

October 7, 2019

TO: Honorable President and Board of Directors

FROM: Gary Arant, General Manager

SUBJECT: FALLBROOK PUBLIC UTILITY DISTRICT AND RAINBOW MUNICIPAL WATER DISTRICT DETACHEMENT FROM THE SAN DIEGO COUNTY WATER AUTHORITY

PURPOSE:

To provide the Board with an overview of the Valley Center Municipal Water District consultant's report regarding the potential detachment of the Fallbrook Public Utility District (FPUD) and the Rainbow Municipal Water District (RMWD) from the San Diego County Water Authority (SDCWA), as well as additional information provided by FPUD, RMWD and the SDCWA.

SUMMARY:

At a Board Meeting earlier this year, staff reported that FPUD and RMWD were evaluating detaching from the SDCWA and annexing to the Eastern Municipal Water District (EMWD). It was also reported at that time that these agencies were contemplating this action based upon the potential cost savings between paying the EMWD wholesale rate versus the SDCWA wholesale rate, purportedly to be almost \$600 / AF savings.

The FPUD / RMWD estimate of cost savings is based upon the interpretation that they can leave the SDCWA without taking with them their respective share of any outstanding SDCWA debt. Obviously, the SDCWA has expressed a different point of view. Assuming that FPUD and RMWD actually make the formal filing for detachment/annexation, these differing points of view will be played out during what will likely be a lengthy, complex and contentious LAFCO process involving both the San Diego and Riverside LAFCOs.

Staff has several concerns about this issue and conveyed to the Board that it wanted to secure the services of a consultant to evaluate a number of associated issues, including:

1. What is the process involved with two SDCWA Member Agencies detaching from the SDCWA and annexing to another MWD Member Agency?
2. What is the legal likelihood it can happen within the context of the SDCWA and LAFCO statute?

3. What will be the financial impact on the SDCWA Member Agencies remaining in the SDCWA?; and
4. Could VCMWD do the same or similar thing to reduce the cost of water to its ratepayers?

The fourth and final question is based on the anticipation that when the District's agricultural customers become aware of the potential cost savings associated with these detachments they will want to know why VCMWD is not taking the same course of action to reduce their cost of water.

To address these issues, staff secured the services of Ken Weinberg, Ken Weinberg Water Resources Consulting, LLC. Mr. Weinberg is the former long-time Director of Water Resources at SDCWA, and the private consultant used by both FPUD and RMWD to do the initial analysis of a potential detachment from the SDCWA and annexation to EMWD. Given Mr. Weinberg's depth of background on the SDCWA and the current knowledge of the detachment issue at hand, staff felt he was the best choice to efficiently research and present the findings from the perspective of VCMWD.

Mr. Weinberg will be with us today to present his report, a copy of which is attached for your review. We have also attached for your information a copy of the "***Preliminary Financial Impact Analysis – De-Annexation, August, 2019,***" developed by the SDCWA.

RECOMMENDATIONS:


This is an informational item only at this point and no action is needed or requested.

SUBMITTED BY:



**Gary Arant
General Manager**

Attachments



**POTENTIAL DETACHMENT
OF FALLBROOK PUBLIC
UTILITY DISTRICT AND
RAINBOW MUNICIPAL WATER
DISTRICT FROM SAN DIEGO
COUNTY WATER AUTHORITY**

**Analysis of Key Issues and Impact on Valley Center
Municipal Water District**

September 2019

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Introduction

Over the last several months Rainbow Municipal Water District (RMWD) and Fallbrook Public Utilities District (FPUD) have been in the process of evaluating whether it is in the long term interests of their ratepayers to remain as a member agency of the San Diego County Water Authority (SDCWA) a member agency of the Metropolitan Water District of Southern California (MWD) or to detach from SDCWA and consider annexation to the Eastern Municipal Water District (EMWD), also a member agency of MWD. EMWD has indicated to both Districts that under its existing rate structure an \$11/AF mark up would be charged over and above the MWD water rate resulting in significant savings on water purchase prices for both agencies. Valley Center Municipal Water District (VCMWD) has indicated that as a member agency of SDCWA it is concerned about the detachment of these two agencies because of the financial impact such an action may have on it and other SDCWA member agencies. VCMWD is also concerned about the future of the Transitional Special Agricultural Water Rate (TSAWR) whose continuation is up for review by SDCWA for the fifth time in 10 years and the concurrent need to clearly articulate why it is not able to take a similar course to potentially reduce water costs to both its Agricultural and Municipal & Industrial (M&I) its customer base. The County Water Authority Act, Water Code §4511¹, provides for the “Exclusion of Territory” from SDCWA.

The evaluation of a potential de-annexation from SDCWA and annexation to EMWD has led both agencies to consider two primary criteria that determine the effects on both Districts ratepayers.

1. long term cost to the ratepayers of remaining a member agency of SDCWA versus annexation to EMWD
2. comparative water supply reliability and associated risk of water shortages of membership in each wholesale water supplier.

On August 21, 2019 RMWD and FPUD jointly submitted a written document entitled *Summary of Potential Rainbow Municipal Water District and Fallbrook Public Utility District Detachment/Exclusion from the San Diego County Water Authority and Annexation to Eastern Municipal Water District*. The joint document provided the financial basis for the two Districts consideration of detachment from SDCWA and annexation to EMWD, and outlined the legal process required to complete the detachment and annexation. In the document submitted by the two agencies to SDCWA they provided the financial comparison of purchasing wholesale water from SDCWA and as a potential member agency of EMWD.

The purpose of this Memorandum is to discuss the issues underlying RMWD and FPUD consideration of detachment, the financial effect on the two Districts and other SDCWA member agencies, and the legal process for implementing such a decision.

¹ County Water Authority Act (As of January 1, 2010) West’s Annotated California Codes Water Code-Appendix Chapter 45. See Appendix A for full text of this section.

Comparison on SDCWA and Potential EMWD Wholesale Rates

<i>Rate</i>	<u><i>TSAWR</i></u>	<u><i>SDCWA FS</i></u>	<u><i>EMWD</i></u>
<i>Treated</i>	\$1,192	\$1,686	\$1,078
<i>RTS</i>	28	28	82
<i>CC</i>	24	24	24
<i>IAC</i>	43	43	0
<i>EMWD</i>			11
<i>Total</i>	\$1,287	\$1,781	\$1,195
<i>Rate Differential From SDCWA FS</i>			(\$586/AF)
<i>W/O Transportation</i>			(\$454/AF)

Source: RMWD and FPUD

The above chart displays the Calendar Year 2020 water rates that the two agencies pay under the Transitional Special Agricultural Water Rate (TSAWR) and Full Service M&I compared with the potential wholesale rate purchasing imported water from EMWD. Both agencies note the significant savings purchasing wholesale water from EMWD and state their belief that in the long term they do not expect the differential between SDCWA and EMWD to substantially change resulting in tens of millions of dollars in savings to customers of RMWD and FPUD.

Key Issues in Detachment

In addition to the cost savings both agencies believe they will realize there are two other issues that are part of the discussion over detachment.

Supply Reliability

As noted above, a decision over detachment takes into consideration the main factor of balancing cost and reliability. With FPUD and RMWD their customers currently are characterized by two different levels of reliability.

Both agencies have a significant number of customers participating in TSAWR and in return for the discounted water rate from SDCWA receive a lower level of reliability in a drought shortage being tied solely to the availability of MWD supplies and not receiving any of the SDCWA's more reliable supplies from the Colorado River, Carlsbad Desalination Project or Carryover Storage Project (CSP) supplies. In a catastrophic emergency TSAWR customers are cut back at twice the rate of M&I customers under the Emergency Storage Project (ESP).

However both agencies have a majority of customers (59% combined) that do not participate in TSAWR and purchase Full Service M&I water from SDCWA benefitting from all of SDCWA's more reliable sources of supply. As evidenced in the last two droughts where cutbacks were initiated by MWD (2010-2011 and 2015-2016) SDCWA reliability was greater and cutbacks substantially lower than the MWD regional cutback level. Although MWD maximum cutback levels during both those droughts was 15%, SDCWA because of its more reliable supplies, provided greater reliability to its member agencies M&I customers during both shortages. In a potential annexation to EMWD FPUD and RMWD M&I customers would be tied to MWD reliability and supply availability in both droughts and catastrophic emergencies. In a catastrophic emergency, such as an earthquake that cuts off imported supplies MWD has emergency storage supplies that would provide a 75% level of Service to its member agencies similar to SDCWA Emergency Storage Project (ESP). However, SDCWA would be able to provide emergency service in the event of an earthquake on the Elsinore Fault that would disrupt Lake Skinner and other associated facilities that serve San Diego county. This would result in a lower level of reliability for those customers in an annexation to EMWD compared to remaining in SDCWA.

It is important to note that FPUD is about to commence construction on a large scale groundwater Conjunctive Use Project in cooperation with Marine Corps Base Camp Pendleton that will result in an average of 3,100 acre feet per year of new local supply or meet roughly 30% of FPUD's annual demand. This will make FPUD's M&I customers much less dependent on either SDCWA or EMWD/MWD in a drought or catastrophic emergency shortage.

Cost Impact To SDCWA Member Agencies

An emerging issue in a potential detachment from SDCWA would be the loss of revenue from FPUD and RMWD that would have to be made up by higher rates and charges to the remaining SDCWA Member agencies .

SDCWA revenues collected from Member Agencies consist of the following general components:

- Variable Commodity Charges
 - Melded Supply Rate
 - TSAWR Supply Rate
 - Transportation Charge
 - Melded Treatment Rate
- Volumetric Fixed Charges
 - Customer Service
 - Storage
 - Supply Reliability
- Non-Volumetric Fixed Charges
 - Infrastructure Access Charge
- Property Tax/Standby Availability Charges

SDCWA staff conducted an analysis that quantified the loss of revenue from FPUD and RMWD if the detachment occurred in FY 2018². That analysis estimated a loss of approximately \$13.3 M annually that would be required to be allocated other member agencies (see Table 1 below). In applying the loss of revenue to Calendar Year 2020 rates SDCWA staff estimated a \$16/AF increase in 2020 rates associated with FPUD and RMWD detachment (see Table 2). That increase would equate to a 1% increase from the approved 2020 SDCWA rate of \$1,686/AF.

Table 1: Preliminary De-Annexation Net Impact

	Forecasted Impact (\$)
Anticipated Avoided Costs	
Avoided Supply Purchases	\$22,268,000
Avoided Treatment Expense	\$9,526,600
Avoided SDCWA O&M	\$0
Total Avoided Costs	\$31,794,600
Anticipated Revenue Loss	
Supply Reliability Charge	\$1,594,400
Customer Service Charge	\$1,691,700
Storage Charge	\$2,787,700
Infrastructure Access Charge	\$1,165,700
Melded Supply Rate	\$25,391,300
Melded Treatment Rate	\$8,258,300
Transportation Rate	\$1,292,800
Other Revenue (1)	\$2,979,800
Total Anticipated Revenue	\$45,161,700
Net Impact	-\$13,367,100
<i>(Avoided Expense - Revenue Loss)</i>	

(1) Includes Property Tax, Standby Charge, and Capacity Fees (FY 2018)

Source: SDCWA

In its August 21, 2019 submission to SDCWA FPUD and RMWD calculated just under \$10 M reduction in revenue for FY 2018 noting that its analysis included MWD fixed charges that would no longer be assessed to SDCWA as it would be payable by EMWD. FPUD and RMWD noted SDCWA’s annual Operating Revenue in FY 2018 was \$686 M making the reduction in revenue range from 1.5% to 2% of total operating revenue.

² Preliminary Financial Impact Analysis | De-Annexation, SDCWA, August 2019

Table 2: Revenue Impact by Rate Category

Fixed Charge Impact	CY2020
Revenue Loss (from Table 1)	\$7,239,552
Transportation Rate Impact	
Revenue Loss	\$1,292,800
CY 2020 Deliveries (less R&F)	367,819
Rate Impact	\$3.51
Melded Supply Impact	
Revenue Loss (Supply)	\$3,123,300
Revenue Loss (Other Revenues)	\$2,979,800
CY 2020 Deliveries (less R&F)	367,819
Rate Impact	\$16.59
Melded Treatment Impact	
Revenue Loss	(\$1,268,200)
CY 2020 Deliveries (less R&F)	367,819
Rate Impact	(\$3.45)
Variable Rate Impact	
Transportation Rate	\$3.51
Melded Supply Rate	\$16.59
Treatment Rate	(\$3.45)
Total Volumetric Rate Impact	\$16.66

Source: SDCWA

Other Factors Affecting Reduced Revenues

The issue of reduced revenue for SDCWA is not confined to the potential detachment of FPUD and RMWD. SDCWA’s Board of Directors is involved in revisiting its 2015 Fiscal Sustainability process because substantial amounts of member agency local supply projects are coming online in the next 5-10 years that will reduce revenues from its variable commodity rates and volumetric fixed charges. The volumetric fixed charges are based on individual member agencies rolling averages of SDCWA deliveries and cannot be totally avoided based on single year of deliveries³. These sources of revenues are based on the amount of SDCWA deliveries to member agencies and local supplies reduce the amount of water delivered by SDCWA subject to these charges.

The difference between the reduction in revenue resulting from member agencies purchasing less SDCWA water and potential detachment of FPUD and RMWD is revenue collected though

³ The Customer Service Charge is based on the prior 3 years of total deliveries. The Storage Charge is based on the prior 3 year average of non-agricultural (non-TSAWR) deliveries. The Supply Reliability Charge is based on the prior 5 year average of non-agricultural deliveries

the non-volumetric fixed charges (Infrastructure Access Charge or IAC⁴), Property Tax and Standby Availability Charge. According to SDCWA's August 2019 analysis in FY 2018 FPUD and RMWD paid a combined \$4.1 M in those charges or 0.6% of FY 2018 Operating Revenue. This loss of revenue distinguishes detachment by RMWD and FPUD from reduced revenues associated with member agency local supply development.

Another cost issue that has emerged is whether a detaching agency is required to pay an "Exit Fee" associated with SDCWA bonded indebtedness. This issue is linked to §4511 of the CWA Act that in part reads:

(1) Territory excluded from the portion of the corporate area of any public agency which lies within the exterior boundaries of a county water authority, the public agency being a unit of the authority, and which exclusion occurs in accordance with the provisions of law applicable to those exclusions, shall thereby be excluded from and shall no longer be a part of the authority; provided, that the taxable property within the excluded territory shall continue to be taxable by the county water authority for the purpose of paying the bonded or other indebtedness outstanding or contracted for at the time of the exclusion and until the bonded or other indebtedness has been satisfied

FPUD and RMWD have interpreted the "*taxable property shall continue to be taxable for the purpose of bonded indebtedness*" does not apply since SDCWA has no debt secured by property taxes. SDCWA has not opined or indicated its legal position on this issue.

Next Steps

After notifying the SDCWA Board of their intentions at the August 22, 2019 SDCWA Board meeting FPUD and RMWD will be requesting authorization from their respective Boards of Directors to submit an application for detachment to the San Diego County Local Agency Formation Commission (LAFCO). Because of the detachment and annexation involves two separate counties both San Diego LAFCO and Riverside County LAFCO will be involved. The two LAFCOs have agreed to divide authority over the process. San Diego LAFCO will oversee the detachment from SDCWA and annexation to EMWD and Riverside LAFCO will consider the increase in Sphere of Influence requested by EMWD. Formal initiation of the process will require approval to submit the applications by the FPUD and Rainbow Boards.

The remainder of this Memorandum will discuss the issues around detachment and legal process in greater detail.

⁴ IAC is non volumetric because it is based on retail agency Meter Equivalent (ME) as representative of connected capacity with access to the SDCWA system

Background

FPUD

Fallbrook Public Utility District (FPUD) operates as a public agency under the Public Utility District Act of the State of California. FPUD was incorporated as a political subdivision of the State of California in 1922. FPUD became a member of the San Diego County Water Authority (Water Authority) at its formation on June 9, 1944. The FPUD serves an area of 28,000 acres. Currently, 42% percent of the annual water deliveries are for agricultural use. This number is significantly lower than in prior years. The remainder is for municipal, residential and industrial uses.

Currently, FPUD has 7,927 residential connections; 521 commercial connections; 188 agricultural connections; 23 reclaimed connections; and 38 public connections. It receives virtually all of its potable water supply from SDCWA.

RMWD

With the advent of Colorado River water imported by the MWD RMWD was formed in 1953 and the District joined the San Diego County Water Authority (SDCWA) and the Metropolitan Water District of Southern California (MWD). Commercial agriculture expanded in the Rainbow Valley because of the availability of reliable and affordable imported water and the District began serving the growing water needs of the agricultural community.

A large portion (approximately 7,900 acres) Rainbow Valley remains underdeveloped. Steep slopes surrounding the valleys and presence of a high groundwater water table since 1966 has limited the amount of future growth the Rainbow Valley can accommodate and has maintained the rural agricultural character of the District's service area. RMWD currently has approximately 7,800 acres of irrigated agricultural land

FPUD & RMWD Unique Location in SDCWA Service Area

In their August 21, 2019 submission to SDCWA FPUD and RMWD noted the following unique attributes of their agencies

“Because of their location, both districts are uniquely and mostly independent of the SDCWA Aqueduct system, its reservoirs and its water treatment plant. These are our key attributes:

- Most of both Districts' water is delivered through MWD owned pipelines
- The Districts' connections on SDCWA owned pipelines are at the very top of SDCWA's Aqueduct system to pipelines that were built in the 1950s and 1970s

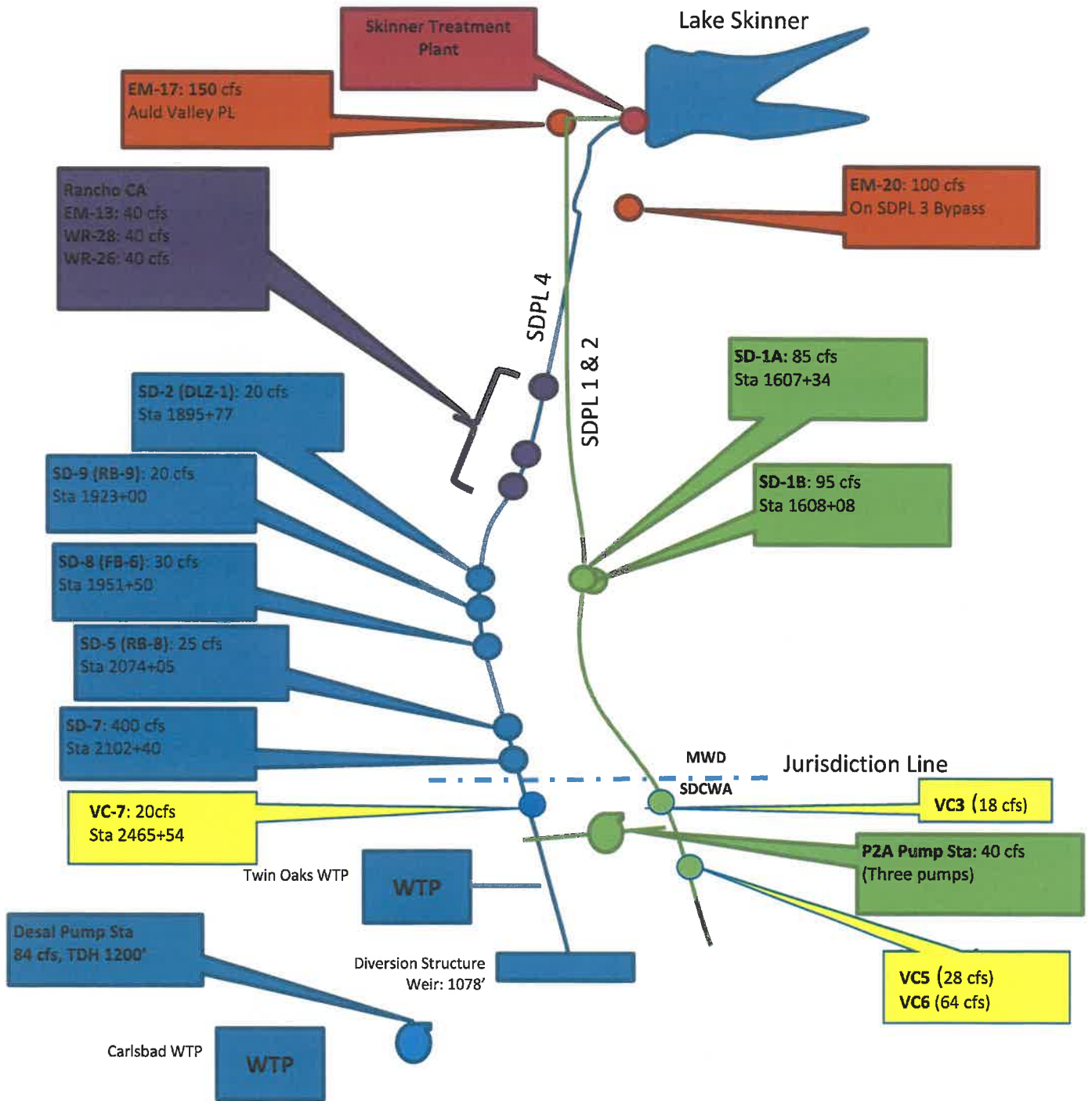
- Because of a lack of facilities neither District receives treated water from the SDCWA Twin Oaks Valley Water Treatment Plant, although in certain hydraulic conditions RMWD can receive limited amounts of water to its furthest southern service area
- Nearly all of both Districts' treated water is currently delivered from MWD's Lake Skinner Water Treatment Plant and all demands can be provided through this plant
- Although both Districts pay for emergency water service, neither can receive deliveries from SDCWA in a catastrophic emergency or even in the event of an SDCWA shutdown for repair as is happening currently
- A substantial amount of both Districts' agricultural customer base is tied to MWD for price and reliability through SDCWA's Transitional Special Agricultural Water Rate (TSAWR) “

Figure 1 below is a schematic of MWD's Lake Skinner Treated Water Service Area. It shows the FPUD and Rainbow connections on the MWD owned sections of the First and Second Aqueducts (Pipelines 4, 1 and 2). The EMWD connections are above the FPUD and Rainbow connections. On average 85% of FPUD's deliveries and 40% of RMWD's deliveries are on the MWD owned pipeline and do not pay SDCWA's Transportation Charge⁵. Also, Because of a lack of pumping capabilities neither agency can receive treated water form the Twin Oaks Valley Water Treatment Plant (TOWWTP) or water stored in SDCWA emergency and carry over storage project.

This is a unique situation among SDCWA member agencies. Very little of the actual SDCWA owned aqueduct system is necessary to deliver water to FPUD or RMWD. This is illustrated in Figure 1 below, a schematic of the southern section of Riverside County and Northern section of San Diego County served by the Lake Skinner facilities owned by MWD. In sharp contrast to Fallbrook and Rainbow, all of Valley Center's seven aqueduct connections are on the pipelines owned by SDCWA. For VCMWD to consider detachment from the SDCWA under similar conditions as FPUD and RMWD would require extending transmission pipelines northward to connect to the importation pipelines north of the MWD / SDCWA ownership point at a significant capital cost which would likely exceed any cost savings associated with buying water from EMWD. The other alternative would be for VCMWD to establish a wheeling agreement with the SDCWA. California wheeling statutes and case law clearly provide the ability of VCMWD to use excess available capacity to wheel water through the SDCWA owned importation pipelines. Due to reduced demand and that VCMWD would be meeting its own existing need for water currently served by SDCWA means that excess capacity is available . This would result in a negotiated wheeling rate which would reduce the savings realized from detachment.

⁵ SDCWA has an unbundled Rate Structure with separate charges for Supply, Transportation, Storage, Treatment and Supply Reliability. SDCWA does not charge Transportation (currently \$132/AF) for deliveries from pipelines not owned by SDCWA.

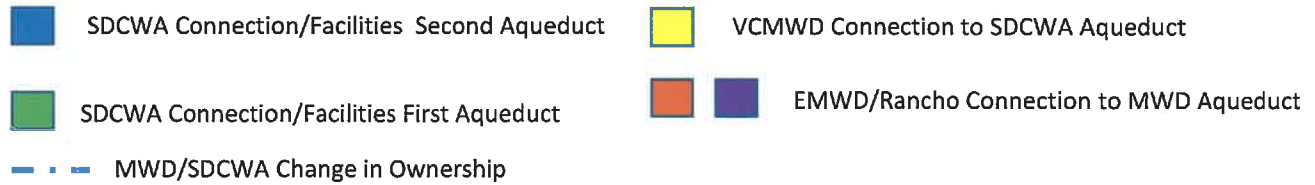
Figure 1 Lake Skinner Treated Water Service Area



NOT TO SCALE

Source: MWD Operations

LEGEND



Operational Feasibility of Detachment

FPUD believes the 15% of its water delivered to a single connection on the SDCWA owned pipeline can be delivered through its existing connections on the MWD owned pipeline without additional infrastructure. It is uncertain how RMWD envisions taking delivery of the roughly 60% of its water currently delivered through the SDCWA owned pipeline. Potential physical improvements and modifications to RMWD distribution system maybe under consideration which would add cost to the detachment and annexation to EMWD. If physical improvements are too costly a wheeling arrangement could be explored with SDCWA as part of the terms and conditions of detachment and annexation.

FPUD & RMWD Customer Profiles

Similar to Valley Center, both RMWD and FPUD have a substantial if not predominant commercial agricultural customer base that has been historically much more sensitive to the price of water.

The following table provides a profile of FPUD and RMWD’s water use based on the average use of FY 2016-FY 2018⁶

Agency	M&I (AF)	TSAWR (AF)	Total (AF)
FPUD	6,480	3,209	9,689
RMWD	9,770	8,073	17,843
Totals	16,250	11,282	27,532

TSAWR Customers

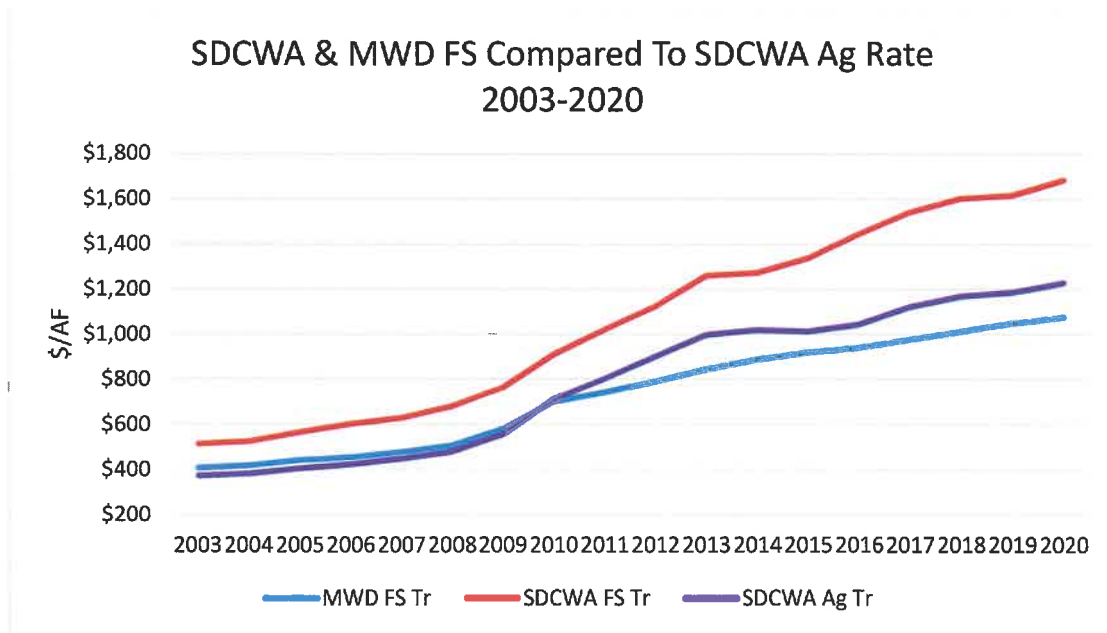
Taken together, 41% of the combined Districts water use reflects customers participation in the Transitional Special Agricultural Water Rate (TSAWR). Although FPUD’s TSAWR participation reflects 33% of its water use additional higher value commercial agricultural customers buy water at the Full Service SDCWA water rater.

⁶ FY 16, FY 17 and FY 18 water use per SDCWA for Agricultural and Non-Agricultural deliveries

Because of the high level of participation in TSAWR a significant portion of both District’s customers pay the lower TSAWR rate which is more closely tied to Metropolitan’s Full Service M&I rate in exchange for reduced reliability from SDCWA in a drought or catastrophic emergency caused shortage event.

Figure 1 compares the SDCWA Full Service rate with TSAWR rate and the MWD Full Service Tier 1 rate.

Figure 1



Source: SDCWA Annual reports and Board Documents

FPUD and RMWD also note that TSAWR is a discretionary program under SDCWA and that the program has come up for review to terminate or modify five times in the last 10 years. Both agencies believe that the financial impact on their commercial agricultural customers would be severe in the event of termination or a reduction in the TSAWR discount. Annexation to EMWD would more permanently tie their agricultural customers to the MWD Full Service Rate and reduce the risk and uncertainty of termination of the TSAWR by SDCWA.

M&I Customers

The combined population of FPUD and RMWD is approximately 54,000 people over a combined service area of 72,000 acres⁷. In their August 21,2019 submission to SDCWA the two Districts noted that both agencies land use is characterized by very low density residential development in a rural and semi-rural setting that according to the County General Plan is not expected to

⁷ FPUD and RMWD 2015 Urban Water Management Plans

change in the long term. FPU and RMWD point to these characteristics as being uniquely different from the rest of the urbanized areas of SDCWA's service area. They believe that land use characteristics are indicative of a utility's smaller rate base that cannot afford to absorb continued rate increases associated with higher levels of reliability for the more densely populated urbanized areas of SDCWA. They noted the rate differential between SDCWA and potential membership in EMWD for their M&I customers.

Comparison of 2020 Wholesale Water Rates

<i>Rate Component</i>	<i>SDCWA</i>	<i>EMWD/MWD</i>
<i>(\$/AF)</i>		
<i>FS TR</i>	\$ 1,686	\$ 1,078
<i>RTS</i>	\$ 28	\$ 82
<i>CC</i>	\$ 24	\$ 24
<i>IAC</i>	\$ 43	\$ -
<i>EMWD</i>	\$ -	\$ 11
<i>Total</i>	\$ 1,781	\$ 1,195
<i>Rate Differential</i>		(\$586)/AF
<i>Rate Differential w/o Transp.</i>		(\$454)/AF

Current and Future Trends Affecting SDCWA Water Rates

Two factors are influencing the future of SDCWA water rates in the near and long term. The first factor is reduced water sales resulting from water conservation and associated behavioral changes in customer water use. These changes have resulted in a long term reduction in M&I water use over the last 10 years in SDCWA's service area and MWD's overall service area. State legislation mandating achievement of water conservation goals in 2009 and 2018⁸ and the experience of two severe multiyear droughts in the last 10 years has structurally altered water use on what is considered a permanent basis. This fundamental change in water use patterns has resulted in reduced water sales over that period and long term projections for continued reductions. For SDCWA this reduction in M&I sales has been compounded by an approximately 2/3 reduction in Agricultural water use since 2007 due to increasing costs of water and effects from the two multi-year droughts.

⁸ In 2009 SBX7-& established the 20% conservation goal by 2020. In 2018 AB 1668 and SB 606

Historical/Forecasted Water Sale

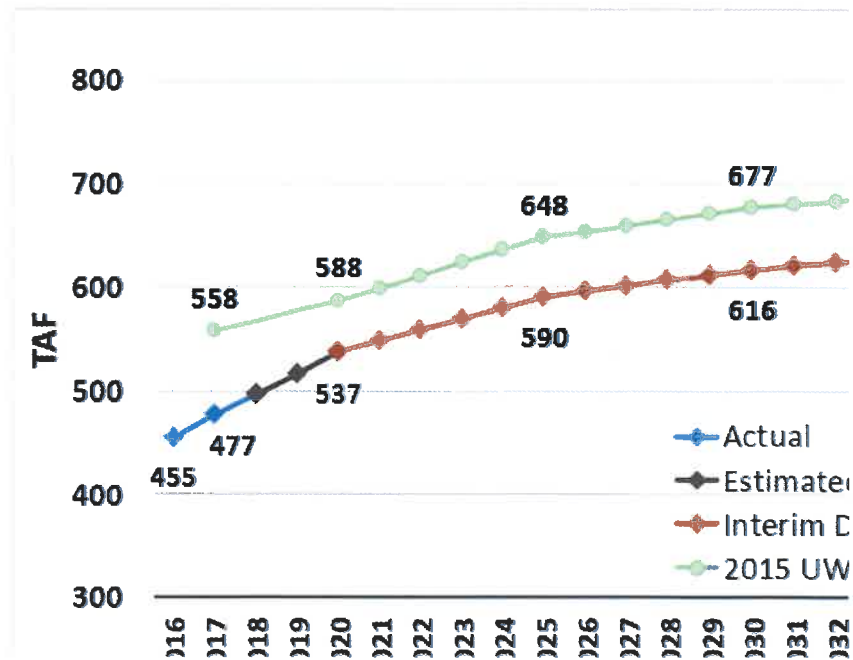


The second factor is that SDCWA member agencies are initiating significant development of new local supplies. the City of San Diego’s Pure Water Program will result in a new supply for the City of 34,000 AF by 2025 increasing to 90,000 AF by 2035. Padre Dam and Helix Water District will purchase over 12,000 acre feet per year from the East County Advanced Water Purification Project beginning 2026. Additional local supply projects being implemented by FPUD, Oceanside, Sweetwater Authority and others will continue to result in reduced purchases from SDCWA. In 2018 . less than 2 years after approving the 2015 Urban Water Management Plan (UWMP), SDCWA released a 2015 UWMP Demand Reset to respond to continued decline in water use and a reassessment of local supply implementation. The graph below indicates the drop in demand and the expected impact of the local supply development in the near term.

Figure 2 below ,shows the long term drop in sales from the Interim Demand Forecast Reset prepared by SDCWA in 2018. While the use of reserves by SDCWA over the last several years has limited recent rate increases it is recognized that is not a long term solution to increasing costs and reduced water sales. Outstanding debt and associated reserve level requirements will continue to put upwards pressure on SDCWA rates and cannot be expected to be alleviated by increased capacity charge revenue from new development or excess revenue from higher water sales as in the past. With lowered demand form conservation being reinforced through state legislation and regulation coupled with significant local supply development by member agencies a structural change has occurred in SDCWA’s wholesale water business.

Figure 2

Interim Demand Forecast

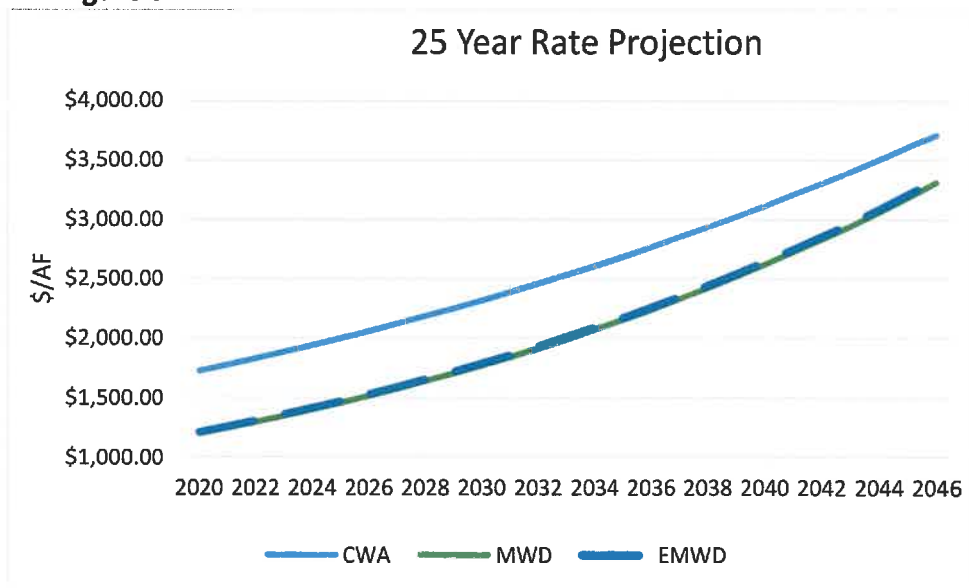


The Fiscal Sustainability process currently underway at SDCWA is addressing the upwards pressure on water rates resulting from these long term trends.

Long Term Financial Savings To FPUD & RMWD

Both agencies estimate that potential savings by detachment from SDCWA and annexation to EMWD will result in several million dollars per year for each agency. Although MWD has been buffeted by many of the same factors experienced by SDCWA, FPUD and RMWD indicated that they do not believe that the fundamental differential between SDCWA and MWD rates will not change over time and included a projection of Full Service M&I rates where SDCWA escalates at 3% annually, MWD at 4% and EMWD at 3.5%. Figure 3 is a projection of future wholesale water rates under those assumptions

Figure 3



Source : FPUD and RMWD. Summary of Potential Rainbow Municipal Water District and Fallbrook Public Utility District, August 21, 2019

Because of EMWD’s relatively small mark up on MWD water there is essentially no difference between the two rates. It is important to note that this relationship and the potential savings for FPUD and RMWD would substantially change if MWD rates increase at a greater rate than SDCWA rates in the future.

Long Term Financial Impact to SDCWA Member Agencies

As discussed above, the financial impact to remaining SDCWA member agencies will be the result of decreased revenues to pay for unavoidable SDCWA costs. For example, if SDCWA does not have to purchase MWD water to serve FPUD and RMWD then that is an avoided cost that does not impact member agencies. On the other hand, as FPUD and RMWD M&I purchases of SDCWA would no longer pay the Melded Supply rate which applies to the cost of QSA water and Carlsbad Desalination that cost would be allocated to the remaining member agencies receiving SDCWA deliveries. This would also apply to the volumetric fixed charges paid for by FPUD and RMWD for Customer Service, Storage and Supply Reliability. Because 41% of the combined FPUD and RMWD customers are in TSAWR and do not pay Storage or Supply Reliability the impact to those charges would lesser than an agency that has 100% M&I customers.

Also as noted above, in this respect FPUD and RMWD detachment is similar to member agencies reducing SDCWA purchases though local supply development. Where detachment is

different is the permanent loss of revenue associated with the IAC, Standby Availability Charges and Property Tax.

Since the issue of an “Exit Fee” or the two District’s potential ongoing responsibility for any of SDCWA’s outstanding bonded indebtedness it is uncertain what the final impact to remaining SDCWA member agencies will be. If compared to total FY 2018 Operating Revenues it appears to be a maximum of 2% or a 1% increase if applied to 2020 water rates and a reduction of 1% in total FY 18 Operating Revenues associated with non-volumetric fixed charges.

Detachment Process

FPUD and RMWD Board’s must authorize an application to be submitted to San Diego LAFCO to initiate the process for detachment/exclusion of the Districts from SDCWA and annexation of the Districts into EMWD. Section 45-11 of the CWA Act sets forth specific requirements to detach from SDCWA, including requiring an election of the electors of the member agency seeking detachment. The LAFCO process is based on the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (Government Code section 56000 set seq.) As noted above, the two county nature of the detachment and annexation requires a process and proceedings by both San Diego LAFCO and Riverside LAFCO.

According to The Districts’ August 21, 2109 submission to SDCWA their understanding from discussions with San Diego LAFCO is that the following will need to take place:

- “• An Application would be filed with Riverside LAFCO to amend EMWD’s sphere of influence to add the territory within the jurisdictional boundaries of RMWD and FPUD, along with a supporting municipal service review document. The Districts understand, again from discussions with San Diego LAFCO, that the outcome of the sphere of influence amendment would be the basis for considering a separate application to San Diego LAFCO, as described in the next bullet.

- Application(s) would be filed with San Diego LAFCO seeking detachment/exclusion from SDCWA and annexation into EMWD (a “reorganization” under the CKH Act). San Diego LAFCO’s consideration would occur following the action of Riverside LAFCO with San Diego LAFCO serving as the principal county for purposes of the reorganization. Ultimately, should both Riverside LAFCO (for the sphere of influence amendment) and San Diego LAFCO (for the reorganization, i.e., detachment/exclusion from SDCWA and annexation into EMWD) be approved, the reorganization would not take effect until after the electors of RMWD and/or FPUD vote in support of the reorganization. If the election is successful, the taxable property within the detaching member agency may still continue to be taxable by SDCWA for the purpose of paying bonded and other indebtedness outstanding or contracted for at the time of the detachment/exclusion. (Water Code Appendix section 41-11(a)(2).)”

This is considered to be a lengthy process that will rely on LAFCO staff analysis of a variety of factors including a Plan of Service that will address key land use, essential and community services, financial implications and objections expressed by any City of other public agencies among many other considerations. Ultimately, approval of the detachment and annexation will be up to the majority vote of the eight serving LAFCO commissioners

Conclusion

At this point, neither Fallbrook PUD nor Rainbow MWD has made a formal application to either Riverside or San Diego LAFCO's for the Detachment / Annexation process to start. Fallbrook and Rainbow are estimating cost savings assumptions based upon their interpretation of the statutory ability of SDCWA to impose exit costs for existing capital debt obligations. Beyond using FY 18 revenues as representative of the cost to other member agencies of FPUD and RMWD detachment SDCWA has not indicated publicly its view on what FPUD and RMWD cost responsibility will be upon exit from SDCWA. The actual costs will likely be determined through terms and conditions set through the potential upcoming LAFCO process.

As a SDCWA member agency, VCMWD has expressed concern about the cost impact of these two agencies leaving the SDCWA. VCMWD is also concerned about the future of the TSAWR and the impact of reduced SDCWA water sales due to local supply development. These issues are being discussed by SDCWA's Board through the initiation of the Fiscal Sustainability process.

VCMWD has also indicated the need to address questions from its customers as to why it is not considering the same course of action as FPUD and RMWD to potentially reduce water costs. Although there are similar characteristics in customer profiles VCMWD does not have the similar physical water supply delivery characteristics of these two agencies. All of VCMWD's connections are on the SDCWA-owned pipelines. In a detachment scenario, VCMWD would either need to make significant capital investments to modify its water distribution system and to connect to the MWD owned pipelines. That is potentially cost prohibitive if the motivation is to reduce costs. An alternative would be to enter into a wheeling agreement with the SDCWA. Both approaches would significantly reduce any cost saving advantages, especially in a scenario where the TSAWR is extended, potentially enhanced and made permanent.

Finally, with the rates paid to the SDCWA, VCMWD M&I customers benefit from the reliability investments in emergency and carry-over storage, in-county water treatment capacity, and the more reliable supplies from the Colorado River Quantification Settle Agreement (QSA) and drought proof Carlsbad Seawater Desalination Project. Similar to the cost versus reliability evaluation that FPUD and RMWD have undertaken VCMWD would need to consider the impact on long-term water service reliability in both drought and catastrophic emergencies if it were to detach from the SDCWA.

APPENDIX A

The County Water Authority Act, Water Code §4511⁹

Sec. 11. (a) **Methods.** Exclusion of territory from any county water authority may be effected by either of the following methods:

(1) Territory excluded from the portion of the corporate area of any public agency which lies within the exterior boundaries of a county water authority, the public agency being a unit of the authority, and which exclusion occurs in accordance with the provisions of law applicable to those exclusions, shall thereby be excluded from and shall no longer be a part of the authority; provided, that the taxable property within the excluded territory shall continue to be taxable by the county water authority for the purpose of paying the bonded or other indebtedness outstanding or contracted for at the time of the exclusion and until the bonded or other indebtedness has been satisfied; provided further, that if the taxable property within the excluded territory or any part thereof shall be, at the time of the exclusion, subject to special taxes levied, or to be levied, by the county water authority pursuant to terms and conditions previously fixed under paragraph subdivision (c) or (d) of Section 10 for the annexation of the excluded territory or part thereof to the county water authority, the taxable property within the excluded territory or part thereof so subject to those special taxes shall continue to be taxable by the county water authority for the purpose of raising the aggregate sums to be raised by the levy of special taxes upon taxable property within the respective annexing areas pursuant to terms and conditions for the annexation or annexations as so fixed and until the aggregate sums have been so raised by the special tax levies.

(2) Any public agency whose corporate area as a unit has become or is a part of any county water authority may obtain the exclusion of the area therefrom in the following manner:

The governing body of any public agency may submit to the electors thereof at any general or special election the proposition of excluding from the county water authority the corporate area of the public agency. Notice of the election shall be given in the manner provided in subdivision (c) of Section 10. The election shall be conducted and the returns thereof canvassed in the manner provided by law for the conduct of elections in the public agency. If a majority of electors voting thereon vote in favor of withdrawal, the result thereof shall be certified by the governing body of the public agency to the board of directors of the county water authority. A certificate of the proceedings shall be made by the secretary of the county water authority and filed with the Secretary of State. Upon the filing of the certificate, the corporate area of the public agency shall be excluded from the county water authority and shall no longer be a part thereof; provided, that the taxable property within the excluded area shall continue to be taxable by the county water authority for the purpose of paying the bonded and other indebtedness of the county water authority outstanding or contracted for at the time of the exclusion and until the bonded or other indebtedness has been satisfied; provided further, that if the taxable property within the excluded area or any part thereof is, at the time of the exclusion, subject to special taxes levied or to be

⁹ COUNTY WATER AUTHORITY ACT (As of January 1, 2010) West's Annotated California Codes
Water Code-Appendix Chapter 45

levied by the county water authority pursuant to the terms and conditions previously fixed under subdivision (c) or (d) of Section 10 for the annexation of the excluded area or part thereof to the county water authority, the taxable property within the excluded area or part thereof so subject to the special taxes shall continue to be taxable by the county water authority for the purpose of raising the aggregate sums to be raised by the levy of special taxes upon taxable property within the respective annexing areas pursuant to the terms and conditions for the annexation or annexations as so fixed and until the aggregate sums have been so raised by the special tax levies. Upon the filing of the certificate of proceedings, the Secretary of State shall, within 10 days, issue a certificate reciting the filing of the papers in his or her office and the exclusion of the corporate area of the public agency from the county water authority. The Secretary of State shall transmit the original of the certificate to the secretary of the county water authority and shall forward a certified copy thereof to the county clerk of the county in which the county water authority is situated.