

CASITAS MUNICIPAL WATER DISTRICT

DATE: March 8, 2013

TO: Board of Directors

FROM: General Manager - Steve Wickstrum
District Special Counsel – Jeffrey Oderman

Re: Staff Report – Public Hearing on Establishment of a Community Facilities District (Ojai 2013-1), the Levy of a Special Tax and the Issuance of Bonds for the Community Facilities District

This staff report provides a general description of activities and actions that are associated with the Casitas Municipal Water District's (CMWD) consideration of the formation of a Community Facilities District (CFD) to acquire and rehabilitate the Golden State Water Company's (GSW) water system in Ojai.

BACKGROUND:

In April 2011, CMWD was approached by representatives of Ojai FLOW with their findings and feasibility analysis (Richard Hajas, March 20, 2011) regarding the high cost of water service within GSW's Ojai service area. In its April 13, 2011, letter presented to the CMWD Board of Directors, Ojai FLOW stated that the residents of Ojai served by GSW have endured rate increases of over 75% since 2008 on top of rates already well above those in surrounding communities. The representatives of Ojai FLOW expressed extreme frustration with escalating water rates, poor service, and the lack of responsiveness by the California Public Utilities Commission (CPUC).

The Ojai FLOW financial feasibility analysis provided further evidence that, based on 2009 water sales in the GSW service area and applying the water rates of each water purveyor, the GSW customers paid annually approximately \$3.14 million dollars more for water service than they would have paid for the same service at the CMWD water rate. It is this \$3.14 million dollars of annual disparity in the cost of water that can be used to support the issuance of bonds for the acquisition of GSW's Ojai water system. For the individual residential water customers of GSW's Ojai service area, Exhibit F and Chart A of the Ojai FLOW financial feasibility analysis, attached hereto, illustrate further the disparity in water charges for various service sizes and bi-monthly water usage. The examples illustrate that the bi-monthly GSW water cost to the residential customer is more than double that if applying the CMWD rate structure to the same level of water consumption. The Ojai FLOW analysis concluded that it is feasible to reduce the cost of water to GSW's Ojai customers by replacing GSW with CMWD. The replacement of water purveyors would require CMWD to acquire GSW's Ojai water system in a manner that is funded solely by GSW's Ojai customers.

In June 2011, Ojai FLOW presented petitions to CMWD signed by approximately 1,900 of GSW's Ojai customers requesting CMWD to consider the acquisition and give GSW's Ojai service area customers the opportunity to vote on paying for the acquisition of GSW's Ojai system. The findings stated in the Ojai FLOW petition are that:

- This action will not be a burden to the existing rate payer of CMWD;
- There will be no change in the place where Ojai Groundwater basin water will be used or change in where Lake Casitas water will be used;
- There will be no increase in overall water demand; and
- The average customer now served by GSW will realize a 10%-15% reduction in annual water costs in the first year.

The CMWD Board of Directors has carefully considered the Ojai FLOW request and the need to protect the interests of CMWD and its current customers, with the understanding that the acquisition would be solely funded by the appropriate properties located within GSW's Ojai service area. The CMWD Board of Directors also considered various funding methods, including those proposed by Ojai FLOW, that would provide the GSW's Ojai customers with CMWD water rates for water usage and annual bond payments for the costs of acquisition and water system integration and rehabilitation improvements that are accomplished through the formation of a CFD.

On January 29, 2013, the CMWD Board of Directors considered taking the necessary actions to initiate the formation of a CFD for the acquisition of the property and facilities owned/held by GSW in its Ojai service area. During this public meeting, the Board of Directors considered the presentation of the Rate and Method of Apportionment that was created by CMWD's special financial advisor, David Taussig and Associates, and heard public comment concerning the proposal to acquire GSW's Ojai system. The presentation by the special financial advisor included a chart of the water charge comparisons of GSW and CMWD, with the addition to the CMWD water charges of the application of the apportioned property tax for the acquisition. In all cases of parcel sizes presented and illustrated in the slide entitled "Water Rate Comparison", attached hereto, the application of the maximum apportioned property tax for the acquisition and the CMWD water charges did not exceed the water charges imposed by GSW.

After hearing the public comments and the presentation by the special financial advisor, the Board of Directors then moved to (1) approve the Local Goals and Policies for Use of Mello-Roos Community Facilities District Act of 1982, (2) adopt a Resolution of Intention to Establish Community Facilities District No. 2013-1 (Ojai) and to Authorize the Levy of Special Taxes Therein, (3) adopt a Resolution Declaring the CMWD Board of Director's Intention to reimburse Expenditures from the Proceeds of Certain Community Facilities District Bond Obligations, and (4) set a public hearing for March 13, 2013, at 6:00PM at the Matilija Junior High School Auditorium. At that Public Hearing, the Board of Directors, acting as the legislative body for the proposed CFD, will consider and finally determine whether to approve the Rate and Method of Apportionment for the proposed CFD, approve the maximum special tax that can be

imposed on properties within the boundaries of the CFD to support the acquisition of the GSW Ojai water system and fund capital improvements to that system, proceed with formation of the CFD, and schedule a special election at which the voters in the proposed CFD will have the opportunity to vote on whether or not to approve these actions.

ANALYSIS:

A. Use of CFD Financing is a Feasible Method of Acquiring GSW's Ojai Water System.

If CMWD is going to acquire GSW's Ojai water system use of CFD financing appears to be the most appropriate and feasible means of doing so.

One of the essential prerequisites for CMWD in becoming involved with the potential acquisition of GSW's Ojai service area is that the financial burden and risk of the acquisition must be borne entirely by GSW's Ojai customers, not CMWD's existing customers elsewhere in the District. The Community Facilities District Act of 1982 provides a mechanism to finance the acquisition consistent with this parameter, as the CFD boundaries will include only the GSW Ojai service area that is to be acquired and not other areas already served by CMWD and the special tax that will be imposed can only be imposed within the boundaries of the CFD.

The CFD law also provides the Ojai community served by GSW the ultimate decision as to whether or not to proceed, as the formation of the CFD and imposition of the maximum special tax must be submitted to the voters in the CFD and approved by not fewer than two-thirds (2/3) of the eligible voters. Thus, the acquisition cannot and will not proceed without strong community support.

The CFD law also protects GSW's Ojai customers because the voters must approve a maximum special tax that can be imposed upon them. Assuming the voters within GSW's Ojai service area approve the CFD by the required 2/3rds vote, CMWD will have no authority to increase the maximum special tax thereafter.

CMWD evaluated other potential acquisition funding mechanisms but none has the advantages of CFD financing. CMWD is unable and unwilling to commit other possible sources of funds toward the acquisition that would put existing CMWD ratepayers at risk. CMWD lacks the authority to fund the acquisition through some sort of water rate surcharge on GSW's Ojai customers as CMWD does not serve those customers at this time and CMWD would be required to pay GSW the full fair market value for its Ojai water system *before* the acquisition is completed.

CFD funding has been successfully used in the recent past for similar public acquisitions of privately owned water systems in California. One example is the 2008 acquisition by the San Lorenzo Valley Water District of the California-American Water Company water system in the community of Felton in Santa Cruz County.

B. The Cost of Acquisition is Feasible.

If the CMWD Board of Directors and the voters in GSW's Ojai service area approve the formation of the CFD and the acquisition of GSW's Ojai water system, CMWD is required to pay GSW the full fair market value for its property. Fair market value is determined based upon the highest price that a hypothetical willing buyer and willing seller would agree to, each being fully informed of the relevant facts and with neither being under any compulsion to sell or buy.

The best evidence of the fair market value of the GSW Ojai water utility is the value placed on that system by the CPUC for rate making purposes—the so-called “rate base” or “book value” figure. As of fiscal year 2012, that figure was somewhat less than \$15 million for GSW's Ojai water system. The fair market value of GSW's Ojai water system is likely to increase somewhat in the near future before CMWD can fix a final purchase price (e.g., as a result of future increases by the CPUC in GSW's approved rate base), but it is doubtful any such increases will be so substantial from a percentage standpoint as to affect the feasibility of the overall acquisition program. While sales of other privately held water utilities in California have occurred at amounts in excess of the seller's CPUC-approved rate base figure, the rate base figure is an important constraint on the high side price an informed buyer would be willing to pay. In this regard, the CPUC must approve any sale of a privately owned water utility to another private buyer and in considering whether to grant approval it applies a so-called “ratepayer indifference” test, meaning the CPUC must be convinced the sale price is not so high that the buyer would have to increase rates charged to its customers in order to recoup the higher acquisition price paid and still earn an adequate rate of return. Thus, the hypothetical buyer of GSW's Ojai water system in the open market could not afford to pay significantly more than GSW's approved rate base figure and hope to obtain CPUC approval. Moreover, while public agency purchasers such as CMWD are not subject to CPUC jurisdiction (and, hence, are not subject to the CPUC's ratepayer indifference test), appraisers are expressly prohibited by the California Evidence Code (Section 822(a)(1)) from considering sales to public agencies with eminent domain power in determining fair market value. So, in the end, the hypothetical private purchaser that *is* subject to CPUC jurisdiction is the only buyer that is relevant and while no guarantees can be made as to the acquisition price CMWD will end up paying for GSW's Ojai water system—and if the parties do not agree the value may end up having to be established by a jury in an eminent domain action—CMWD's staff believes the \$15 million rate base figure provides a strong starting point for assessing the likely acquisition costs that will be incurred.

CMWD is aware that certain sources have asserted that GSW has “water rights” that are associated with its Ojai water system that have independent value that CMWD has not taken into account. A figure of \$50 million for these supposed “water rights” has been publicly used. In this regard, CMWD recently received a March 8, 2013, letter from an attorney representing GSW asserting that GSW has “appropriative” water rights in the Ojai basin. Whether or not GSW *does* have any such water “rights”—there has

been no adjudication establishing the existence or extent of water rights in the Ojai basin—in CMWD’s view those rights would have no impact on the fair market value of GSW’s Ojai water system and it appears to CMWD that GSW and its supporters are using the \$50 million figure in an effort to scare people into thinking a public acquisition of GSW would be infeasible. The fact of the matter is that the CPUC would not allow GSW to charge its customers more for water even if it established it has appropriate water “rights,” a hypothetical buyer in the open market would not be willing to pay GSW for “rights” that have no potential to increase its income or profits, and the fair market value of GSW’s Ojai water utility therefore would be unaffected. The only conceivable circumstance in which a regulated public water utility such as GSW could claim its water rights (assuming such rights do exist) add to the fair market value of the system would be if those rights included the right to use water for a non-utility purpose (e.g., export and sale). GSW has not claimed and could not claim any such right so its theoretical argument about water “rights” is beside the point in terms of the cost of acquisition. It is noteworthy that a similar “water rights” claim was made when the County of Santa Cruz and San Lorenzo Valley Water District initiated the formation of a CFD and acquisition of California-American Water Company’s Felton water utility a few years ago and, when the County and District did not back down, the community’s voters solidly supported the CFD, and it came time for Cal-Am to prove the value of its Felton water system, Cal-Am dropped the issue entirely.

Given these facts, can CMWD acquire GSW’s Ojai water system for a price that will reduce the Ojai customers’ cost for water? CMWD staff and consultants believe the answer is a definite “yes.” The Ojai FLOW feasibility analysis (the methodology of which has been analyzed and confirmed by CMWD) determined that as of 2011 GSW’s Ojai customers were paying approximately \$3.14 million more for water than they would be paying if they were served by CMWD (not to mention that the gap appears to be widening with each passing year). Using conservative assumptions, Taussig and Associates has determined that if a CFD were formed within GSW’s Ojai service area, a maximum special tax were imposed on the properties in the CFD totaling this same \$3.14 million, and CFD bonds secured by the special taxes were sold to fund the acquisition CMWD would likely be able to raise net bond proceeds in excess of \$40 million. Again, while there are no guarantees on the amount of total CFD funding that could be achieved, the margin between the approximately \$15 million current “value” of the GSW system (using the current CPUC-approved rate base figure) and the approximately \$40 million in net bond proceeds that Taussig estimates CMWD could raise—WITHOUT INCREASING THE TOTAL COST OF WATER TO GSW’S OJAI CUSTOMERS—demonstrates that there is a very large cushion or contingency to address acquisition costs.

While CMWD has not yet conducted a detailed inspection of GSW’s physical plant and facilities, CMWD is aware that GSW is planning major infrastructure expenditures in the coming years. These expenditures, it should be noted, will *further* increase water costs to GSW’s Ojai customers even above the already high rates charged by GSW. CMWD could use the “excess” bond proceeds available after the acquisition of GSW’s Ojai

water system to construct/install needed capital facilities and still *lower* the water costs of GSW's Ojai customers.

The fact that CMWD is able to deliver water at a significantly lesser cost than GSW should not be a surprise and does not necessarily reflect adversely on GSW management. As a local public agency, CMWD simply has certain inherent advantages from a cost-of-service standpoint: (1) as a for-profit company GSW is entitled to earn a rate of return or profit from its operations, whereas CMWD is a non-profit entity and does not earn (or charge for) a profit; (2) as a private entity, GSW pays income taxes and property taxes (for which its customers must pay through their water rates); CMWD does not; (3) CMWD *receives* an allocation of local property taxes which help to support its cost of providing service to its customers; GSW does not; (4) GSW incurs and charges to its customers the "regulatory expense" of filing and processing its rate applications through the CPUC and reporting to and complying with other CPUC rules and programs; CMWD is not subject to CPUC jurisdiction and incurs no such costs; (5) as a public agency, CMWD can borrow funds at lower tax-exempt rates; GSW's "cost of capital" is higher; and (6) CMWD already serves a large, contiguous geographical area in Ventura County and has certain built-in economies of scale that could be brought to bear in serving GSW's Ojai service area, whereas GSW's operation involves numerous small non-contiguous service areas managed from remote locations. CMWD is not disparaging GSW in terms of its costs of providing service; CMWD is simply saying it can provide service at a significantly reduced cost.

One final comment regarding the relative cost of delivering water service as between GSW and CMWD. The CFD bonds used to acquire GSW's Ojai water system and perform near-term upgrades will be paid off in 30 years or so. That may seem like a long time now, but as time passes the pay-off date will draw closer and eventually will occur. At that point, the Ojai customers' total cost of water service will decrease substantially more, as they would be subject only to CMWD's (lower) water rates and no additional CFD special taxes.

C. Governance Issues.

The primary justification for CMWD's acquisition of GSW's Ojai service area has been its ability to provide water service at a lesser cost. If, however, CMWD acquires GSW's Ojai water utility CMWD believes GSW's Ojai customers will realize additional benefits as well, of a type referred to here as "governance" issues. These "governance" benefits that would be achieved by a CMWD acquisition include the following: (1) the Ojai customers of GSW currently have no right to participate in the management of the water utility that serves their community, as they would with CMWD; (2) members of the CMWD Board of Directors live in the community and are easily accessible to local residents and ratepayers, whereas GSW management do not and are not; (3) the members of CMWD's governing board perform a public service for the good of the community, with virtually no personal financial return; GSW's Board represents a typical out-of-area corporate organization that seeks to maximize profit for the company's

owners/shareholders; (4) CMWD has public meetings in the community and is subject to the Brown Act; GSW is not; (5) CMWD is subject to the California Public Records Act which requires its records to be made available to the public; GSW is not; (6) under Proposition 218 CMWD's voters have numerous procedural protections prior to having their water rates increased, including the right to "protest out" any proposed fee increases by a majority vote; GSW's customers do not; and (7) CMWD's customers have numerous opportunities to express their will at the local level, whereas GSW's customers' only "recourse is to attempt to pierce the technical, legalistic, and nearly impenetrable CPUC process with officials and staff located hundreds of miles away.

D. California Environmental Quality Act.

The formation of a CFD is not a "project" subject to the California Environmental Quality Act (CEQA) and, thus, there is no need to conduct CEQA review at this time. Formation of the CFD and related actions will not commit CMWD to funding any particular capital improvements that would have the potential to cause an environmental impact. Environmental review is appropriately reserved until such decisions are made.

E. Eminent Domain.

The formation of a CFD does not commit CMWD to using its power of eminent domain to acquire GSW's Ojai water utility. *If* the CMWD Board of Directors takes the actions now recommended and *if* the voters in the CFD boundaries approve those actions by the required two-thirds (2/3) vote, CMWD would then be in a position to prepare a formal appraisal of the GSW property interests, present a formal purchase offer to GSW based on that appraisal, attempt to negotiate the acquisition with GSW on a mutually acceptable basis, or, if negotiated acquisition fails, consider whether to acquire the system by exercising CMWD's power of eminent domain. Before eminent domain is approved, the CMWD Board would have to conduct a public hearing and adopt a so-called "resolution of necessity" by a two-thirds (2/3) vote making certain determinations that the public interest and necessity require the taking. The actions now recommended do not preclude the matters that would have to be considered by the CMWD Board of Directors at that time.

F. In-Person vs. Mailed Ballot Election.

If the Board of Directors determines to proceed with the formation of a CFD and conducting a special election to submit the matter to the voters in the GSW Ojai service area (the proposed CFD boundaries), the Board will need to determine whether the election will be a traditional "in-person" election with polling places or a mailed ballot election. Ojai FLOW requests that the election be an in-person election with polling places. The cost of conducting the election in that manner is higher; staff will be available to address the alternatives (including the estimate cost differential) at the March 13 hearing.

RECOMMENDED ACTIONS:

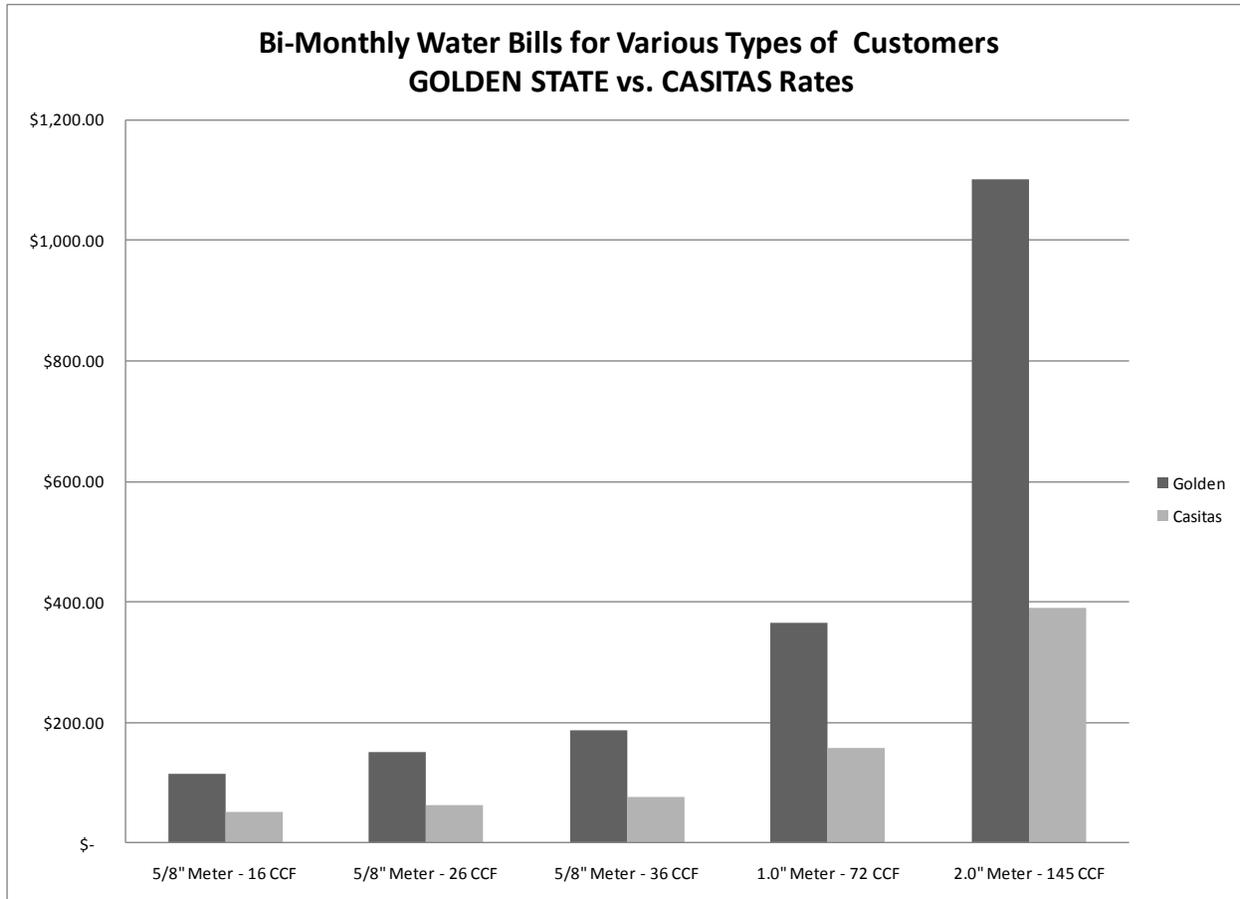
At the conclusion of the public hearing on March 13, 2013, it is recommended that the CMWD Board of Directors take the actions listed below. The recommended actions conclude the formation process for the CFD, approve the Rate and Method of Apportionment, maximum special tax, and maximum appropriation and bonded indebtedness amounts for the CFD, submit the CFD to the voters, and set the date for the CFD election.

- 1) Adopt the Resolution Authorizing the Formation of Casitas Municipal Water District Community facilities District 2013-1 (Ojai), Authorizing the Levy of a Special Tax therein, preliminarily establishing an appropriations limit therefore and submitting levy of the Special Tax and the establishment of the appropriations limit to the qualified electors thereof.
- 2) Adopt a Resolution determining the necessity to incur bonded indebtedness within the Casitas Municipal Water District Community Facilities District No. 2013-1 (Ojai) and submitting a proposition to the qualified electors.
- 3) Adopt a Resolution calling a special election by way of polling place ballot, or, by way of mail ballot for the purpose of approving a special tax in the Casitas Municipal Water District Community Facilities District No. 2013-1 (Ojai) for the issuance of bonds by said district and establishment of an appropriations limit.
- 4) Accept the Community Facilities Report prepared by David Taussig and Associates, Inc.

Exhibit F

Chart A		
Golden State vs. Casitas Charges For Various Types of Customers		
	Golden	Casitas
5/8" Meter - 16 CCF	\$ 115.07	\$ 51.62
5/8" Meter - 26 CCF	\$ 151.14	\$ 62.54
5/8" Meter - 36 CCF	\$ 187.10	\$ 76.01
1.0" Meter - 72 CCF	\$ 366.04	\$ 157.80
2.0" Meter - 145 CCF	\$ 1,102.30	\$ 391.10
Golden State charges based (excluding surcharges) Cal PUC Sheet 5990-W		
Casitas charges based 9.2.4 Rate Schedule (Residential Rates)		

Chart A



GOLDEN STATE charges based on Cal. PUC Sheet 5990-W (excluding surcharges). CASITAS charges based on residential rates in CASITAS 9.2.4 Rate Schedule

History of Water Rate Increases

Historically GOLDEN STATE rates have been consistently higher than CASITAS. Chart B compares the historical cost to the typical GOLDEN STATE customer with the cost when CASITAS's historical charges are applied for the same service.

Water Rate Comparison

Funding Pre-Acquisition & Acquisition Costs

