LATENT POWERS FOR ASSUMPTION OF SEWER
SERVICE RESPONSIBILITY FROM THE RAINBOW MUNICIPAL WATER DISTRICT
(RO14-04; LPE14-04)**

ATTACHMENT

**Attachment: Proposed “Fallbrook PUD and Rainbow MWD Reorganization”
(July 6, 2015 Staff Report)**

Supporting Documents are available on the LAFCO Website

http://www.sdlafco.org/Webpages/fallbrook_rainbow_reorg.htm

DISTRIBUTED TO COMMISSIONERS UNDER SEPARATE COVER

8B

8C

8D

**SAN DIEGO LOCAL AGENCY FORMATION COMMISSION
SEPTEMBER 14, 2015
CONTINUED PUBLIC HEARING
AGENDA ITEM NOS. 8B, 8C AND 8D**

**(RELATED TO THE PREVIOUS JULY 6, 2015
AGENDA ITEM NOS. 7A, 7B and 7C)**

**MUNICIPAL SERVICE REVIEW AND SPHERE OF INFLUENCE
OF WATER AND WASTEWATER SERVICES WITHIN THE
FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER DISTRICT
(MSR13-66; SR13-66; MSR13-82; SR13-82)**

**ADOPTION OF AMENDMENT TO THE SPHERES OF INFLUENCE FOR THE
FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER DISTRICT
(SA14-04A; SA14-04B)**

**PROPOSED “FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER
DISTRICT REORGANIZATION” (FALLBROOK PUBLIC UTILITY DISTRICT; RAINBOW
MUNICIPAL WATER DISTRICT): DISSOLUTION OF THE RAINBOW MUNICIPAL WATER
DISTRICT; ANNEXATION OF TERRITORY FORMERLY WITHIN THE RAINBOW MUNICIPAL
WATER DISTRICT TO THE FALLBROOK PUBLIC UTILITY DISTRICT; AND EXPANSION OF
FALLBROOK PUBLIC UTILITY DISTRICT’S LATENT POWERS FOR ASSUMPTION OF SEWER
SERVICE RESPONSIBILITY FROM THE RAINBOW MUNICIPAL WATER DISTRICT
(RO14-04; LPE14-04)**

EXHIBITS

- Exhibit A: MSR Determinations: Rainbow MWD**
- Exhibit B: MSR Determinations: Fallbrook PUD**
- Exhibit C: Statement of Determinations: Sphere of Influence for the Rainbow MWD**
- Exhibit D: Statement of Determinations: Sphere of Influence for the Fallbrook PUD**
- Exhibit E: Draft Resolution: “Fallbrook PUD and Rainbow MWD Reorganization”**
- Exhibit F: Terms and Conditions: “Fallbrook PUD and Rainbow MWD Reorganization”**
- Exhibit G: Compensation of Rainbow MWD Classifications to Fallbrook PUD Classifications**

Supporting Documents are available on the LAFCO Website

http://www.sdlafco.org/Webpages/fallbrook_rainbow_reorg.htm

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