

Why Not Declare Bankruptcy?

Typically, bankruptcy for a government entity with taxing powers (i.e. power to raise revenue) is exceedingly difficult and expensive to accomplish. Recently, a few government entities have declared bankruptcy and more are currently considering this approach. Generally, filing for bankruptcy protection under Chapter 9 should be considered a last resort, to be effected only after every effort has been made to avoid it.¹

However, in the case of the Borrego Water District, its present financial difficulties are not caused by a large amount of debt or future contingent liabilities that a bankruptcy might potentially resolve. The District's financial difficulties are caused by: (a) a lack of revenues to cover normal operations and future repair and replacement of the infrastructure necessary to provide 24 x 7 water and wastewater services to its 2,200 customers and (b) a deficit of cash reserves that would cushion the District's cash flow during adverse times. For these reasons, the District is not creditworthy to borrow in the public capital markets. A reasoned and responsible course for resolving this issue is to increase revenues enough to provide the District with the ability to continue services to its customers. The proposed rate increases accomplish this objective, without seeking more than is actually necessary to stabilize the District's financial position. At this time, greater increases in rates than those proposed are not necessary.

Why can't the Board just ask our state legislators or federal Congresspersons to help out?

To date, the state legislators and Congressional representatives for Borrego have been extremely helpful. However, this help does not extend and may not legally extend to paying for or subsidizing services provided to the District's customers. It is the responsibility of ratepayers to pay the economic cost of the services provided to them by the District. The help that state legislators and Congressional representatives may provide is for obtaining grants related to specific projects, such as for groundwater management planning.

Nationwide, about half the water districts have increased their rates in the past few years and many more have plans to increase their rates in the near future. Rate increases are normal and expected in the water and business to cover rapidly increasing cost of operations and to replace

¹ John Knox and Marc Levinson, "Municipal Bankruptcy: Avoiding and Using Chapter 9 in Times of Fiscal Stress," San Francisco: Orrick, Herrington & Sutcliffe LLP, 2009.

aging infrastructure. What is unusual in the District's case is the severity of the financial distress that requires us to raise rates significantly and quickly.

How come the ratepayers are being asked to pay this rate increase and the rest of the Valley's pumpers don't have to pay?

The rate increases go only to pay for the services provided to the District's customers and the related infrastructure necessary to provide those services. The situation in the Valley where some pumpers pay for the water and others do not is because the groundwater basin is not a "managed" basin. As the upper aquifer is dewatered and it becomes more expensive to withdraw water from the basin or to bring water into the basin from a pipeline, it will be necessary for the basin to become a "managed" basin. When that occurs, all pumpers will be required to pay something for the groundwater that is pumped beyond the annual average recharge rate of the basin. There is approximately \$150,000 in the fiscal year 2011-2012 and 2012-2013 capital budgets to pay for the engineering and legal work necessary for the District to begin developing a plan for establishing a managed groundwater basin in the Valley.

Why not do one big lump sum increase for one year and then reduce the increases to a minimum thereafter instead of stringing it out?

The increases proposed balanced the needs of the District with the economic demographics of ratepayers. A very large increase would put significant financial pressure on many in the community creating additional revenue and collection issues for the District. Increasing rates to meet revenue sufficiency over time rather than in one fell swoop enables ratepayers to adjust to the new rates. Often, small changes in improving the end use efficiency in water use can ameliorate the impact of rate increases. Such improvement in using water more efficiently typically requires time for a ratepayer to implement. Further, the proposed increase is a maximum, not a minimum. In the future, if the District's economic situation were to significantly improve, these rates may be adjusted downward. However, at this point in time, there is no way to determine whether future events will have a positive effect on the District's revenues.

Since you haven't laid off employees, how can you say you are cutting costs?

Actually, the Board has effectively "laid off" the previous general manager whose monthly salary, benefits, travel and conference expenses cost the District over \$787,000 during his three years of employment by eliminating his position and combining the positions of general manager and operations manager. Recently, it promoted Jerry Rolwing who will serve as both

SPECIFIC QUESTIONS FROM CONCERNED CITIZENS

General Manger and Operations manager at no increase in salary. The Board further asked Dr. Brian Brady, the former general manager of the Imperial Irrigation District (IID), to assess whether the District was over or under staffed and whether salaries and employee benefits were reasonable for Southern California water districts. In his report he concluded that the District's staffing levels were appropriate for a remotely located water utility, the District's salaries by position were approximately 85% of the norm for Southern California water districts, and employee benefits were within normal ranges (see: http://www.borregowd.org/uploads/Brian_Brady_final_budget_staffing_report.pdf).

Why is water so expensive in Borrego?

Once the new rates for fiscal year 2011-2012 go into effect, the water rates in Borrego will still be one of the lowest rates among desert communities in Southern California. Even if all the proposed rate increases go into effect over the next five years, something that may or may not occur based on future events, the District's rates will still be neither the most expensive nor the least expensive among Southern California desert communities. Rates are established for each water and wastewater utility based on the revenue requirements for that utility. Each utility has specific operating costs, capital costs and "contributions to special replacement, improvement, expansion, rate stabilization, and self-insurance funds" that are required "to provide for adequate facilities, to allow for proper asset replacement and maintenance, to address debt service and coverage requirements, and to ensure that the utility is operated on a self-sustaining basis."² For additional comparative information see:

http://www.borregowd.org/uploads/water_use_cost_comparisons_v5.pdf.

Will the State of California mandate rate increases if the ratepayers reject them?

Unlike some other states, the State of California has no regulatory mechanisms: (a) to mandate rate increases if ratepayers reject them through a Proposition 218 protest; (b) to "rescue" the District from insolvency; or (c) to mandate the District to continue operating when it no longer has the funds to operate and provide potable water to its customers. The health and safety laws in the State require the District to provide potable water to its customers. However, if customers do not approve a rate increase necessary for the District to provide safe, potable water to its

² See: George A. Raftelis, *Water and Wastewater Finance and Pricing: A Comprehensive Guide, 3rd Edition* (Boca Raton, FL: Taylor & Francis, 2005), 181, 185.

customers, the health laws cannot “force” the District to continue to supply water to people’s homes. Also, there are no funds set aside by the State to provide emergency funding to protect the health and safety of customers should the District be forced to alter or to discontinue some of the services it presently provides to customers due to insolvency.

Why should I care about the overdraft and the District having the financial resources to address the overdraft when the aquifer still has fifty years of water left and I will be long dead and gone by then?

The concern is not that an aquifer has 50-years or 500-years of water left. The concern is when the economic impacts of withdrawing more water than is replaced each year (an overdraft) from the aquifer show-up. An aquifer can have 100-years of water left in it, but in 5-years already be too expensive to pump and use, much less, make potable for human consumption.

The economic costs to the District’s ratepayers and the entire community typically mandate addressing a significant annual overdraft in a timely fashion. These include: (a) increased pumping costs for all pumpers of the groundwater basin; (b) dramatically increased water treatment costs as water quality declines; (c) costs of subsidence as building and roads on the surface are damaged; and (d) loss of aquifer recharge capacity as compaction of the aquifer’s pore space occurs.

Our history and security here in the Borrego Valley sometimes provides the sentimental belief that the things we fear will never come to pass. That someone else, somehow, will solve the Valley’s groundwater overdraft problem. But, prudent persons will reject these sentiments and prefer to face the facts so that this community can plan intelligently for the needs of its posterity.³

Is the District providing Montesorro (Rams Hill) water for free or at a reduced rate? I’ve also heard that de Anza golf course is getting free water from the District. Is this true?

Under the laws of the State of California governing special water districts, the District is not allowed to give free water to **any** of its customers, nor to require one class of ratepayers to

³ The fact that the uncertainties allow one to construct a relatively benign future does not provide for ignoring futures in which economic water supply runs out. The doubters are right that uncertainties are rife. They are wrong when they present that as a reason for inaction. *Technological optimism*, the belief that some future technology can fix any water problem, has not been borne out historically. Also, technological fixes are typically expensive and ultimately uncertain themselves. See Howard G. Wilshire, Jane E. Nielson, and Richard W. Hazlett, *The American West at Risk: Science, Myths, and Politics of Land Abuse and Recovery* (Oxford & New York: Oxford University Press, 2008), 5, 8, 365, 367.

SPECIFIC QUESTIONS FROM CONCERNED CITIZENS

subsidize another. Different categories of ratepayers, such as residences and commercial users and those with different meter sizes can and often do have different rates based on the economic cost of providing services. For example, other local desert water districts listed on our web site in the “Comparison of Water Use Charges among Desert Communities” have several levels of rates depending on a number of factors including meter size, demand rate, use rates, and volume. Because water utilities are non-profit, these varying rates are based upon the cost to the District to provide services.

Why can't the District just issue a bond to raise the money it needs to operate?

To sell a bond issuance, the District must be creditworthy. That is, investors must have confidence that the money they lend the District will be paid back without default. Presently, this is not the case. Because of the lack of adequate cash flow to readily pay the principle and interest due on a loan, the District is no longer creditworthy. Cutting expenses alone cannot solve this situation. As any businessperson understands, not attending to the real costs of the business does not save money in the medium or long term even if a quick short term “savings” might be achieved. In fact cutting expenses any further than what the District has already done could potentially raise the District's costs and reduce future cash flow because preventative repairs and maintenance would be deferred until failure occurs. Once failure has happened, this is often much more expensive to fix than preventive maintenance. For example, periodic oil changes for your car is usually much less expensive than avoiding these costs and waiting for your car's engine to fail. Only increased revenues can solve this situation and that means a rate increase.

Isn't it unfair that commercial accounts are exempt from the rate increase?

No customer of the District is exempt from the rate increase. The rate increase applies to all equally. Apparently, there is some confusion and misunderstanding by some as to the difference between rates and rate structure. Whereas rates for all users will increase, the rate structure will not change. Under the current rate structure, commercial accounts are not subject to Tier 2 rates, only residential accounts. Some individuals mistakenly believe that this is unfair and indicates that residential users are subsidizing the commercial water users. However, this is not the case. One user category subsidizing another category of users is not allowed under California state law. Residential users are not allowed to subsidize commercial users and commercial users are not allowed to subsidize residential users. Each category of user must

pay their fair share. Only a cost of service analysis will determine whether any changes are necessary in the current rate structure and in what direction these changes will occur. The District plans to undertake such a study at a later date. The assertion that the proposed rates are unfair because at present commercial users do not fall under the Tier 2 rate structure is false in that it misunderstands how rates are developed and what is allowable under California law.

Why isn't the District proposing a different rate structure at the same time it is proposing different rates?

The District's cash flow situation is so dire that the immediate requirement is to increase revenues through higher rates beginning July 1, 2011. The proposed rate increase is not optional if the District is going to continue to provide 24x7 services to its customers on an ongoing basis. Without adequate cash, if there were a failure in costly equipment or a natural disaster, there could be significant delays in making repairs and long disruptions in service. The Board's duty to ratepayers is to take quick and decisive action to restore financial stability to the District. Thus, the decision was made to examine and develop the rate structure at a later date when the looming financial emergency didn't threaten the District's ability to provide reliable continuous water and sewer services.

Why hasn't the Board reduced employee expenses more dramatically, given the large percentage employee expenses account for in the annual O&M budget?

Employee expenses were reduced about 20% in FY 2012 from FY 2010 by consolidating the positions of general manager and operations manager. Additionally, wages have been frozen for three years and given the District's financial status will likely remain frozen into the future. Pension benefits are vested under state law and cannot be changed for existing employees. The District's medical, dental, and vision plans are similar to others in this industry and offset the lower than average salaries paid to District staff. A review showed salary levels are about 85% of the norm for southern CA water districts. An initial review of staffing levels indicates that because of our remote location, the District may be better off economically using trained in-house staff rather than contractors to perform field work such as repairing distribution pipelines, etc. because they can respond more quickly when equipment fails or emergencies occur. The benefit to ratepayers is the restoration of services sooner rather than later. The Board has observed the staff closely over the past months and believes the District has a competent,

SPECIFIC QUESTIONS FROM CONCERNED CITIZENS

dedicated staff who work hard each day to provide safe, potable water and sewer services 24 x 7 to the District's customers. To suggest that these hard working, dedicated employees must somehow be "punished" for the failings of this board or previous boards is inappropriate. Even so, the Board is reviewing employee benefit expenses as well as all other spending in an effort to restore the District to financial stability. For more information on these issues see: http://www.borregowd.org/uploads/Brian_Brady_final_budget_staffing_report.pdf.

Why hasn't the Board reduced operating expenses more so that rates would not have to increase as much?

Cutting operating and maintenance (O&M) expenses of a water utility is a double-edged sword. For FY 2011-12, the Board has trimmed approximately \$700,000 from the FY 2010-11 budget. It is unlikely this significant reduction can be extended beyond the next few years due to an expansion of federal and state regulations governing the District's services and inflation which has/will significantly increased the cost of materials and supplies. Even so, this Board is well aware of the financial burden ratepayers face and is committed to a keeping spending in check while continuing to fulfill our responsibility to provide reliable services.

Public health is our greatest concern. Community water systems in the U.S. supply treated potable water via a positive pressure system directly to people's homes. This system usually works so well, many individuals take it for granted and mistakenly believe that just like any other business, all that is necessary to save money is cut expenses. However, a positive pressure system is extremely expensive to operate 24 x 7 and is regulated by multiple layers of government agencies each with specific requirements that MUST be met. The fines for failing to meet these requirements are very costly and the District has worked hard to meet all standards.

Anyone who has traveled to a less developed country can attest to the value of a reliable community water system capable of delivering safe, potable water. One of the reasons why this water is often unsafe to drink is that communities in these countries cannot afford to run a 24 x 7 positive pressure water system and bacteria enter the system making the water unsafe to drink. In addition, their governmental oversight may be unable or unwilling to enforce health standards.

Delivering safe water and disposing properly of sewer waste costs money. When a community fails to adequately fund its O&M and infrastructure costs there can be catastrophic results. Inadequate quality and water-borne diseases make people sick. This happened in April 1993 in Milwaukee where 400,000 became ill, 4,000 were hospitalized, and 100 people died from

exposure to *cryptosporidium oocysts* in the drinking water. A contributing factor was inadequate investment in water treatment facilities. More recently in May 2000 in Walkerton, Ontario, a town of 5,000 people, a perfect storm of a broken water main, a sick animal, heavy rains, poor maintenance and repair practices, and operator error combined to introduce *E coli 0157:H7* into the public water supply sickening 2,300. Hundreds were hospitalized and seven people died.

The Board must balance our responsibility for your health, the requirements of regulatory agencies, the remoteness of the Borrego valley and the financial uncertainties of the US economy when it decides what to cut from the budget. The right bottom line question is “Are we certain that we are spending enough for O&M to deliver safe, potable water to our homes and businesses?”

What will really happen if the District’s ratepayers do not approve of a rate hike?

As the District falls behind in making necessary repair and replacement investments in infrastructure because it cannot borrow the necessary funds, the water system will fall into disrepair and may no longer meet state and federal regulatory requirements. As the system falls out of compliance, large fines are levied by the regulatory agencies and a moratorium on any new connections to the water and sewer system may be enforced by these agencies. The combination of these factors - a community water system in financial difficulty, poor water and sewer service due to lack of staff and funds, and onerous regulatory oversight - may result in an overall devaluation of the community. That could include lower property values, reduced business investment, and a loss of community services as organizations and business leave the area. In other words, a downward spiral that is self-perpetuating and both difficult and expensive to correct once begun.

I don’t understand why it is so expensive to run a water utility. What will these proposed rate increases be used for?

The proposed rate increase beginning on July 1, 2011 will be used primarily to provide necessary cash flow for working capital needs. None of this increase goes to increasing salaries, hiring more personnel or doing anything other than the bare-bones normal work of a community water system. Even after cutting \$700,000 in operating costs from the FY 2011 to FY 2012 budget and dramatically scaling back capital improvements projects for FY 2012, all this increase does is maintain existing services and begin planning for establishing a managed

SPECIFIC QUESTIONS FROM CONCERNED CITIZENS

basin. Establishing a managed basin is one of the few ways to spread the cost of the overdraft across all pumpers, including agriculture, of the Valley's groundwater basin.

Why can't you eliminate the base charge and just charge people for the water they use?

If all the District's customers used zero units of water, the District would still have fixed monthly expenses to pay which cover the costs of providing 24x7 water and sewer services. The base charge covers a portion (not all) of these fixed expenses. The commodity fee accurately assesses customers for the variable cost to the District of supplying water. As a customer uses more water, they are charged more.

Why should current ratepayers have to pay for shortfalls created by unwise decisions made by former boards?

Unfortunately, what is is. Those of us who live in the community and use present services are the only ones who can pay. There is no federal or state organization to bail us out. We are responsible for the actual costs of operating, maintaining, repairing, and improving the present water and sewer system serving Borrego. Unwise decisions affect us all. That is why the current Board encourages community participation in all its decision making processes and has attempted to be transparent in providing community access to its decisions. We are attempting to avoid the unintended consequences that chronically affect isolated decision making at all levels.