

Good afternoon. In the 10-minutes I have, I hope to provide you with a framework for how to think about the finances of the District -- and why rates will increase for F 2013. I will also show you how both are linked to the overdraft.

This slide this tells much of the story of where the District has been and where it is now:¹ The numbers are from the audited statement of cash flows for each of these FYs:

from F 2005 - '08: there was a conservative use of cash from reserves;

- from F 2009 - '11: there was a significant change in outflows, creating large operating deficits and eliminating the District's credit and current ability to borrow funds in the public bond markets. About 75% of this cash that was spent -- and what this graph does *not* reflect, the cash that what promised to be spent, or that will be spent in the future due to the decisions made during this period -- was to do something about the overdraft -- assuming: (1) that ratepayers who are responsible for about 10% of the overdraft can pay *all* the costs associated with the overdraft; and (2) that water can be imported to the Valley *for free* so that withdrawals can continue as today with no economic consequences.² This Board believes these assumptions are mistaken;
- The objective for F 2012 is to have a balanced budget: cash available at the end of the year will be about the same as the cash at the beginning of the year. This turnaround *could not have been accomplished* without the hard decisions this Board has made over the past year, the extraordinary efforts of our present District staff and current General Manager, and the support of this community to raise rates. I want to thank each of you who lent your support to accomplish this very difficult turnaround.
- However, the turnaround is not yet complete. We have only gotten to first base, if you will. The objective for F 2013 is to generate surplus cash flow and to accumulate savings (cash reserves). This is a requirement that the rating agencies have to restore credit so that the District can borrow in the public bond markets by F 2016/17.³ Yes, rates will be higher than in the past, but the District's rates will still be one of the lowest rates in San Diego County - both today and through F 2016.

To better understand the finances of the District, I would like to spend a few minutes and reflect on what the District's duties are and how it fulfills its mission:

1) to deliver safe, potable (poat' a ble) water to your homes and businesses;

2) to repair and replace in a timely fashion the infrastructure that delivers this safe, potable water; and

3) to protect the source of supply -- the groundwater in the Borrego Valley Basin.

If these duties are done well, no worries. If a water utility fails at any of them, things can go from bad to worse, often affecting the economy of the community, property values, and even the health of those living in the community.

To produce safe, potable water requires a water utility to spend adequate operating and maintenance (O&M) expenses: have enough personnel; have trained operators. Maybe the worst case of skimping on O&M expenses was in May 2000 in Walkerton, Ontario, a town of 5,000 people: 2,300 people fell ill, hundreds were hospitalized, and 7 people died from a virulent strain of E-coli bacteria (E-coli O157:H7) due to a combination of factors brought on by inadequate O&M expenditures.⁴

This Board has reduced the District's O&M expenses about \$800,000 from last year.⁵ We believe that some additional savings *may* be possible. But, we are proceeding carefully to do only what is prudent and safe.

Not making timely repairs of infrastructure can also cause problems. Maybe the worst case of failure to repair and replace their water infrastructure in a timely fashion allowed a protozoan parasite (cryptosporidium oocysts) into the water supply that sickened 400,000 people in Milwaukee in April 1993; 4,000 were hospitalized, 100 people died.⁶

The replacement cost of the District's investment in infrastructure is about \$62.5M. To keep this infrastructure operating in the least costly and safest way requires continuous repair and replacement.

Delaying repairs can result in degrading water service, increasing service disruptions, increasing expenditures for emergency repairs and even health risks.

The \$400,000 in this year's capital projects is less than the \$1M or so annually that should normally be spent. That is because all expenditures must be done on a pay-as-you-go basis; i.e., paid for from current revenues. These expenses can not be paid either from existing cash reserves or new debt as in the past. Instead, 100% of the rate increase for F 2012 was used to pay these non-O&M expenses. By F 2016/17, the District will need to borrow \$6-7M to catch-up with its repairs and replacement of infrastructure -- assuming it is creditworthy to do so by then.

Thus, the question a thoughtful person might ask is: “Are we spending enough? On the right things?” Successfully addressing this question and reestablishing credit gets us to second base.

However, we can't arrive at home plate without resolving the overdraft. In this community almost everyone has an opinion about the overdraft. Some claim there is no overdraft. Some say it doesn't matter if there is one. Others believe the overdraft will be resolved through *market forces*. Or discovering a new water source *over the next hill*. Or importing water from the Imperial Irrigation District.

In the 1980's, best estimates were that the overdraft was around 9,400 AFY. The assumption then was that *market forces* would lower this overdraft. This assumption was wrong. Today, we believe that the overdraft is around 16,000 AFY.

Usually, the problem is not that “the water runs out.” Things often come to a head when the water becomes prohibitively expensive because it requires more treatment to make it usable for drinking and for irrigation and instead of needing one well to withdraw X amount of water, one now needs 4 new wells.

Communities here in California typically do one of two things to deal with an overdraft: They (1) do nothing, or (2) they manage the basin.

The “do nothing” approach has proven to be the most expensive, by far. This Board believes a managed basin is the most responsible means to enhance the community's economic growth; to preserve property values; and to protect this environment where we choose to live.

One of the objectives of the grant proposal the District has recently submitted to DWR⁷ is to begin the planning work necessary to establish a managed basin “*to preserve and conserve the priceless resource,*” to quote the District's mission statement.⁸

Resolving the overdraft is not something that the District or this Board can impose on the community. It is something that those who believe they have a stake in the future of this community need to work together to resolve. The days of benign neglect or denial concerning the overdraft are over.... Thank you....

Our next speaker is Tim Ross, a Senior Engineering Geologist from the California Department of Water Resources, Southern Region office who will discuss the Overdraft: what is it and where are we today?

TO RECAP:

The overdraft is real. There is no uncertainty. It is not getting smaller. It has increased over the past years. It will likely increase further if no alterations in land use are made. No additional studies are required to establish whether there is an overdraft;

There is no inexpensive or inexhaustible source of water in the “deep aquifer” of the basin;

There are no unclaimed water sources “over the next hill” large enough to make-up the annual deficit caused by the overdraft. Any potential unclaimed water source like the Clark Dry Lake aquifer that *may* be able to meet the District’s needs (something that could cost as much as ~\$1M just to determine) may potentially be as expensive as imported water from a known source (e.g. IID);

Building a pipeline is fraught with difficulties. Identifying a source for imported water is uncertain. What is certain is that any imported water would be more expensive than present costs for pumping and distributing water from the basin;

Presently, DWR’s regional water management process is providing a disciplined framework to get everyone involved and on the same page maybe for the first time ever: the US Corps of Engineers; the US Bureau of Reclamation; the USGS; DWR; San Diego County Department of Planning; San Diego County Flood Control; the Resource Conservation District of Greater San Diego County; the Borrego Water District; and all the local and regional bodies who have a stake in the future of this region and this Valley;

Other communities have successfully used this process to resolve equally difficult and potentially contentious overdraft situations. What has succeeded in other regions is that stakeholders participate in the planning process and work together for the common good;

In summary: Continuing to overdraft the Basin is like operating a business in liquidation. It’s expensive in *all* ways.

If you have questions or if you don’t agree with the direction this Board is taking, I urge you to go to the District’s web site and read the extensive materials available there that tell the story for the decisions this Board is making. Our objectives are to preserve the economic vitality of this community, the integrity of the natural environment, and your property values.⁹

If you still believe that you have a better idea or that we may have missed something important,

come speak with us at the Board workshop on the third Tuesday of most months or the business meeting on the last Wednesday of each month.

The Board also plans on holding a Town Hall in November to discuss the results of the County's Flood Control Study - something that will affect all future development in the Valley. At this November Town Hall the US Bureau of Reclamation will also update us on potential sources of imported water in the region and their costs.

There will be two Board seats up for election this November. If you believe that it is important to resolve the overdraft, vote for candidates that are willing to work for the common good to do so.

If you believe that it is important to have a financially viable water district to protect your health and your property values, then vote for candidates that support this objective.

YOU will determine the future of this community, not this Board. Resolving the overdraft and maintaining the ongoing financial integrity of YOUR water district are issues that will outlast the tenure of any one Board.... Thank you....

Now, the presenters will answer a few moderated questions before we open the floor for your comments.

QUESTIONS & ANSWERS

Q: Will water rates increase for FY 2013?

A: The Board has not yet made a decision as to how much rates will increase for FY 2013. The maximum amount rates can increase is limited to 30% as per the FY 2011 218 process. Speaking for the entire board, we will continue working hard to keep rates as low as possible and will appreciate your support and assistance along the way.

Q: How will the rate increases be spent?

A: In June 2011, as a result of the 218 process, revenue increases were approved for FY 2012-2016 of 30%, 30%, 10%, 10%, 5% for each of these fiscal years.¹⁰ These revenue increases were analytically determined to provide the cash flow and reserves (savings) necessary to return the District to creditworthiness, defined as the ability to borrow approximately \$6-\$7M for repair and replacement of infrastructure, by FY 2016/2017:

- less than 8 cents of each dollar of revenue increase through FY 2016 will go to pay increases in O&M expenses (mostly electricity costs, but also about \$300,000 in expected pension increase costs that the District is legally obligated to pay as a result of decisions made by the prior Board in 2010);
- about 24 cents will go for capital improvements and groundwater management. The pay-as-you go repair and replacement of infrastructure from the current year's revenues as neither cash savings nor new public debt is available to fund these costs as in the past;
- the remaining 68 cents will go to replenish savings (cash reserves). This is a requirement that the public bond market credit rating agencies have for reestablishing credit and the ability to borrow by FY 2016/2017.

Q: Are Operations & Maintenance (O&M) expenses are too high?

A: The District has made significant cuts to the FY 2011 O&M budget including eliminating 2 full time employee positions and reducing hours for others. On our web site is a list of changes made that began as soon as we took office. It includes eliminating health benefits for Board members, reducing vehicle and office expenses, cutting legal fees, eliminating the cost of

operating the Club Circle Golf course. The Board continues to pursue ways to reduce electricity, pension, and other personnel costs without negatively impacting the operations of the District.

Q: Does the District really need reserves?

A: Reserves are our savings accounts. Without them, we would have no viable method to ensure continuous water service during emergencies. Cash reserves are required for the District to return to fiscal stability, to borrow money for capital improvements; and to enable the District to operate in an efficient manner. It is irresponsible to risk the economic well-being of this community by failing to fully fund reserves.

Q: If the District would just eliminate all the studies, would it not need a rate increase?

I hope that the presentations today will obliterate this myth. If this community wants to resolve the overdraft, not only is the work discussed today necessary, it must be done right and in a timely fashion.

Q: Are rates are too high?

A: Yes and no. Yes they are higher than in the past, but as compared to other Districts, even if revenue requirements increase through FY 2016 as presently forecast, the District's rates will still be near the median for groundwater dependent water districts located in Southern California's desert communities. Currently, we are among the least expensive for water rates in San Diego County. Even with BWD's forecast rate increases, we will still be one of the lowest rates in San Diego County in FY2016.

To put this in perspective, by FY 2016, if all the proposed revenue increase goes into effect, it will cost about the same amount for 250 gallons of water from the District as it costs today for 1 gallon of bottled water purchased from Costco. But, the water from the District is regulated and regularly tested, unlike the bottled water. Water from the District is also likely to be as good or better quality than the bottled water you can buy. That is, even at its potentially most expensive, potable water from the District is about 250 times less expensive on a fully costed basis than the best alternative - without the added cost of recycling the plastic bottle.

Q: What about adjudication?

When reason fails and all hope is lost, one moves to adjudication. Or, conversely, adjudication could be viewed as a useful means to establish who has what rights in an overdrafted basin and the monetary value of these water rights.

Q: Why not just adjudicate the basin and skip the lengthy process to establish a managed basin?

Adjudication is only one of a number of means to arrive at a managed basin. A managed basin is required for importation for replenishment purposes and is even more necessary if no importation is probable for the foreseeable future due to cost. Discussion of a managed basin always includes adjudication as a tool for establishing the authority and funding mechanism to manage the basin. The *plan* to manage the basin would still need to be developed and paid for by someone other than the courts. The Board has consulted a raft of experts in CA water law on the QT. All recommend pursuing a negotiated settlement and/or legislation as preferred options before adjudication. They believe this will speed the process even if adjudication ultimately results, not slow it down. The IRWM process is presently the best means to work out the details of a managed basin plan and to fund this work if the grant is awarded. We should know this by August. The IRWM proposal also has funds for consulting w/ water law experts on a paid basis rather than on the QT.

Q: Why even offer importation as an option? Importation is infeasible.

The most credible means to rule out importation is to use the cost estimates that the Bureau of Reclamation are coming up with. That way, the economic reality comes from a third party expert, not a ratepayer or the District. The Board has asked Reclamation is be able to present this work at a November Town Hall.

Q: I'm angry. I'm angry about the rate increases.

Your anger is nothing compared to how angry this Board has been at finding the financial mess we did when we took office. Nobody likes to raise rates. But, if you want potable water to continue to flow to your homes and businesses that is what it will take. If this Board had not taken on the burden of turning around the District's finances, the doors to the water District would have probably closed by the first quarter of FY 2012 (July 1, 2011-September 30, 2011).

Q: What about nitrates?

Nitrate (NO₃) is regulated as a primary contaminant by both federal and state agencies, and can have significant human health effects. Nitrate contamination of the groundwater has been noted in various wells throughout the ABD region, including the northern portion of the Borrego Valley Groundwater Basin. In some cases both public and private groundwater wells in the Valley have been measured with nitrate levels that exceed or approach regulatory limits for drinking water prior to these wells being removed from service for drinking water supply. The source of these nitrates are most likely anthropogenic as high nitrate concentrations are not "naturally occurring" in the groundwater of the Basin. (Mueller & Helsel, 1996; USGS, 2000).

Sources

Mueller D. K. and Helsel D. R. (1996) Nutrients in the Nation's Waters - Too Much of a Good Thing, Circular 1136, U.S. Geological Survey.

U.S. Geological Survey and Institute of Food and Agricultural Sciences, University of Florida, *Distribution, Movement, and Fate of Nitrate in the Surficial Aquifer Beneath Citrus Groves, Indian River, Martin, and St. Lucie Counties, Florida* (2000).

NOTES:

¹ From “Statement of Cash Flows” audited statements for FY 2005-2011:
 FY 2005 \$314,767; 2006 \$865,712; 2007 (\$748,784); 2008 (\$672,505); 2009 (\$1,083,739); 2010 (\$2,998.159); 2011 (\$1,695,187).

² Some of this cash was probably used for O&M expenses e.g. compensation for the previous GM and previous General Counsel:

WILLIAMSON'S COMPENSATION - 2/2008-2010	STRADLING COSTS - 02/2008 -12/31/2010			
	2008	2009	2010	TOTALS
Salary	139,201	202,036	260,484	601,721
Insurance	12,016	15,483	15,986	43,485
Calpers	19,728	27,519	56,957	104,204
Workers Comp	1,406	2,041	2,631	6,077
Conferences, ETC....(approx)	8,000	10,000	10,000	28,000
TOTAL WILLIAMSON	180,350	257,079	346,058	783,487
TOTAL STRADLING	151,313	125,864	111,834	389,011
TOTAL BOTH....	331,663.70	382,942.65	457,891.96	1,172,498.30

³ See FitchRatings, “U.S. Water and Sewer Revenue Bond Rating Criteria” (August 10, 2011); Standard & Poors, “How U.S. Municipal Water and Sewer Bonds Correlate with Some Key Measures of Issuers’ Credit Quality,” (September 26, 2011); Standard & Poors, “Key Water and Sewer Utility Credit Ratio Ranges,” (September 15, 2008).

⁴ Robert D. Morris, *The Blue Death: Disease, Disaster, and the Water We Drink* (New York: HarperCollins Publishers, 2007), 237-46. Robert D. Morris, MD, PhD, is an environmental epidemiologist and a leading researcher in the field of drinking water and health. He has taught at Tufts University School of Medicine, Harvard University School of Public Health, and the Medical College of Wisconsin and has served as an advisor to the EPA, CDC, NIH and the President’s Cancer Panel. His work has been featured in the New York Times and the London Times, and on Dateline NBC and the BBC. He lives in Seattle, WA.

TOWN HALL 2012 - FINANCES PRESENTATION - MANUSCRIPT

⁵ FY 2011 O&M budget = ~\$3.2M

FY 2012 O&M budget = ~\$2.5M (actual projected as of January 2012 is \$2.4M)

Changes (net) in direct & indirect O&M budget from FY 2011 for FY 2012:

\$ 150,000 Williamson salary differential (not replaced)

\$ 50,000 change in district counsel conservative)

\$ 600,000 do not count depreciation expense as cash contribution to O&M budget but move to non-O&M expense coverage for pay-go CIP

\$ 25,000 experience through January 2012 in managing O&M field expenses

\$ 25,000 experience through January 2012 in managing O&M admin expenses

\$ 60,000 deferral of Viking interest expense (not included in FY 2011 O&M budget)

\$ 910,000 Net difference (approximate) in actual use projection through FY 2012 year end as of January 2012

⁶ Morris, 178-214.

⁷ See http://www.borregowd.org/uploads/Planning_Grant_Application_3.08.2012.pdf.

⁸ *The Mission of the Borrego Water District is to preserve and conserve its priceless resource so as to reverse the overdraft of the Borrego Valley while at the same time to provide quality water and sewer service in an efficient, cost effective manner while providing a high level of customer satisfaction.*

⁹ See http://www.borregowd.org/Notice_of_Rate_Increase.php.

¹⁰ See http://www.borregowd.org/uploads/2011-6-1_Rate_Increase_unsigned.pdf.