

Attachment No. 39

**EPASD Response to MSR,
Materials for Board
Presentation**

To: Mr. Akin Okupe, General Manager

East Palo Alto Sanitary District

From: Dennis C. Scherzer, Director

East Palo Alto Sanitary District

RE: LAFCO MSR Response

1-31-22

I have read the draft of the Municipal Services Review (MSR) prepared for San Mateo County LAFCo. Due to the limited time allotted for review and comment on this draft, I focus on Section 5. *East Palo Alto Sanitary District*.

Due to the necessity for accuracy in a document such as this, I call out undocumented statements of fact, speculative hypotheses regarding the context in which the East Palo Alto Sanitary District (EPASD) operates, information voids, incorrect titling of projects and streets, and typos in general. The EPASD Board of Directors is seriously concerned that information contained in the MSR is complete, accurate, and free of contextual and textual errors.

- **Statements in bold type represent responses to quotes from the MSR.**
- *[Bracketed statements indicate recommendations for improvements to the text and/or format of the MSR.]*
- The City of East Palo Alto is referred to as the City.
- The East Palo Alto Sanitary District is referred to as EPASD.

Section 5. Page 1.

“Financial Adequacy”

Par. 1: The City of East Palo Alto’s (City) “recent General Plan (GP) update provides for increased density for new development in select areas.” True.

Then paragraph 2 immediately creates a purely speculative conclusion, casting gray light on EPASD throughout the entire chapter 5:

Par.2: “However, EPASD has been unable to provide ‘will serve’ letters to developers given EPASD’s constrained sewer capacity to accommodate new development.”

EPASD can demonstrate that several large-scale developers are unwilling to enter into the accepted industry-wide process that would create the circumstances that elicit “will serve” letters from EPASD. Although every developer whose project would cause the existing sewer mains to surcharge, or supersede their present

design capacity during Peak Wet Weather Flows (PWWF) is responsible for construction costs to enlarge the existing system to accommodate the increased flows, a few have refused to agree to accepted construction and finance practices.

Without such contractual agreement, EPASD is “unable to provide” will serve letters for any proposed development.

These are the facts, and they’re indisputable.

The MSR continues that EPASD, “lacks a plan to finance sewer expansion to serve new development”.

EPASD is then blamed for the MSR’s incomplete and inaccurate assessments of EPASD’s ability to serve new development, rather than correctly assigning the problem to developers and City planning staff:

“Consequently, new housing, including the expansion of the supply of affordable housing, and commercial projects in EPA have been unable to proceed.”

This statement is blaming EPASD for circumstances that have not been proven or documented as the responsibility of EPASD. These are land use issues that are outside of EPASD’s authority, and are the responsibility of the City’s planning department. This is a manifestation of the “gray light” of bias being projected against EPASD in this document.

The obvious intent appears to have the remainder of the document justify this biased conclusion.

Fortunately, EPASD’s operations, especially finances, are quite sound as demonstrated by this MSR, however the results rarely (and begrudgingly) acknowledge how well EPASD operates and maintains its system.

Curiously enough, in paragraph 3, the MSR refers to a hypothetical Capital Improvement Program (CIP) “intended to help create a path forward”, including “improved City fiscal sustainability for services to the East Palo Alto Community.”

No mention of EPASD. The “path forward” does not appear to include EPASD, rather a proscribed role for EPASD in support of the City that assigns EPASD a role as supplicant to the City rather than a partner in development.

[The MSR refers to the City of East Palo Alto as both the “City”, and “EPA”, and the East Palo Alto Sanitary District as both “EPASD” and the “District”. The persons preparing the MSR should choose one succinct designation for each agency and continue to use it throughout the document. This reduces confusion and reflects accuracy.]

The focus should now shift to the recommendations contained in the CIP proposed within the MSR:

Page 19.: “Framework for a CIP Finance Plan”

Par. 3: “The framework prioritizes existing ratepayers’ health, safety and financial concerns while striving to provide benefits to ratepayers who are also residents of the City of East Palo Alto; those benefits include increased tax revenue to both EPASD and the City, increased economic development, jobs and related revenues, and additional affordable housing.”

[A significant portion of EPASD is within the city of Menlo Park. Why aren’t our Menlo Park residents included in the statement of intended benefits?]

EPASD is more concerned with controlling costs to existing ratepayers. Economic development and affordable housing are land use policy issues squarely within the purview of the City, and because EPASD and the City have very separate operational revenue streams, associating the two as a homogenous mutual benefit is an inaccurate assumption.

“Possible CIP Finance Plan Goals and Objectives” (CIPFP)

“1. Provide safe, efficient, and cost effective (sic) sanitary sewer services.”

This is evident in EPASD’s everyday practices, as attested to in the MSR.

“2. Ensure that growth pays its own way and does not place a financial burden on existing customers.”

This MSR is a product of forces external to EPASD in association with the City, to refute that statement and place new development’s financial burden squarely on the shoulders of EPASD ratepayers. This is a long-standing policy of EPASD, and the EPASD Board of Directors is adamantly and unanimously opposed to causing existing ratepayers to subsidize new development.

Additionally, to require existing ratepayers to subsidize new development violates state law.

“3. Equitably recover costs based on the new or increased capacity needs of each new development or redevelopment project.”

[Are there such things as “redevelopment projects”?]

Otherwise, this is consistent with current EPASD policies and practices.

“4. Include recommended projects to address capacity deficiencies in the system and a schedule.”

[This statement is very poorly worded.]

Does the MSR include “recommended projects to address capacity deficiencies in the system”?

Is this statement addressing treatment capacity or conveyance capacity of the piping system?

What projects, or types of projects are being referenced here?

“5. Include impact fees within the connection fees to help contribute to future downstream projects needed for pipe capacity.”

This is a conflation of two concepts. Connection fees differ from impact fees.

The notion of an “impact fee” is inaccurate. The costs of system upgrade construction (“impact costs”), are the responsibility of the developer. No fees for construction are required or collected by EPASD.

“6. Sustain investment to increase performance levels and avoid significant interruptions created by failure of arterial infrastructure.”

This is consistent with long-standing EPASD policy. A recent example is a new electronic flow monitoring network that warns of overflow problems and provides engineering data for system maintenance, the current full-system tv inspection.

“7. Generate cash flow each year to fund pay-as-you-go capital construction projects while using debt financing judiciously for specific large, long-lived capital projects. This enables future users to share in the costs without overburdening existing ratepayers.”

This idea conflicts with item number 2. above. The “debt” in debt financing will be paid by existing users. This is another expression of the notion that EPASD should increase rates in order to subsidize future development. The idea is illegal.

“8. Develop priorities for repair, replacement and upgrade, as recommended by SSMP best practices, focusing on EPASD goals (e.g., public health and safety, cost effectiveness, public benefit, legal requirements, etc.).”

This currently is Standard Operating Procedure at EPASD.

“9. Strive to leverage funding (including grants and low interest loans, capacity charges and developer funds, existing cash flow and reserves, and rate-secured financing) to achieve multiple priorities with each project and thereby improve cost effectiveness.”

This again assumes that causing existing ratepayers to subsidize new development is somehow a good (or legal) idea. It lumps connection fees with construction costs that are developer responsibility, and advocates entering existing ratepayers into debt in order to fund new development.

Finally, on page 21 the MSR concludes by theorizing that benefits accrue to EPASD by increased property tax and rate revenue. A nice idea, **however there is no discussion**

or proof of the increased cost of service to EPASD by subsidizing new development that would render additional property tax and rate revenue.

Page 1. Par. 4.:

“EPASD appears to have adequate financial resources and unrestricted net position to continue current operations;”.

This statement validates EPASD’s ongoing fiscal policies.

“...however, the lack of a financing plan for its capital improvements raises concerns.”

Initially, this statement conflicts with page 9., paragraph 4 which states, “The District pursues an ongoing program to replace aging pipes based on condition inspections. ‘Construction Replacement Fund’ budgeted expenditures average \$1.0 million from FY16-17 through FY19-20 according to EPASD budgets.”

Budgeting \$1 Million per year for construction finance is a “financing plan”. The veiled conclusion in the MSR is that EPASD’s construction financing plan include funds to subsidize new development carved out of increased costs to ratepayers.

The MSR repeats this speculative theory in the same paragraph:

“EPASD lacks a plan to provide service to future development which could help provide more cost-effective system improvements consistent with recommendations of EPASD’s consultants.”

Again, EPASD is being held responsible for the City’s land use planning, or more specifically, the lack of it. This is evidenced by the City’s current General Plan (GP) which contains practically no information regarding EPASD’s system’s ability to immediately serve proposed mega development within the City. The GP, a vital and basic planning document, is supposed to predict new development impacts until 2035, yet doesn’t consider sanitary sewer impacts worth noting. Additionally, EPASD’s attempts to correct this deficiency in the City’s planning documents have been rebuffed by City staff.

As for “EPASD’s consultants”, which consultants have advocated that EPASD ratepayers subsidize new development? When and where have they recommended this?

Finally, no “project” exists at EPASD unless the developer completes the necessary permit applications and submits engineering construction plans to EPASD.

Page 2., Par.2.:

“EPASD prepares an annual financial report consistent with Generally Accepted Accounting Principles.”

When an auditor deems an organization's finances are consistent with Generally Accepted Accounting Principles", it represents the best statement that can be offered by auditors. EPASD's annual audits have all resulted in this conclusion by the independent financial auditors. The MSR thus recognizes EPASD's adherence to sound fiscal accountability practices.

The remainder of the page identifies specific minor factors in accounting methodology that have not elicited comment from the auditors. Much of this narrative tries to assert that projected expenditure (budget) should absolutely match year-end balance figures. Such psychic awareness is not available at EPASD.

What has actually occurred has been historically consistent with best financial accounting practices. All public funds are accounted for, including revenues, expenditures, and funds remaining at EPASD.

Page 3., Par.4.:

"The change in total service charge revenues since FY17-18 is equivalent to an average of 1.3 percent annually."

[The MSR fails to indicate whether this is an increase or decrease in this revenue.]

Page 4 speaks to property tax revenues. EPASD does not rely on this revenue stream as a significant source of revenue. These monies can be used for General Fund expenditures, unlike Connection Fees (restricted funds).

Page 5., Par. 2.:

"Other Revenues"

This section fails to mention that EPASD's funds are held in a multi-agency investment pool managed by San Mateo County (SMCo). The interest that EPASD receives is directly related to SMCo's management of EPASD funds within that pool.

Par. 5.:

"EPASD policy call (sic) for operating reserves equal to at least 12 months of operating expenses."

The EPASD policy requires that EPASD's Ending Fund Balance of its financial statement include enough funds to operate EPASD in lieu of revenues forwarded by SMCo. EPASD's Sewer Service Charges are collected on the SMCo property tax roll. The funds are transferred to EPASD twice annually. A six-month operating capital is the bare minimum requirement as EPASD's fiscal year begins July 1, and the first fund transfer from SMCo (consistent with schedule of property tax collection) occurs in December/January.

The 12-month provision, included in EPASD’s annual budgets, assures enough operating capital in case there is a delay or disruption in SMC’s scheduled ability to transfer revenues to EPASD.

Page 6., Par. 3.:

[The “Lighthouse development” is referenced in this paragraph. Apparently, this is referring to the “Light Tree”. Such mistaken references reduce the accuracy and efficacy of the MSR, and call into question the accuracy of other statements contained within the MSR.]

Par. 4.:

“EPASD maintains a Connection Fee Fund that can be utilized for capital improvements to the system.”

[No mention or discussion of the fact that these are restricted funds, why they are designated as restricted, and the limited use that these funds can be applied to.]

Par.6.:

“...the District has established a trust administered by the Public Agency Retirement Services (PARS)...”

[The MSR should identify “PARS”. According to a January 30, 2022 telephone interview with Mr. Okupe, EPASD’s General Manger, no such entity as PARS is associated with EPASD’s pension/retirement programs. Is the MSR referring to “PERS”, or “CalPERS”, the Public Employees’ Retirement System? EPASD fully participates in CalPERS.]

Page 7., Par. 3.:

“Pension and OPEB Liabilities”

“At the start of FY20-21, EPASD (sic) unfunded pension liabilities totaled \$1.98 million...”

Although the MSR quotes from recent EPASD agendas, it fails to mention the recent Board-approved payment to the State of California that completely resolved this shortfall. Again, the MSR is inaccurate and misleading, again casting EPASD in a bad light.

Page 8., Par.2.:

“Public utilities often are recommended to carry higher levels of debt...”

This is another attempt to justify burdening existing ratepayers with the cost of subsidizing new development.

- **Why would EPASD do that?**
- **Whom has recommended this to what agencies?**
- **When were these recommendations made?**

- **How much are these “higher levels of debt?”**

Par. 4.:

“EPASD borrowed funds from the State to finance construction of the Cured in Place Siphoning (sic) project.”

EPASD did not have to lobby the State for these funds. They were made available to EPASD as part of their participation in a multi-agency project that reconfigured San Francisquito Creek for flood control purposes. EPASD’s trunk line transits beneath the creek by means of a siphon. Without the multi-agency participation, EPASD would not have been able to secure these funds.

“The District also borrowed to fund the costs of the Ultraviolet Disinfection Project.”

This is a deliberate misstatement of fact designed to imply that State funding is immediately available to EPASD. EPASD is a partner in the Palo Alto Regional Water Quality Control Plant (PARWQCP). The UV disinfection equipment is part of the wastewater treatment system at PARWQCP. EPASD is one of five partners in that plant. Again, due to the multi-agency participation at PARWQCP, State funding was made available. EPASD did not apply for or secure these funds, the City of Palo Alto did. EPASD payments to Palo Alto for wastewater treatment includes funds designated to resolve EPASD’s share of this debt.

Par. 5.:

“EPASD has a program to loan funds for property owners to repair and replace lateral sewer lines.”

EPASD’s Lateral Replacement Program has been in effect since 1985. It is designed both to ensure public health and safety by assisting property owners in maintaining their sewer laterals. It has often facilitated emergency repairs due to lateral failures.

Property owners receive loans to cover lateral repair and replacement costs which, through contractual agreement, are then repaid through increased sewer service charge (SSC) assessments collected on the SMCo property tax roll. Projected SSC revenues, identified by EPASD on their annual tax roll submissions are fully funded by SMCo under the Teeter Plan. SMCo, by agreement with EPASD, is then authorized to pursue delinquencies if they occur. The Lateral Replacement Program agreements also include a Point Of Sale clause that requires that the unfunded remainder of these loans is paid whenever a property changes owners.

The MSR implies that pipeline replacement, (whether required or not) is a viable financial strategy because these existing fixed assets are of an age where their depreciation schedule exceeds their actual value. Supposedly, this means that pipes should be replaced solely for the creation of new and increased depreciation values that would benefit EPASD finances.

This is a patently ridiculous notion designed to blend into and support the erroneous notion that EPASD should cause existing ratepayers to subsidize new development.

Par.4.:

(EPASD's budgeted pipeline construction/replacement) "...expenditures average \$1.0 million from FY 16-17 through FY 19-20 according to EPASD budgets. However, EPASD's audited financial reports show that capital additions ... averaged \$530,00 for the same time period."

Another attempt to justify financing system improvements to subsidize new development at ratepayers' expense.

EPASD does not repair or replace pipelines that are sound and functioning in good order. The system is in good repair. Most CIP expenditures relate to "point repair" projects that address system-wide needs for replacement and repair. The simple fact is although \$1 Million is budgeted for construction/replacement, there is no requirement that those funds be expended if not needed.

Page 11., Par. 1 and 2.:

The MSR creates issues with EPASD's Sewer System Management Plan (SSMP). The MSR again fails to mention the system-wide TV inspection program currently underway at EPASD. The results of this survey will identify system problems, allowing our engineers to develop an accurate CIP to facilitate system repairs and/or replacements.

Par. 2.:

(The EPASD SSMP), "did not include a fee component to fund costs for increased capacity to serve new development..."

The MSR continues to bang the broken drum advocating that EPASD create fees for future development to be imposed on existing ratepayers. It also again conflates connection fees with the developer-borne construction costs associated with new development.

DEVELOPERS ARE REQUIRED TO ENGINEER AND FUND SYSTEM CONSTRUCTION COSTS NECESSARY TO SERVE THEIR PROJECTS.

EPASD DOES NOT CHARGE FEES FOR CONSTRUCTION COSTS SERVING NEW DEVELOPMENT.

Page 12, Par. 1.:

The underlying scheme driving the MSR is exposed:

“Planning for future development helps to reduce ratepayers’ costs to fix current system deficiencies by leveraging grants, low-interest state loans and development funding.”

Again (and again and again) the MSR assumes that it is a viable concept for EPASD ratepayers to subsidize new development.

“Thoughtful implementation of planned development also brings new rate revenues to improve services and reduce costs to East Palo Alto ratepayers and increases City of East Palo Alto revenues for infrastructure and enhanced public services for East Palo Alto residents.”

This addresses conditions present within the City’s land use and planning process, and is not the purview of EPASD.

Par. 2.:

The MSR mentions concerns regarding rising sea levels and local flooding affecting SMCo as expressed by the Grand Jury and the City’s GP in 2015. Currently, and historically, a significant portion of EPASD pipelines is constantly submerged below the water table. EPASD’s conveyance facilities are further impacted by high tides and increased groundwater levels associated with rainfall episodes. EPASD has constantly expended CIP funds to reduce infiltration from groundwater sources.

Flooding is the responsibility of the City. SMCo transferred O&M of the stormwater collection system within the City. The City’s ability to adequately maintain this system is questionable, especially when the storm sewer system’s ongoing failure to prevent flooding of Weeks Street during rainfall episodes is considered. Although the City collects significant revenue from property owners for the O&M of the storm sewers, the Weeks Street problem has existed for the entire period since the City’s incorporation in 1983. The City has attempted to require a private school project in that area to fully fund the City’s obligation to properly maintain the Weeks Street storm sewer.

EPASD has had no Sewer System Overflows (SSO) in recent history, as confirmed by the MSR, and the Regional Water Quality Control Board. Imagine if the City were to control EPASD’s facilities and managed them as they do their storm sewers.

Page 14, footnote 67:

EPASD’s 2021 Master Plan addendum Table 11 represents “pipe upsizings (sic) so it is not possible to see the impact of d/D without the pipe upsizings (sic).”

[No explanation of the term “d/D”. Explanation required as this is a public document, not an engineering survey.]

The MSR fails to reflect that the bulk of the costs to for serving new development are construction costs. Different diameter pipes are installed in similar sized trench excavations. Physical pipe costs are much lower than construction costs.

Conclusion:

The MSR is blatantly designed to create justifications for EPASD to impose enhanced service fees upon existing ratepayers for the purpose of subsidizing new development. The MSR fails to recognize that EPASD is subject to Article 13D, specifically Section 6.b.1-4 of the California Constitution which prohibits EPASD from charging ratepayers more for their service than it costs to provide it. Subsidizing new development would require rate increases above and beyond what is required to provide sanitary sewer services for existing ratepayers.

Overall, the MSR validates EPASD's operational efficacy and recognizes that current and historic policies and procedures at EPASD serve its ratepayers well, and are proactive in efficient and cost-effective operation of this public utility.