



July 30, 2015

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

VIA EMAIL AND US MAIL

Subject: Requested Documents for Financial Analysis

Dear Mike:

Per your request, we have put together the second set of documents that you requested as part of the "Step Three" process described in your letter of July 10, 2015. We appreciate the opportunity to provide comments on the financial analysis contained in the Fallbrook Public Utility District (FPUD) application to LAFCO.

A good number of the items below request additional information that is crucial for a proper evaluation of FPUD's proposal to LAFCO, but only FPUD can provide this information. We are unable to address some of these items without this information, so once FPUD submits its documentation, we would request an opportunity to review and comment on their submittal prior to Commission consideration.

Here is our response to the items with comments added below each item:

1. Indicate whether the Fallbrook PUD/Rainbow MWD Consolidation Study was adopted or accepted by each of the subject districts. If so, provide the adoption/acceptance date and minutes.

RMWD Response: The Rainbow Municipal Water District (RMWD) Board never considered or approved the Draft District Consolidation Study (hereafter referred to as "the Study") that was presented to LAFCO by FPUD as part of their application package. The document was a draft staff document that was discussed briefly but never came to the board in a final version for consideration. Our review of FPUD meeting minutes from the same time period did not reveal any evidence that the FPUD board considered or adopted the Study.

2. Indicate whether the Fallbrook PUD/Rainbow MWD Consolidation Study is complete or missing any sections? Explain your response.

RMWD Response: The Study is incomplete, as the section regarding governing law is blank. This is especially telling considering that governance was one of the key issues related to the decision by the RMWD board not to pursue consolidation. It is also incomplete because it is a draft staff report that was not approved by either agency.

3. What positions is Fallbrook PUD proposing to eliminate, if the reorganization is approved?

RMWD Response: N/A to RMWD. We are very interested in reviewing this information once it is available. We would request the opportunity to comment further on FPUD's submittal in this area.

4. Disclose and provide an explanation for any positions that have been added, eliminated, or in any other way, impacted as a result of the initiation of the proposed reorganization or in anticipation of the proposed reorganization for fiscal years beginning in 2013, 2014, 2015. Indicate the classification and number of positions, if applicable.

RMWD Response: RMWD has reduced its filled position workforce from 55 in 2011/2012 to a budgeted total of 51 for FY2016. Four of the budgeted positions for Full Organizational charts were provided in our July 15<sup>th</sup> submittal. The reductions were in the following positions:

- One Wastewater/Projects Superintendent position was eliminated due to a retirement
- The Cross Connection Control Technician position was combined with the 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 although as development ramps up the need for this position may be re-evaluated.

Also, it is important to note that the FPUD Board adopted a new MOU for their employees, and as part of that action they raised the salary scale for their employees. The impetus for the raise of salaries was, according to a quote from General Manager Brady in this week's Fallbrook Village News, was "...to coincide with a market survey of 13 other water agencies." In the LAFCO report, there is a claim, disputed by RMWD, that FPUD's salaries are lower than RMWDs based on a salary survey that was performed by

FPUD without RMWD's involvement. We would ask LAFCO to investigate the nature of the increase in FPUD salary scales in their new MOU and whether the "market survey" referred to by Mr. Brady is the same one used to claim that RMWD salaries are 17% higher than FPUD. A copy of the article from the paper is attached as Exhibit A.

5. Explain the impact the reorganized district and associated staffing changes will have on service reliability and overall service provision.

RMWD Response: RMWD has reviewed the available information and finds that the level of cuts contemplated by the FPUD proposal is not feasible without degrading service levels to our 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. RMWD runs very lean in its operations with no room for cuts of this magnitude without negative impacts on service provision.

RMWD asked Raftelis Financial Consultants (RFC), a respected public agency financial consulting firm, to review the Study and provide a report (attached as Exhibit B). 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."**

6. Disclose which agency or agencies and staff, consultants, or volunteers prepared the pro forma Budgets presented in the Consolidation Study.

RMWD Response: While RMWD'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. Our records do indicate that FPUD hired Mr. Phillip Forbes as a consultant to do work on the consolidation study. Mr. Forbes subcontracted work to Mr. Jeff Armstrong to do certain financial work. Both Mr. Forbes and Mr. Armstrong are former colleagues of Mr. Brady from their days working at Rancho California Water District. FPUD billed RMWD for a portion of this work. Invoices provided to RMWD by FPUD demonstrate that Mr. Armstrong was working on the development of the pro-forma budgets used in the Study. Copies of the first page of the contract and the invoices are included in Exhibit C.

7. Provide backup or supporting documents that were used to develop the pro forma summaries in the Consolidation Study. For example, provide the full detailed analysis that resulted in the pro forma statements presented on page 37 of the Study. RMWD does not have the backup to this information.

RMWD Response: We would presume that the information may be possessed by FPUD or their consultants. We would like to review this information when it becomes available

The pro-forma budgets provided in the Study represent the basis for the financial savings claimed by FPUD in its application. 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."***

8. The asset and liability table shown on Page 19 of the Study needs to be updated to reflect each of the district's current liabilities.

RMWD Response: According to the LAFCO staff report, FPUD's current liabilities are \$37 Million. RMWD has a total liability of \$18.2 Million, as the LAFCO staff report incorrectly states that RMWD would need to take on additional debt due to the Caltrans sewer realignment work along Highway 76. As we have indicated to LAFCO staff and members of the Special District Advisory Committee in a letter dated December 15, 2014, the Highway 76 project's costs were much lower than previous estimates and the project was paid for out of current reserves.

Again, 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 RMWD is much lower than FPUD both in terms of total assets and in terms of debt service coverage. RMWD's debt as a percentage of assets stands at about 17% while FPUD's is over 28%. If consolidated, the new agency would have debt to asset percentage of 22.5% which is better for FPUD but significantly worse for RMWD. Since the end of FY2014, FPUD has taken on significantly more debt – the LAFCO report places the total debt at the end of 2015 at \$37 Million. RMWD's total debt is not changed. When these numbers are used, the FPUD debt as a percentage of assets goes up to 33.6%, while RMWD's stays the same. The consolidated agency would have a debt to asset percentage of 24.2%, which is a massive increase from RMWD ratepayer's perspective.

9. The Consolidation Study recommends layoffs of 20 positions over three years, but the LAFCO recommended action has a two year moratorium on layoffs. Explain the service and financial impact associated with this difference.

RMWD Response: While it is already clear that the monetary savings outlined in the Study are impossible to justify based on the Study, the moratorium on layoffs defers any savings for several years. Since the FPUD proposal does not indicate which positions would be eliminated or which employees are nearing retirement age, it is impossible 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. Without question the Study is insufficient justification to withstand a challenge by labor groups if and when employees are laid off.

10. The LAFCO staff report contains early retirement conditions. This condition was not factored into the Consolidation Study. Should this condition be imposed and if so, what possible financial impact would result within 2-5 years following the reorganization?

RMWD Response: As noted above, the 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, 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 included in the cost of the reorganization.

11. The water rate increases from SDCWA shown in the Consolidation Study need to be adjusted to current values.

RMWD Response: N/A to RMWD – FPUD should revise these numbers.

12. What is the basis for increasing "all other revenues" by 3% per year on page 37 of the Consolidation Study? What are these revenues?

RMWD Response: N/A to RMWD – We do not have the background information.

13. The Consolidation Study assumes that the increase in customer rates will match SDCWA rate increases. Is this an accurate assumption?

RMWD Response: RMWD believes that this is inaccurate. 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.

For instance, consider a situation where the rate charged to a customer is \$1.00 per unit and it consists of 75% SDCWA costs and 25% local costs. If SDCWA increases its rate by 5% 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. Since the nature of the cost savings projected by FPUD amount to a percent or two of the total budgets of each agency, small errors like this in a financial analysis can have a big impact on the outcome of the analysis.

14. The pro forma summary table on Page 38 of the Consolidation Study makes a projection on possible rate impacts. Explain the basis for these conclusions and whether the projections need to be modified.

RMWD Response: N/A to RMWD – the background information on the pro-forma information is needed to explain the basis for these numbers.

15. The cost savings projected in the Consolidation Study were based on a best case scenario. Provide a high to low estimate to accommodate unforeseen elements that may affect cost-savings. Explain the assumptions for the range.

RMWD Response: RMWD 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, it is impossible to predict any one exact outcome – yet that is what the Study does. Consider one of the main financial drivers in San Diego water costs – SDCWA wholesale rates. When projecting costs forward, 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 one 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 that reduces the ability to cut positions in the numbers projected
- 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 due to disputes, recall elections, etc.
- Excessive staff time to administer changes in administrative codes, HR policies, MOUs, Standard Operating Procedures, employee shifts and working hours, uniforms, logos/branding, website changes
- Costs associated with public outreach related to reorganization
- Costs associated with litigation, elections, or other impacts of the LAFCO decision
- Potential citizen suits related to Ordinance 95-1

There are many other variables that could be added to the list here. Each of these processes could go smoothly and cost effectively, or could become tedious quagmires of time and expense. Any cost projections should include a best case scenario as presented by FPUD in the Study, as well as a worst case scenario. The reality is 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.

Further, this analysis is being made on cost only, but the further the costs are cut, the likelihood of negative service impacts increases. 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.

16. What is the relevance of showing the number of employees per water account on page 39 of the Study?

RMWD Response: This is a particularly flawed analysis and serves as an inaccurate smokescreen to deflect attention from the real world conditions. A simple recitation of number of employees per account ignores many realities associated with the actual operation of a water system. Having the same number of employees per meter does not mean that two agencies are equally efficient. There are many other factors that come into play with regard to how many employees it takes to manage a given system.

One of the primary factors that the Study fails to consider is service density. RMWD has about 7800 connections spread over 80 square miles, and FPUD has a bit over 9100 in an area half the size. FPUD's service density is over double that of RMWD. RMWD has 320 miles of pipe spread over those 80 square miles but FPUD only has 270. Not only does RMWD have nearly 20% more pipe, our employees handle over 30% more pipe per water employee than FPUD.

RFC has considered this situation in their attached report and provides a detailed statistical review of the two agencies. 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."**

17. Provide a quantification of the "other potential benefits" listed on page 40 of the Study and the likelihood that each would be realized? What is the relative contribution to the \$150K to \$300K cited here from each?

RMWD Response: RFC reviewed this information and found that **"Again, there is no detail regarding these costs"** and **"A detailed analysis would need to be done to estimate the actual costs of the consolidation"**. Such speculation on costs may be OK within the context of a draft staff report on a topic, but this sort of data is inappropriate for use by LAFCO to consider in the dissolution of a public agency.

18. If the reorganization occurs, it is assumed that the Fallbrook PUD's General Manager would become the overall General Manager and the Rainbow GM position would be eliminated. Will a percentage of the Rainbow GM's salary be reallocated to the RMWD side of the accounting system? Conversely, will any other FPUD administrative staff/managers take on additional leadership roles?

RMWD Response: N/A to RMWD.

19. What percentages of these positions would apply and how would they be derived? For example, would it be based on water sales, water accounts, miles of pipes, or what? Once that percentage is derived, how do the relative costs land on each divisional account?

RMWD Response: N/A to RMWD. There are many ways to apportion costs but the Study fails to mention any. It is impossible to determine the relative benefit to either set of ratepayers without this information.

20. According to the Consolidation Study, it appears that without reorganization, FPUD may experience a deficit situation each year, but then experiences a surplus after reorganization. Explain this financial situation and indicate if a transfer of funds from RMWD ratepayers to FPUD is the cause for FPUD's improved fiscal condition.

RMWD Response: N/A to RMWD. This question refers to the transfer of funds from RMWD to FPUD as a possible cause for FPUD's improved financial condition. Some have speculated that this is one of the primary drivers for FPUD's unilateral application to LAFCO. Some of this speculation could be based on a quote from FPUD Board Member Al Gebhart from an article in the Fallbrook Village News (<http://villagenews.com/local/candidates-prepare-for-nov-6-election/>). He is quoted in the paper saying, "... it could mean a revenue stream to FPUD from the consolidation by using our management team to help run the two organizations..."

Thus there is evidence that at least part of FPUD's motivation for this unilateral action is to create revenue for the FPUD side of the accounting system.

21. Provide adopted service level standards for operating and maintaining systems and responding to customer service requests or system emergencies. An example is: "Respond to a customer service request of no water to house" within a defined timeframe.

RMWD Response: RMWD does not have specifically adopted service level standards outside of our after-hours standby crews. Our 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 1 hour to the incident site.

During normal daily operations, high priority calls are handled as soon as possible. High priority calls are things like leak reports, customers out of water, or calls on possible sewer backups. Normally, we 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. RMWD 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.

22. Provide a discussion of the expected service level impacts associated with reducing personnel by up to 20 positions in the reorganized FPUD in the next three years.

RMWD Response: It is impossible to describe the service level impacts without knowing the actual positions that FPUD is planning to cut from the organization. Once FPUD provides this information we would like the opportunity to review and revise our comments on this topic.

23. Update as necessary, any or all of the pro forma statements included in the July 6, 2015 LAFCO staff report, with an explanation describing the update.

RMWD Response: The pro-forma statements in the LAFCO staff report are inaccurate and are inappropriate for providing a complete picture of the situation to the Commissioners. As noted above, the basis for the cost assumptions is unsupported by any facts and the projections into the future should provide a high/low estimate of costs and savings rather than a single number.

Mike Ott  
SD LAFCO  
July 30, 2015  
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If LAFCO would like RMWD to produce a set of properly constructed financial projections of a proposed consolidation, we would need additional information from FPUD on actual job cuts and additional time to produce the information. The abbreviated time frame allotted for this response does not allow for a proper study to be completed.

If we have missed any information requested, please let me know and we will get that to you. 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", with a stylized flourish at the end.

Tom Kennedy  
General Manager

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

Fallbrook Village  
News  
July 23, 2015

# FPUD, employees reach labor agreement

**Joe Naiman**

Village News Correspondent

The Fallbrook Public Utility District (FPUD) has reached a new labor agreement with the Fallbrook Public Utility District Employees Association (FPUDEA) and the Fallbrook Management Employees' Association.

The Memorandum of Understanding (MOU) which had been signed by FPUD negotiators and FPUDEA representatives needed ratification by the FPUD board of directors, and on June 22 the FPUD board voted 3-1 in favor of the new agreement. Bert Hayden, Don McDougal, and Charley Wolk provided the necessary three votes for passage. Al Gebhart voted against the agreement. Milt Davies was not present at that day's meeting.

"The MOU is for three years and the two main components are a two percent cost of living for each of the three years plus the adjustment of the salary schedule to coincide with a market survey

of 13 other water districts," said FPUD general manager Brian Brady.

In 2011, the FPUD board approved a four-year agreement which was expense-neutral to the district; the FPUD employees received an annual 2 percent cost of living increase which was offset by an added 2 percent employee contribution to fund FPUD's California Public Employees' Retirement System pension obligation. That agreement expired on June 30, 2015.

Brady and FPUD human resources manager Casey Walters represented the district administration in negotiations with the FPUDEA and Teamsters negotiators. The negotiations began in February; FPUDEA approved the final agreement terms June 9 and the Fallbrook Management Employees' Association ratified the MOU on June 15.

*To comment on this story online, visit [www.thevillagenews.com](http://www.thevillagenews.com).*

# Exhibit B



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Pasadena, CA 91101

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Fax 626 . 583 . 1411

[www.raftelis.com](http://www.raftelis.com)

July 24, 2015

Mr. Tom Kennedy  
General Manager  
Rainbow Municipal Water District  
3707 Old Highway 395  
Fallbrook, CA 92028

**Subject: Review of the 2012 "District Consolidation Study" Draft Report**

Dear Mr. Kennedy:

Per your request, Raftelis Financial Consultants, Inc. (RFC) provide an independent review of the "District Consolidation Study" draft report (Report) prepared by the General Managers of Fallbrook Public Utility District and Rainbow Municipal Water District, dated October 22, 2012. The following memorandum documents the finding of RFC's independent review of the Report.

Should you have any questions, please do not hesitate to contact me at (626) 583-1894.

Sincerely,

**RAFTELIS FINANCIAL CONSULTANTS, INC.**

By: \_\_\_\_\_

A handwritten signature in blue ink, appearing to read 'Sudhir', written over a horizontal line.

Sudhir Pardiwala, PE  
Exec Vice President

By: \_\_\_\_\_

A handwritten signature in blue ink, reading 'Andrea Boehling', written over a horizontal line.

Andrea Boehling  
Financial Consultant

## FPUD/RMWD DISTRICT CONSOLIDATION REVIEW

**Agency:** Fallbrook Utility District (FPUD)

Rainbow Municipal Water District (RMWD)

**Study:** Review of the 2012 “District Consolidation Study” Draft Report (Report)

**Date:** July 24, 2015

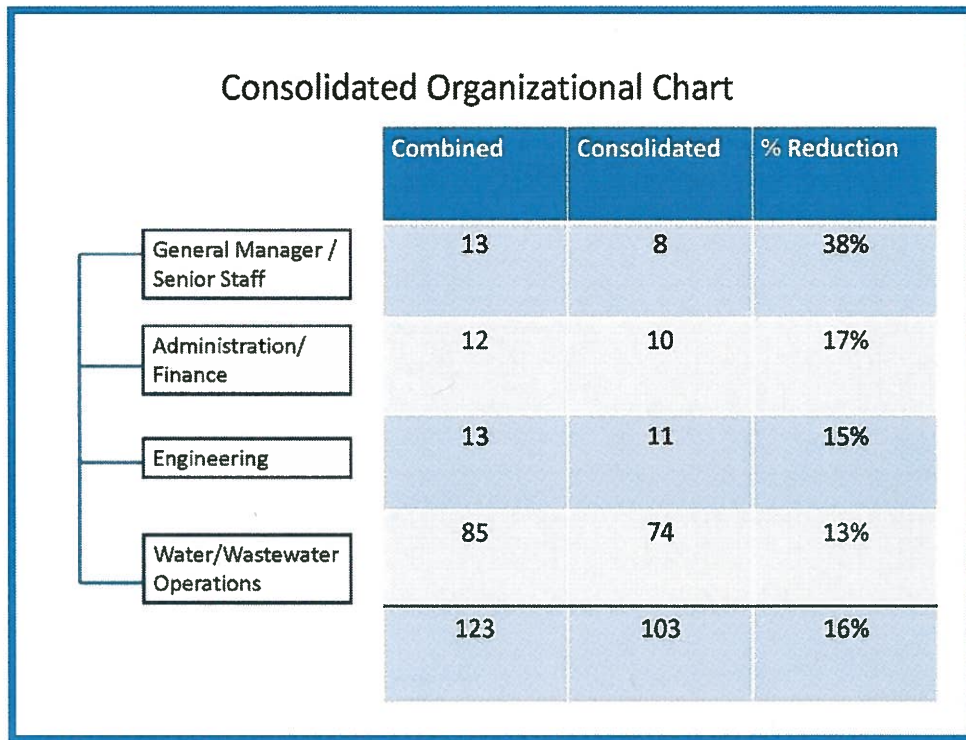
### BACKGROUND / SUMMARY

The Report was drafted in 2012 by the then current General Managers of FPUD and RMWD with the intention of exploring the possibility of consolidating the two districts or forming a Joint Powers Authority (JPA) to oversee the districts. RFC noted the Report appeared to be in draft format and did not appear to be finalized. It is unclear if the report was presented to or approved by the FPUD Board of Directors; RMWD has indicated that it was not approved by their Board of Directors.

Based on RFC’s review of the Report, the main objective of the proposed consolidation is to create a “more cost-efficient new entity that can meet the service objectives with no decline in service”. While the Report briefly discussed the possible business models, accounting structures, asset assessments, human resource issues, water supply, and contract obligations, the basis of the cost savings presented in the 3-Year Pro-Forma was related entirely to staff reductions. The Report concluded that “due to the timing of management retirements, the consolidation could provide an immediate savings of over \$600,000 dollars, with the potential to save an additional \$2 million over the next several years primarily through retirement and attrition without a reduction in the level of service”. These assumptions were evaluated and discussed in the following sections.

### STAFF REDUCTIONS WILL RESULT IN ANNUAL SAVINGS OF \$2,535,000

RFC reviewed the Report and supplemental information in an attempt to verify the cost savings projections. The Report indicated that over a three (3) year period twenty (20) positions would be eliminated. The following chart, as provided in the Report, generally indicates where staffing reductions would occur. However, the report failed to clearly show the specific positions that would be eliminated from within each district or proposed service area.



RFC was unable to confirm the potential savings from the proposed reduction in staff due to the lack of necessary information. Not only did the Report fail to identify the specific positions being eliminated, but it also failed to show any support, break-down, or justification for the stated “annual savings of \$2,535,000”. At a minimum the study should clearly establish the basis of the \$2,535,000. RFC performed a high-level reasonableness check by dividing the stated annual savings of \$2.5M by the expected number of eliminated positions. This resulted in an average savings per eliminated position of \$125k. While this level of savings may be possible by cutting management and senior-level positions, it is unlikely that all of the positions eliminated would be of managerial level. In addition, it is reasonable to expect that as senior managers take on greater responsibilities for the larger consolidated agency they may warrant higher compensation. If this were to occur, these additional costs would need to be considered since they would lower the potential cost savings. This reasonableness check emphasizes the importance of understanding the basis for the assumed annual savings. Based on of the information provided in the Report, ***RFC concluded that there is insufficient information to support the conclusion that a consolidation would result in the stated annual savings.***

In order to determine the true potential savings, RFC would recommend a detailed staffing analysis be performed. During this type of analysis, both the financial and operational ramifications would be examined. The specific positions being eliminated would be identified, pertinent financial information related to each position would be gathered such as salaries, benefits, expected retirement schedule, severance package details, and the potential impacts and costs associated with potential union

involvement would be considered. In addition, the operational impacts of eliminating each position would be thoroughly examined.

### SAVINGS ACHIEVED PRIMARILY THROUGH RETIREMENT/ATTRITION

RFC also reviewed the Report and supplemental information in an attempt to validate the statement that savings would be primarily achieved through retirement and attrition. As mentioned above, the Report failed to provide the specific positions proposed to be eliminated or any of the supporting information such as salary or retirement schedules. Therefore, ***RFC was unable to validate the statement that the proposed savings would be captured primarily through retirement and attrition.***

### SAVINGS ACHIEVED WITHOUT A REDUCTION IN THE LEVEL OF SERVICE

The Report stated the potential savings would be achieved without a reduction in the level of service. ***This appeared to be a statement of opinion rather than a conclusion supported by facts.*** The study analyzed the consolidated number of water employees as a factor of the number of combined water accounts serviced by the districts. The Report compared this factor of 5.0 employees per 1,000 accounts to other neighboring agencies whose factors ranged from 3.2 to 6.6. Since the factor was within the range of other neighboring agencies the Report concludes that the projected reduction in workforce and resulting consolidated employees was a reasonable assumption. This conclusion fails to take into consideration that each district is unique and assumes that the consolidated district would be capable of reducing staff and realizing additional workforce efficiencies. ***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.*** It should be noted that RMWD had 55 employees at the time the Report was written. Currently there are 51 employees and therefore the reductions would be lower than estimated. Cutting staff, when there is already a backlog of work at RMWD, does not appear to be a viable options, if the same level of service needs to be maintained.

While the analysis of the number of employees needed to serve 1,000 accounts may be used within the industry as a tool to help gauge efficiency, it is intended to be one of many tools and should be used in conjunction with other measures and information. It is possible for an agency to appear inefficient using one measure, such as the measure indicated in the Report, but in reality be very efficient and therefore unable to further increase efficiencies. This may happen for example when an agency has a small number of water use customers spread over a relatively large service area. In this instance, it may take slightly more employees to service the area but those employees may cover more miles of pipeline, travel farther, operate and service additional pump stations, and effectively move more water per day than neighboring agencies.

Eliminating positions within a given organization will result in initial cost savings, however, there are other factors to consider besides the initial cost savings. Factors that need to be considered include, but are not limited to, expected and potential growth of the service area(s), existing conditions and characteristics of

each utility/district, service area density, staff utilization/capacity, and anticipated short-term and long-term capital projects/repairs and replacements.

RFC did not see any indication or information within the Report related to an operational staffing analysis. The seven (7) reductions shown in the chart above for General Manager/Senior Staff and Administration/Finance appear reasonable based on the fact that these type of positions would likely be duplicated in the event of a consolidation. However, further analysis would need to be performed in order to determine the effect on operations of the remaining thirteen (13) reductions in the areas of Engineering and Water/Wastewater Operations. RFC would recommend a detailed staffing analysis be performed to determine whether or not a reduction in staffing would affect the level services being provided.

### CURRENT OPERATIONAL CHARACTERISTICS

As supplemental information RMWD provided an analysis of the current operational characteristics of both FPUD and RMWD. The table below summarizes the analysis/comparison.

	FPUD	RMWD	RMWD vs. FPUD
<b>Water Connections</b>	9,170	7,815	-15%
<b>Miles of Pipe</b>	270	320	19%
<b>AF/Yr</b>	10,700	20,000	87%
<b>Sewer Connections</b>	4,992	2,070	-59%
<b>Miles of Pipe</b>	78	62	-21%
<b>MGD</b>	1.75	1.00	-43%
<b>GPD Pumped</b>	40,000	126,000	215%
<b>Equivalent Employees (EE)</b>	68	51	-25%
<b>Total EE's less WWTP EE's</b>	59	51	-14%
<b>Connections per EE</b>	155.42	153.24	-1%
<b>Mile of Pipe per EE</b>	5	6	37%
<b>AF / EE</b>	181	392	116%
<b>Collection Systems EE's</b>	8	5	-38%
<b>Miles per EE</b>	9.75	12.4	27%
<b>Square Miles</b>	44	80	82%
<b>Connections / Square Mile</b>	208	98	-53%
<b>Water Miles of Pipe / EE</b>	4.58	6.27	37%

As shown in the analysis, 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. Based on this analysis, it appears that RMWD operates much more efficiently than FPUD. In this situation, it is unlikely that staffing reductions could take place within the RMWD portion of the consolidated organization without compromising service levels. ***The result of this is that cost savings to the RMWD side of the divisional accounting proposed in the consolidation will be minimized.***

## **COSTS OF CONSOLIDATION**

The Report estimated costs of consolidation at \$300,000 per year for two years. ***Again, there is no detail regarding these costs.*** Typically, reductions in upper management are accompanied by severance package which may far exceed the costs shown. Similarly, reductions in staff positions may also require severance packages, it is not clear whether these have been considered in the analysis. In the short term it is quite possible that these factors would actually increase instead of decrease costs to the consolidated entity. A detailed analysis would need to be done to estimate the actual costs of the consolidation.

Additionally, there is a California Voting Rights Act (CVRA) lawsuit pending against FPUD from the Mexican American Legal Defense and Education Fund. While the liability cannot be quantified, every agency that has been sued for a violation of the CVRA has lost or settled, and have had to pay out a significant amount of attorney's fees to Plaintiffs as a result of the loss/settlement. While this may be primarily FPUD's liability, in the event of a consolidation it would be difficult to guarantee that cross collateralization would not occur and negatively impact not just FPUD but also RMWD.

## **OTHER AREAS OF CONSIDERATION**

While the conclusions reached in the Report focused largely on the financial reasons or potential cost savings through consolidation, the Report also addressed other areas of concerns, discussed additional benefits and costs, and made recommendations regarding the business model moving forward.

### *Divisional Accounting*

The Report recommends utilizing divisional accounting whereby each division (FPUD and RMWD) would have its own accounting records. Under this approach, assets, liabilities, revenues, and expenditures would all stay within the individual divisions and divisional rates and charges could be maintained. The key concept being that one division's obligations would not become the responsibility of the other division. This approach appears reasonable and is a common practice in the industry. However, this approach has many challenges that need to be addressed. Shared assets, liabilities, and expenses such as general and administration costs would need to be allocated to each division based on the benefits received. Under this type of accounting, the appropriate allocation method would need to be determined for each different type of shared asset, any shared liabilities, and shared expenditures. The Report gives examples of possible allocation methods but does not specifically identify which approach or measures would be utilized. Staff would need to track their time or allocate their time between the divisions which can significantly impact the administrative process. ***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.***

*Financial Position*

The Report indicates the new consolidated entity “would realize a greater financial strength from the ability to report the consolidated financial statements” and went on to state “the consolidated new entity would have a stronger financial position than either FPUD or RMWD alone”. However, this may not be the case. If one entity is performing poorly and is consolidated with a better performing entity then the consolidated entity will fall somewhere between the two individual entities. Similarly, if you have two poor performing entities and you combine them they will still have a weak or poor financial position. RFC analyzed the, Revenues, Expenditures, Assets, and Liabilities figures as of June 30, 2011 as shown in the Report and included below for reference.



Contrary to the statement that the new consolidated entity would have a stronger financial position than either FPUD or RMWD alone, RFC’s high-level overview indicates that RMWD would have a stronger financial position prior to being consolidated. As shown in the table below, as of June 30, 2011 RMWD had a positive net cash flow whereas FPUD had a negative cash flow. Consolidating the entities and reporting overall results would tend to hurt RMWD’s credit rating.

	Revenues	-	Expenditures	=	Net Cash
RMWD	\$ 31.9M	-	\$ 31.7M	=	\$ 0.2M
FPUD	\$ 23.5M	-	\$ 24.2M	=	\$ (0.7M)

Similarly, RFC also performed a high-level overview of the Assets and Liabilities. Since this data is rather old, RFC reviewed the readily available 2014 Financial Reports for both FPUD and RMWD. As shown in the table below, in 2014 prior to consolidation RMWD had a liability to asset value ratio of 17.2% whereas after consolidation this would increase to 22.5%, which does not benefit RMWD’s ratepayers.

	Liabilities (As of June 30, 2014)	÷	Assets (As of June 30, 2014)	=	% Liability
RMWD	\$ 20.4M	÷	\$ 118.5M	=	17.2%
FPUD	\$ 31.1M	÷	\$ 110.2 M	=	28.2%
Consolidated	\$ 51.5M	÷	\$ 228.7M	=	22.5%

*Asset Condition Assessment*

The Report appeared to review each district’s assets and concluded that they were similar in age and infrastructure. It also indicated that significant capital rehabilitation and replacements will be needed in the future but failed to evaluate the impact this would have, if any, on the consolidation. Even though this is not an acquisition, it would be prudent to approach the consolidation as if it were an acquisition. Meaning that **besides the age of the assets or the timing of rehabilitation and replacement, the related reserves, debt obligations, and overall health and equity of the utilities should be considered.**

*Water Supply Projects*

The Report briefly discussed each district’s sources of water supply and concluded that the consolidation would have no negative impacts on existing or planned water supply projects. The Report also stated that additional benefits may be realized by expanding the FPUD recycled water program to serve RMWD customers. However, **the Report did not provide any support that this would be financially feasible or practical**, and in fact indicated that the Wastewater Treatment Plant (WWTP) needed improvements in order to improve the reliability of the recycled water system. Further analysis would need to be performed in order to confirm whether or not it would be feasible to expand the recycled water system. Due to the geographical nature of the RMWD service area (geographically spread out with lots of changes in elevation), **it is likely that expanding the recycled water system to serve RMWD customers may not be economically viable.**

*Other Potential Benefits*

The Report also identified several other additional benefits which would potentially generate further savings from the consolidation. However, the Report did not provide sufficient information to determine the real feasibility or likelihood of realizing these benefits. A minimum annual savings range of \$150,000 to \$300,000 was given **but there was no detail or support to indicate how this number was derived.** Further analysis would need to be performed in order to determine the validity of these other potential benefits.

**CONCLUSION**

Based on the review of the Draft Consolidation Study Report, RFC was unable to confirm the conclusion in the Report that “due to the timing of management retirements, the consolidation could provide an immediate savings of over \$600,000 dollars, with the potential to save an additional \$2 million over the next several years primarily through retirement and attrition without a reduction in the level of service”. It is RFC’s professional opinion that additional analyses, such as detailed staffing and operational analysis, should be performed in order to confirm the statements and conclusions contained within the Report. It is prudent and necessary to review the entire financial position of each district and confirm that a

reduction of 20 employees would have not have a negative impact on the level of service. Severance costs as well as current and future financial position should be reviewed thoroughly. ***It appears that FPUD is financially weaker and consolidation from that aspect would strengthen FPUD customers to the detriment of RMWD customers.***

# Exhibit C

## CONSULTANT AGREEMENT BETWEEN FALLBROOK PUBLIC UTILITY DISTRICT AND PHILLIP L. FORBES

This agreement is made this 25th day of May, 2012, between the Fallbrook Public Utility District (hereinafter referred to as "District") and Phillip L. Forbes (hereinafter referred to as "Contractor").

### RECITALS

WHEREAS, District desires to hire the services of an independent contractor to provide consultant services regarding district consolidation related issues; and

WHEREAS, Contractor desires to provide the district consolidation services; and

WHEREAS, the parties desire to fix the terms and conditions of said service by this agreement.

NOW THEREFORE, BE IT RESOLVED:

1. Status. District hereby contracts with Contractor, as an independent contractor, to provide consulting services regarding district consolidation related issues, for a limited project. Contractor enters into this agreement as, and shall continue to be, an independent contractor. Under no circumstances shall Contractor look to the District as his employer. Contractor shall not be entitled to any benefits accorded to District's employees including PERS retirement, worker's compensation, disability insurance, vacation, or sick pay. District makes no representation as to the effect of this independent contractor relationship on Contractor's PERS retirement benefits, and Contractor specifically assumes the responsibility for making such a determination.

2. Services. Contractor shall provide consulting services, as needed, as described in Exhibit A. Contractor shall be responsible for the manner and means of accomplishing such services. Contractor agrees that all property, including, without limitation, all equipment, tangible proprietary information, documents, books, records, reports, notes, contracts, lists, computer disks (and other computer-generated files and data), and copies thereof, created on any medium and furnished to, obtained by, or prepared by Contractor in the course of or incident to his performance of services under this Agreement, belongs to District and shall be returned promptly to District upon termination of this Agreement.

3. Compensation: Contractor shall be paid on an hourly basis as outlined in Exhibit B. Contractor shall submit an invoice, at least on a monthly basis, and shall be paid within one week. Except as otherwise provided herein, Contractor shall provide all labor, materials, and equipment as necessary to perform the services under this Agreement without any additional

1-5-12	3,100.00	11,140.00	10/25/12	2965-81	104,191-
-31-12	2,475.00	11,925			
-10-12	7,325.00	44,300			
-13-12	1,500.00	3,800			

Phillip L Forbes  
Consulting Services

September 13, 2012

6486  
INVOICE # 6486  
DISCOUNT \$  
NET DUE \$ 1500.00

2717 Via Del Robles  
Fallbrook, CA 92028

760-330-1790

Brian Brady

GENERAL EXPENSE AMOUNT  
2908-00-07 1500.00


phillipforbes7@gmail.com

General Manager

Fallbrook Public Utility District

990 East Mission Road

Fallbrook, CA 92028

APPROVAL  INPUT DATE SEP 13 2012  
FPUD/2110D-JC. Start Review

INVOICE

For the Period from June 22, 2012 through September 12, 2012

August 3, 2012	- Planning Meeting with Brian Brady	1.0
August 19, 2012	- Prepare and Review Presentation for September 11, 2012 Joint Board Meeting	1.0
September 10, 2012	- Prepare for September 11, 2012 Joint Board Meeting	.5
September 11, 2012	- Attend Joint Board Meeting	2.0
	4.5 Hours @ \$ 200 Per Hour	\$ 900
	Attached Invoice from Jeff Armstrong Dated September 11, 2012	600
	Total Invoice Payable to Phillip Forbes	\$ 1,500

0.12  
11282  
9/13/12

Jeff Armstrong  
27601 Dogwood Street  
San Diego, CA 92162

DATE: SEPTEMBER 11, 2012  
INVOICE # 003

TO Phillip Forbes  
2717 Via Del Robles  
Fallbrook, CA 92028

QTY	DESCRIPTION	UNIT PRICE	LINE TOTAL
2.0	Revise Presentation to a condensed version and review material for the public meeting 8-18 through 9-10	150	300.00
2.0	Attend Public Meeting 9-11-12	150	300.00

•

TOTAL \$600.00

Thank you for your business!

Jeff Armstrong  
27661 Dreyfus Street  
Munich, CA 92562

DATE: OCTOBER 23, 2012  
INVOICE # 004

TO Phillip Forbes  
2717 Via Del Robles  
Fallbrook, CA 92028

QTY	DESCRIPTION	UNIT PRICE	LINE TOTAL
2.25	Begin report on Divisional Accounting 9-25-12	150	337.50
3.00	Revisions to Divisional Accounting & Begin Pro-Forma report 9-28-12	150	450.00
2.50	Additional work on both reports 9-29-12	150	375.00

TOTAL \$1,162.50

Thank you for your business!

Phillip L. Forbes  
Consulting Services

2717 Via Del Robles  
Fallbrook, CA 92028

760-330-1790

phillipforbes7@gmail.com

October 25, 2012

INVOICE 6486  
INCREASE \$  
DISCOUNT \$  
NET DUE \$ 2965.81

JOB GL EXPENSE AMOUNT  
2903-02-07 2965.81

Brian Brady

General Manager

Fallbrook Public Utility District

990 East Mission Road

Fallbrook, CA 92028

DATE  
9/27/12

SPUD, R. W. D. 32 100 Review

INVOICE

For the Period from September 13, 2012 through October 24, 2012

September 19, 2012	- Planning Meeting with Brian Brady	1.0
September 19, 2012	- Telephone Conference with Jeff Armstrong	.5
September 24, 2012	- Planning Session with Jeff Armstrong	1.0
September 28-29, 2012	- Prepare and Review Sections of LAFCO Consolidation Application	3.0
September 28, 2012	- Telephone Conference with Julie Reeder of The Village News	.25
October 3, 2012	- Planning Session with Brian Brady	1.0

Phillip L Forbes  
Consulting Services

INVOICE – continued

2717 Via Del Robles  
Fallbrook, CA 92028

760-330-1790

phillipforbes7@gmail.com

October 15, 2012	- Review LAFCO Consolidation Application	1.0
October 23, 2012	- Planning Meeting with Brian Brady	1.0

8.75 Hours @ \$ 200 Per Hour \$ 1,750.00

Attached Invoice from Jeff Armstrong Dated October 23, 2012 1,162.50

Miscellaneous Expenses from October 3 and October 23, 2012 53.31

Total Invoice Payable to Phillip Forbes \$ 2,965.81

OK  
MB  
10/26/12