

**MINUTES OF THE SPECIAL BOARD MEETING
OF THE BOARD OF DIRECTORS/BUDGET AND FINANCE COMMITTEE
OF THE RAINBOW MUNICIPAL WATER DISTRICT
JUNE 20, 2012**

1. **CALL TO ORDER** - The Special Meeting of the Board of Directors/Budget and Finance Committee of the Rainbow Municipal Water District on June 20, 2012 was called to order by President McManigle at 4:00 p.m. in the Board Room of the District, 3707 Old Highway 395, Fallbrook, CA 92028. President McManigle and Vice Chairperson Petty presiding.

2. **PLEDGE OF ALLEGIANCE**

3. **BOARD OF DIRECTORS ROLL CALL:**

Present: Director Brazier
Director Griffiths
Director Lucy
Director McManigle
Director Sanford

BUDGET AND FINANCE COMMITTEE ROLL CALL:

Present: Member Clyde
Member Petty
Member Lucy

Absent: Member Fagan
Member Carlstrom
Member Stitle

Also Present: General Manager Seymour
Assistant General Manager/District Engineer Lee
Finance Manager Buckley
Accountant Thomas
Superintendent Miller
Superintendent Maccarrone
Superintendent Walker
Human Resources & Safety Manager Bush
Executive Assistant/Board Secretary Washburn
Water Operations & Customer Service Manager Atilano
Associate Engineer Plonka
Supervisor Zuniga
Utility Worker Coffey
Utility Worker Hoelscher
Utility Work Heincy
Administrative Assistant Dechert

(*) - Asterisk indicates a report is attached.

Three members of the public were present.

4. PUBLIC COMMENT RELATING TO ITEMS ON THE AGENDA

There were no comments.

5. BOARD MEMBER COMMENTS

Mr. Seymour announced RMWD has recovered approximately \$191,000 from FEMA after the relentless efforts of Superintendent Miller.

6. COMMITTEE MEMBER COMMENTS

BOARD AND COMMITTEE MEMBER INFORMATIONAL ITEMS

7. PRESENTATION AND DISCUSSION REGARDING PRO-FORMA BUDGET AND OTHER FINANCIAL MATTERS RELATING TO THE POTENTIAL CONSOLIDATION BETWEEN THE RAINBOW MUNICIPAL WATER DISTRICT AND FALLBROOK PUBLIC UTILITY DISTRICT

(Consultants will make a presentation regarding a draft budget and divisional accounting practices. Although this meeting is scheduled as a Budget and Finance Committee Meeting, it has been noticed as a Board Meeting in case a quorum of the Board is present.)

(This item is for information only.)

Mr. Seymour presented copies of the schedule for the entire consolidation and merger of RMWD with FPUD processes.

Mr. Seymour announced today everyone will take a first look at the financial analysis to the Budget and Finance Committee and how the meeting was announced as a potential Board meeting in case a quorum of Board members were to attend which did occur. He also pointed out the plan was not to take any action today due to the fact it was informational only and provide an opportunity to get input and ask questions.

Mr. Seymour introduced Phil Forbes and Jeff Armstrong as the consultants working for RMWD and FPUD who will be giving the presentation today beginning with some background information on the consultants themselves.

Mr. Forbes addressed the Board and thanked everyone for coming to the meeting. He mentioned they had a similar meeting on Tuesday, June 19th, at FPUD with their finance committee. He introduced Jeff Armstrong, the current Chief Financial Officer and Treasurer at Rancho California Water District with whom he has worked for twenty-four years on various projects.

Mr. Forbes noted how Rancho California had a very similar situation as to what RMWD was experiencing with the thought process of potential consolidation with FPUD. He pointed out there was actually a merger and consolidation in the 1970's in the Temecula/Murrieta area where there were once two water districts that both he and Mr. Armstrong worked on together on the divisional accounting.

(*) - Asterisk indicates a report is attached.

Mr. Forbes discussed the Divisional Accounting for the potential consolidation of FPUD and RMWD slide of the presentation. He noted the cost of one District does not become the cost of the other, the assets and liabilities can be separated, the rates are set to reflect each District's cost of service, and the revenues are applied to appropriate divisions. He explained both service areas could stay in place and become the two divisions under one consolidated District.

Mr. Petty asked if a Memorandum of Understanding would need to be established between the districts. Mr. Forbes stated it could be should the Board Members decide to proceed in that manner. Mr. Forbes pointed out the District does not necessarily have to be set up as divisions; however, this was the practice in which he and Mr. Armstrong have experience. Mr. Seymour added LAFCO explained to them that the two districts can come up with whatever agreement everyone agrees to and then put it into a Work Plan, as opposed to a Memorandum of Understanding, to present to them for consideration and possible approval.

Director Griffiths inquired as to how there could eventually become united as one facility. Mr. Forbes recalled the concept being presented at this time was an accounting technique for one district that will be sharing facilities, assets, etc. with two separate divisions.

Mr. Forbes provided a comparison of the Rancho California Water District Demographics and what a combined consolidated RMWD and FPUD would look like. He stressed the importance of achieving higher bond and credit ratings after consolidating.

Director Sanford expressed concern the number of employees proposed for RMWD and FPUD at 103 may be heavy when Rancho California Water District is much larger operating with 147 employees. Mr. Forbes explained RMWD and FPUD have more wastewater employees than Rancho California.

Mr. Forbes touched on the Rancho California Water District consolidation with Santa Rosa Ranches Water District in 1976 including the Eastside Property Owners lawsuit filed in 1980 in which a Settlement Agreement was reached in 1981 clarifying/defining the terms of the consolidation resolution to ensure appropriate divisional accounting.

Mr. Forbes turned the presentation over to Mr. Armstrong. Mr. Armstrong talked about the technical aspects of establishing accounting systems to record revenue and expenses to really address the issues regarding equity and fairness between two different divisions. He reviewed Activity Based Costing utilizing separate job numbers for each activity as well as an example of divisional accounting and how it flows through a chart of accounts. He continued to demonstrate how an allocation of shared costs could be achieved.

Discussion ensued clarifying the allocation of shared costs and what that entailed.

Mr. Forbes presented examples of Rancho California Water District's statements in order to demonstrate the results of the allocated shared costs. Mr. Forbes confirmed for Director Griffiths this was a hard bookkeeping activity.

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Mr. Armstrong discussed the Rancho California Water District sets of rates by division. He verified the numbers presented on the slide were actual numbers. He noted when the rates are combined, the M&I rates are actually higher than the agricultural rates. Mr. Forbes and Mr. Armstrong confirmed RCWD does co-mingle the water of Rancho and Santa Rosa divisions.

Discussion ensued regarding the type of water utilized by these two divisions.

Mr. Petty said since they have covered the operational aspect of consolidation, he wanted to know if there would be discussion on the capital improvement and infrastructure side. Mr. Forbes said although he doesn't know the operations of RMWD, there may be facilities the district may want to share operationally to be more efficient and cost effective. Mr. Armstrong pointed out the financial software system may be something else that could possibly be combined in order to cut expenses by sharing it equally.

Director Lucy asked if during the Rancho California merger if there were some things that were such a burden with the divisional accounting that efficiencies were lost. Mr. Armstrong stated he thought it was important to understand exactly what steps needed to be taken in order to make sure everything was dialed into correctly and know what you are doing. He stated it was little extra work, but not a significant burden. Mr. Forbes added when he arrived, they were able to enhance, improve, and fully automate the divisional accounting system.

Director Griffiths asked what the final objective was for Rancho California Water District for fifty years down the line. Mr. Forbes stated with the actions that took place when the Rancho California and Santa Rosa districts were merged with the LAFCO order, they were to remain separate divisions and should they try to combine it could create a lawsuit relative to the cause. He said he felt this was a fair and equitable means of merging the two entities. He also noted the Board Members of RMWD and FPUD would have to make the ultimate decisions and all he and Mr. Armstrong could do was share their experiences.

Director Sanford asked if they had one general manager and separate division managers. Mr. Forbes stated they did not; they had one general manager, one Chief Financial Officer, and one staff.

Mr. Petty asked about the physical facilities that are being brought to the table as well as the capital expenditure programs for each of the entities and how they would be meshed and how did they determine a value of the two areas. Mr. Forbes provided a response that they did a lot of long term financial planning at Rancho (30+ years into the future) based on engineering studies that projected capital facility numbers. He pointed out that engineering study would be refreshed every two or three years with tweaks as the divisions moved along. Mr. Armstrong stated by identifying things as Mr. Forbes explained, each division was still identifying the capital needs of each division and then the financial plan for that division would run it accordingly. Mr. Petty asked for confirmation that during the process they were able to identify facilities that will be equally shared or benefit both divisions. Mr. Forbes confirmed this was true.

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Director Lucy inquired as to how many employees there were when the Rancho California Water District consolidation began back in the 1970's. Mr. Forbes said he was unclear how many employees there were in the 1960's and 1970's; however, when he arrived there in 1986 there were 100-110 employees. He noted the growth impacted the district immensely and they were forced to outsource for construction crews, meter installations, and a great deal of other work during the massive growth period. Director Lucy stated RMWD has concerns with reducing water sales over the next ten years when Rancho California Water District were fortunate of having real growth increase in the meter and water sales. Mr. Armstrong added although they saw the employee count ramp up, it has tapered off and has remained at the same level for quite some time. He pointed out they were currently shifting their current staff to address maintenance issues.

Director Lucy asked what the main motivation was for the Rancho/Santa Rosa merger. Mr. Forbes said he believed both boards were controlled by the same landowners due to the fact there was not much in the area.

Ms. Thomas said when listening to the financial philosophy, it sounded to her that when Rancho Water and Santa Rosa merged, they shared the same philosophy versus RMWD and FPUD that do not share the same philosophy. She provided the example of one district having bond issues and other does not. Mr. Forbes explained when Rancho and Santa Rosa merged; a revenue stream was set up to pay the bonds back over time and had property assessment in place.

Director Sanford inquired how going out for a bond issue gets addressed when there are two divisions. Mr. Forbes stated if the asset being bonded strictly benefits one division, then the other division would not be obligated for the bond. He explained how in recent years, the bond issuances at Rancho/Santa Rosa have been consolidated for Rancho California Water District; therefore, technically the obligation was over the entire district with the accounting mechanism being a divisional mechanism so that the asset and the liability for the bond liability would be on the division that the bond benefited. He confirmed divisional bonds could be issued; however, he cautioned it would not be the way to go in that it would be more costly than the issuance of a consolidated bond due to the higher credit rating.

Director Griffiths asked how the ratepayers would vote on something like divisional bonds. Mr. Forbes said his experience was that it would need to be determined by the agency how the ratepayers would vote on issues. Director Griffiths expressed concern that concentrated areas of population could control the outcome of the voting process due to the fact RMWD has worked very hard to keep the Rainbow areas as rural as possible. Mr. Seymour stated the voting process would all depend on LAFCO.

A member of the Fallbrook Panning Group said it has never had a problem with isolating certain areas due to the fact members are elected at large. Discussion followed.

Mr. Seymour asked if RMWD has a reservoir close by Fallbrook's infrastructure and it is determined it would be very cost effective for Fallbrook to utilize it, would there be a way FPUD could pay RMWD to compensate its maintenance, repairs, etc. Mr. Armstrong explained something could be established based on the asset value on the front end so that the asset can

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be split up and then divide the cost of the population between divisions. Mr. Petty stressed how to divide up the assets was extremely important part of the financial situation in this process especially when it comes to dividing up assets, infrastructure, etc. Mr. Forbes stated these things do not happen overnight; therefore, there is time to evaluate everything and get it set up right.

Director Griffiths asked whether or not RMWD could join Metropolitan Water District directly. Mr. Seymour answered it was not possible due to the fact MWD would not allow RMWD to join them. Discussion ensued.

Mr. Forbes talked about the Assumptions and Data Source information provided in the slide presentation. He noted their information came from the numbers provided by both RMWD and FPUD. Mr. Armstrong ran through some of the Pro-Forma Assumptions provided in the handout.

Mr. Forbes talked about the labor projections over three years. He pointed out it was key to note the reduction in staff at the current levels that are budgeted due to the fact there are several unfilled positions at both RMWD and FPUD. He noted they were essentially projecting that in Year 1 of the consolidation there would be six fewer staff, six more in Year 2, and eight in Year 3. He stated two of the reduced staff members would be through expected retirements in Year 1. He mentioned this would be where the biggest savings would come from with a consolidation due to duplication in executive staff as well as other areas that could be combined.

Mr. Forbes reported the cost of consolidation for Year 1 has been estimated at \$300,000 and another \$300,000 in Year 2.

Mr. Forbes pointed out there were other potential benefits such as both districts utilizing the same accounting computer software; however, they did not attempt to quantify what all of them were in order to keep from presenting a projection that was too optimistic. Mr. Armstrong added after they had looked at all the costs, they proceeded to increase the water revenue at the same projection as water costs and all other revenue to 3% to make it balance.

Mr. Armstrong presented the Consolidation Results in Potential to Reduce Workforce and how the reduction would be phased.

Mr. Armstrong walked everyone through the numbers provided in the Consolidation Benefit Assumptions – Workforce. He pointed out that by looking at the average rate flow per employee for both districts, it is actually very close. He explained in Year 1 there are only two positions they were aware of and the other four from RMWD were only utilized for the purpose of preparing the benefit assumptions. He noted the annual savings of \$975,000 would be for six positions in the first year including labor, benefits, and everything folded in. He pointed out the \$975,000 savings would be offset by the \$300,000 consolidation costs bringing the net savings to \$675,000. He continued to review the savings for the second year which totals \$668,000 after reducing six more positions bringing the cumulative savings to \$1,643,000 less

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the consolidation costs of \$300,000 for a net savings of \$1,343,000. He reviewed the third year pointing out after reducing staff eight more positions would make the annual savings \$892,000 bringing the cumulative total savings to \$2,535,000. He noted in Year 3 and every year after the combined district would have a savings of \$2.5M with the reduction in staff. Mr. Seymour pointed out some of these figures were soft and some were hard costs. Mr. Forbes said he thought the \$600,000 cost associated with consolidating seemed to be reasonable.

Mr. Armstrong explained the matrix prepared to show the employee per 1,000 water accounts provided in the handout. He stated this matrix was prepared in order to do a check to make sure the numbers were reasonable. Mr. Seymour pointed out the matrix was not saying RMWD was like Rancho California Water, but rather show the numbers going down was a good thing.

Mr. Forbes stated the information provided on the Other Potential Benefits page was not quantified. He said he hoped in the future RMWD would become a member of JPIA again in order to reduce insurance costs in the future due to the fact it would be a benefit to RMWD. Discussion followed.

Mr. Forbes continued to explain the list of cost reduction opportunities as well as income enhancement opportunities associated with a consolidation including possibly reducing the things both districts currently outsource or vice versa.

Mr. Petty asked about the engineering staff and how the two would combine. Mr. Seymour said this was one of the areas that would be consolidated eventually through attrition over a few years without layoffs. Mr. Petty inquired about the utilization of the yards and facility stations. Mr. Seymour explained RMWD would be more of the operation and maintenance yard and the FPU D would house the administrative aspects of the operation.

Mr. Armstrong explained the Three Year Pro-Forma information provided in the handout in order to show how the savings would total \$2,535,000 per year. Mr. Seymour pointed out although there would be an approximately \$.20 per hundred cubic foot cost savings, there would not be a water rate reduction due to the fact Metropolitan Water District would eat up those savings in their costs. Mr. Armstrong presented the Consolidated Pro-Forma Summary.

Mr. Forbes noted they had provided a statement of net assets in order to show how the assets and liabilities could improve should the two districts merge. He stressed the two agencies could qualify for a better credit rating as a combined consolidated district.

Mr. Forbes summarized the points made on the "Wrap Up" page of the handout.

President McManigle asked if there were any questions.

Director Griffiths stated he had some misconceptions regarding these consultants scope of work and asked whether or not they were finished with the project with which they were tasked. Mr. Forbes stated this would be up to the Boards and General Managers, but essentially they were finished today.

Mr. Seymour mentioned he had provided copies of comments relating to the possible consolidation received from Mr. Strapac, a member of the Engineering Committee (attached

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hereto). He also mentioned he had provided everyone with a copy of the schedule of events that have taken place or will take place during the consolidation investigation process.

Mr. Petty pointed out this presentation was regarding to basically presenting the financial data and the kind of framework in showing the Board consolidation could be done and hoped there would be a similar meeting on some of the other aspects of it including the politics of the situation. Mr. Seymour pointed out Mr. Lee and Mr. Bebee of FPUD were conducting a facility condition assessment of the infrastructure to try to compare and contrast the two agency facility conditions. He added Mrs. Bush and the Human Resources person at FPUD were also putting together a comparison or matrix of the employee Memorandum of Understandings and how that would come into play when it comes to addressing the matter of employees. He stated hopefully by the end of October these reports will be ready for review. He concluded by stating the Boards will need to decide the political aspect of merging.

Director Griffiths said he did not see any planned bond issues FPUD may be involved in trying to achieve. Mr. Forbes stated they were currently unaware of any bond issues coming up in the next three years; however, should they become aware of any they could be built into any of the projections.

Jack Woods of the Fallbrook Planning Group said he did not see any increase in hookups or sewer connections based on the developments on the east of Interstate 15. He pointed out should those developments occur it would increase the RMWD's revenues. Mr. Seymour explained in order to provide a more "apples to apples" comparison these developments were not included at the request/requirement of LAFCO, especially due to the fact these may or may not occur for more than three years down the road. Director Lucy mentioned the Budget and Finance Committee's has been taken a look at these issues and presented five and ten year projections to the Board.

Mr. Clyde said as a matter of course for both Boards and/or Budget and Finance Committees, he felt a list of all contracts that are in force that will expire over the next 2-5 years ought to be listed for everybody's review so they are not surprised with something two years after in the interest of this merger.

Director Brazier noted the Board needed to make an imminent decision in regarding the possibility of an offer of monies from the State Revolving Fund and whether or not the district go out to the ratepayers regarding incurring indebtedness to cover that loan. Mr. Seymour said he anticipated one or both loans would be offered prior to the decision to consolidate.

Discussion ensued regarding whether or not the Budget and Finance Committee had a quorum. It was decided it did not matter since there were no action items on the agenda.

8. LIST OF SUGGESTED AGENDA ITEMS FOR THE NEXT SCHEDULED BUDGET AND FINANCE COMMITTEE MEETING

There were no items suggested.

(*) - Asterisk indicates a report is attached.

9. **ADJOURNMENT - To Tuesday, June 26, 2012 at 12:45 p.m.**

Action:

Moved by Director Brazier to adjourn. Seconded by Director Sanford

5:42:00 PM

After consideration, the motion CARRIED by the following vote:

AYES: Director Brazier, Director Griffiths, Director McManigle, Director Lucy, and Director Sanford.

NOES: None.

ABSTAINED: None.

ABSENT: None.

The meeting was adjourned with a motion made by Director Brazier and seconded by Director Sanford to a regular meeting on July 24, 2012, at 1:00 p.m.

The meeting was adjourned at 5:42 p.m. 5:48:08 PM

George McManigle, Board President

Dawn M. Washburn, Board Secretary

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