



August 7, 2015

Mr. Mike Ott
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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

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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



Tom Kennedy
General Manager

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