



Meeting Date: 8/8/05
Agenda Item No: 5
Manager: Olga Martin Steele
Extension: 2326
Director: All

BOARD AGENDA MEMO

Discussion Action Consent Information

SUBJECT: Response to Grand Jury Report

RECOMMENDATION:

Authorize the Board Chairperson to sign the attached letter and response to the Grand Jury final report, "The Santa Clara Valley Water District – What's Beneath the Surface?", including any changes the Board may make.

If the Board does not approve a response by September 19, 2006, the District would not be in compliance with California law.

RATIONALE:

California Penal Code § 993 (c) requires that a governing body of the particular public agency or department which has been the subject of a Grand Jury final report shall respond within 90 days to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the governing body. California Penal code § 993.05 contains guidelines for the format of the response which have been incorporated into the District's response. Further, under EL 9.9, the CEO must supply for the consent agenda all items delegated to the CEO yet required by law or contract to be Board approved.

EL-3.7 COMPLIANCE:

Not applicable

SUMMARY:

The 2005-2006 Santa Clara County Grand Jury conducted a review of District operations. The Grand Jury issued their final report to the District Board dated June 16, 2006. The District Board's response to the Report is due no later than Tuesday, September 19, 2006.



CEQA REQUIREMENTS:

Not applicable.

ADVISORY COMMITTEE INPUT:

Not applicable.

SUBJECT:

Response to the Grand Jury Report

PUBLIC OUTREACH:

An initial press release was issued in June highlighting the report's primary finding that the District "generally does a commendable job of providing water, protecting watersheds, and implementing flood control in Santa Clara County." No additional public outreach is planned at this time.

FINANCIAL IMPACT:

There is no specific fiscal impact related to the District responses at this time. There may be future cost savings to the District proceeds with pension obligation financing under Recommendation #7. A complete analysis of that option will be presented to the Board later this fiscal year.

Response to Grand Jury Report “The Santa Clara Valley Water District – What’s Beneath the Surface?” dated June 16, 2006

Finding # 1

“The District generally does a commendable job of providing water, protecting watersheds, and implementing flood control in Santa Clara County.”

District response: **Agree.**

Finding # 2

“Voters fail to participate actively in SCVWD director elections. Many directors run unopposed and many directors serve for multiple consecutive terms. The elected directors may not represent a broad cross-section of the population.”

District response: **Disagree**

This year, two of the District Board positions were up for election. One of the incumbent board members faced three challengers and will have a runoff election in November. The other incumbent board member had one challenger and won election in June. By way of comparison, two County Board of Supervisors’ seats were also up for election (the same geographic districts). One incumbent supervisor ran unopposed while in the other district, three candidates squared off for an open seat. Our research indicates that the pattern of contested and uncontested elections is very similar when comparing the Board of Supervisors to the District Board. **Also, in terms of voter participation, it is interesting to note that 49,396 voters participated in District 1 Water District Board election, while only 45,185 participated in the District 1 Supervisor race.** In District 4, the County Supervisor race among three contenders garnered 48,451 total votes while the District election between two candidates resulted in 44,973 total votes.

Recommendation # 2

“Independent voter-advocacy organizations, such as the League of California Cities, public forums such as the Commonwealth Club, chambers of commerce and news media should encourage, educate and energize the public about the importance of participating in the electoral process. This may also provide a forum for explaining and vetting SCVWD programs for a broader set of stakeholders.”

District response:

The recommendation cannot be implemented by the District as it is directed at voter advocacy organizations, public forums, chambers of commerce and news media and do not apply to the District.

The District, however, welcomes greater voter participation, which in turn fosters more direct and effective policy decisions. We believe that the best oversight of budgetary and water-resource issues occurs when voters effectively use the ballot box to hold elected leaders accountable. The District encourages greater scrutiny and transparency, and places a high priority on stakeholder and community involvement.

The District is a member of most of the chambers of commerce in Santa Clara County. District staff not only serves on the board of directors for several chambers, but also actively participates in the environment and government sub-committees of the chambers. The District's participation in chambers of commerce helps educate and communicate current and future District projects that impact local businesses.

The District also has regular contact with advocacy organizations including, but not limited to, the Silicon Valley Leadership Group, the Committee for Green Foothills, the Santa Clara County Farm Bureau and the Santa Clara County Special Districts Association.

With regard to vetting District programs, as the report notes there are already many sources of oversight and accountability. These include: Santa Clara Valley Water Commission, which reviews water operations and rate-setting; a committee of the District's retailers; seven board advisory committees; public rate hearings; an annual independent audit of District financial statements, and the Independent Monitoring Committee oversight of the Clean, Safe Creeks and Natural Flood Protection Plan.

Significantly, the District this year is taking stakeholder and community participation to an even higher level with the development of a five-year capital improvement program, a fact recognized by the Grand Jury. The program will be adopted by the District Board after numerous meetings with public agency representatives, water retailers, cities, the county and the general public. **For the first time, we are requesting that each local government review the CIP for its consistency with their general plan.**

In addition, the District actively seeks community participation through regular community meetings, news media interaction, its website, newsletters and project mailers. The District's media outreach regularly results in coverage by local and regional newspapers, and regional television and radio stations. Water District Board meetings are now regularly listed in the weekly "Government Watch" column in the San Jose Mercury News, the Bay Area's leading newspaper. In fact, the newspaper also covered the District's June 2006 elections.

Finding # 3

"The current statutory basis of the SCVWD includes a provision for annual Board of Supervisors review of the SCVWD budget. There is an effort under way (AB 2435) to terminate this relationship between the SCVWD and the BOS."

District response: **Agree**

Recommendation # 3

"The Grand Jury firmly believes the current oversight arrangement should not be terminated. The effective management of a service as vital to the County as water cannot be improved by reducing oversight. The reality of limited voter involvement argues all the more retaining the relationship between the SCVWD and BOS. Currently two BOS members serve on the Water Commission and two on the Valley Transportation Authority Board. Participation of BOS members would serve to strengthen the link between the SCVWD and the BOS to perform the budget oversight function as well."

District response:

The District agrees with the finding, but not the recommendation. The recommendation will not be implemented because it is neither warranted nor reasonable. The existing budget approval structure disenfranchises voters by creating confusion and preventing voters from effectively using their ballot to hold elected Water District Board members accountable for representing their budgetary and water-resources project interests.

If any or all of the District Board's policy decisions to be more environmentally responsible, to set rates at a certain level, to prioritize the construction of certain capital projects, or to use pay-as-you-go financing rather than incur debt were changed by the Board of Supervisors through its review and adoption of the District budget, then who would the voters hold accountable? Who would be responsible and liable for the consequences of the two boards disagreeing on these areas where the Grand Jury found there are very different opinions?

Historically, the county's review of the District's budget has consisted of a brief presentation by the District as a routine part of the County's annual budget deliberations. The presentation was usually followed by a stamp of approval from the County. Times have changed. The District has grown as an agency, both in terms of its charter and expenditures. New regulations, environmental issues and increased public scrutiny have vastly increased the complexities of the District's operations. The District Board is an elected and involved board focused exclusively on water issues. County Supervisors have a broader service-oriented focus. For real scrutiny, accountability and sunshine, the County would need to carry out more than a 15-minute cursory discussion and instead devote considerable staff resources and industry-related expertise it currently does not possess.

As mentioned in reference to Recommendation # 2, the District already has many sources of oversight and accountability, including Santa Clara Valley Water Commission, seven board advisory committees; and an annual independent financial audit.

As a result, both the County and the District acknowledge that there is no longer any need for the County to review the District budget. Both agencies agree that this is a duplication of effort which can be costly, and moreover exposes the County to liability in an area where it has no expertise or control.

In addition, the current budget process does not allow voters to hold the Water District Board solely accountable for flood protection and the quality, safety and sustainability of our water supply.

The proposed legislation would align the Water District's budgetary practices with all other independent special districts statewide by providing for a board of directors that is independent of another elected body. This will provide clearer accountability to Santa Clara County voters, businesses and residents for services they pay for and deserve.

As a result, the District and County have chosen to continue to pursue AB 2435 so that the elected District Board is directly accountable to voters. That jointly sponsored legislation is supported by 13 of the 15 cities in Santa Clara County, representing 96 percent of the total county population.

Finding # 4

"Currently two SCVWD directors are appointed by the BOS and yet participate in decisions about rate setting, eminent domain, taxation, and debt issuance, without direct mandate from County voters."

District response: **Agree**

Recommendation # 4

"No district board members should be appointed. The two board positions that are currently appointed should be converted to be filled directly by County supervisors, who are already elected by the people. Currently two BOS members serve on the Water Commission and two on the Valley Transportation Authority Board. Participation of BOS members would serve to strengthen the link between the SCVWD and the BOS to perform the budget oversight function as well."

District response:

The recommendation to have two County Supervisors serve on the District Board will not be implemented because it is neither warranted nor reasonable. While the appointed members of the District Board have served the District and the public well, the District agrees that no board members should any longer be appointed, and the proposed legislation AB 2435 addresses that. We disagree

that the two board positions should be converted to be filled directly by two County Supervisors. The elected District Board members represent each of the five supervisorial districts in the county. If there were two County Supervisors on the Water District Board, voters in their electoral districts would have double representation in violation of federal law and principles of fairness. Further, it is unreasonable to believe that two supervisors, who already have demanding full-time responsibilities, could reasonably devote the time necessary to manage a large, complex water supply and flood protection agency like the District.

As mentioned in response to Recommendation # 3, both the County and the District believe that a fully independent Water District will ensure the District Board's accountability to voters. In fact, the existing structure of the Board of Supervisors approving the District's budget disenfranchises voters by creating confusion and preventing voters from effectively using their ballot to hold elected Water District Board members accountable for representing their budgetary and water-resources project interests, as called for in the Voting Rights Act.

Finding # 5

"There are strongly held diverse opinions concerning the proper role of the SCVWD and its spending. Actions by the District Board have led to projects and expenditures that are not always supported by the public or by retail distributors. These have led to heated public debates about the scope and efficiency of SCVWD operations.

District response: **Disagree**

Actions by the District Board have led to projects and expenditures that are supported by the Clean, Safe Creeks and Natural Flood Protection Special Parcel Tax (Measure-B) that was passed by two-thirds of the county voters in November 2000. Rate increases have been made in response to recommendations of the Water Retailers Committee and the Water Commission. It has been a small number of critics that have questioned these decisions.

Recommendation # 5

"The District needs to better communicate and vet its activities with the various stakeholders and the public. Program goals should be selected through procedures that are more responsive to these views."

District response:

The recommendation has been implemented with the Water District expanding its already extensive outreach this summer to gather feedback on its first five-year capital improvement program (CIP). The objective of the annual CIP outreach is to coordinate the District's program with cities and the County. The outreach efforts will also include meetings to seek feedback from stakeholders, advisory committees and the general public. As with all significant programs the

District Board of Directors will consider comments from cities, the County and stakeholders before adopting the final CIP.

As stated earlier, this latest effort strengthens the District's already broad outreach and community feedback and input gathering process. This process includes the use of stakeholder- and collaborative-planning processes, and involvement of advisory committees to better communicate and vet its programs and projects with the community.

The District seeks public involvement through many means, including:

- Board meetings
- Advisory committees
- Project-related public and neighborhood meetings
- Water rate hearings
- Public outreach through flyers, mailers and customer surveys
- Integrated Water Resources Plan
- Joint meetings with cities
- Website that provides information about services and programs, as well as financial information including budgets, financial statements and a description of reserves
- Public review of environmental impact reports and other environmental documents

The District, which the Grand Jury acknowledges is "perceived by peers and public as a premier operation," continues to improve its efforts to engage and educate the public. As the Grand Jury points out in the report, "The District chooses to operate as a pioneering organization... Along with this expanded role the District conducts more extensive public relations and educational efforts."

Finding # 6

"Water rates have increased significantly over time. Part of this increase is caused by higher costs and part is due to Board policies regarding future projects and allocation of costs. There are rate differentials between North and South County which raise contentious issues that are not well understood."

District response: **Agree**

Recommendation #6

"The District should clarify the reasons for rate differentials (between North County and South County) and trends among users to ensure that stakeholders, including the public, have an understanding of and confidence in the equity of rate-setting practices. The District should carefully prioritize its capital projects and other costs to ensure that rate increases are fully justified by needs vetted with the Water Commission and the public."

District response:

The recommendation has been implemented. The District conducts extensive and open water-rates and budget hearings and, as the report notes, these rates are reviewed by the Water Commission. However, the District agrees that rate-setting practices could be explained better to the public. To this end, this year the District heightened its efforts with rate-hearing presentations, water reports and the budget to better explain to the public what the water rates pay for. The District continues to look for ways to improve this.

With regard to prioritization of the District's capital projects, the Grand Jury acknowledges "the process used to identify, prioritize, fund, develop, and construct these projects is systematic and thorough." As the report notes, it is a lengthy and complex process, partly "due to involvement of multiple jurisdictions and regulatory requirements, as well as the need to obtain funding from government agencies."

The process involves management and Board review, and public outreach prior to final Board approval. This effort will receive a further boost with the development of the District's five-year capital improvement program, which is seeking community and stakeholder input on all capital projects, including water supply projects.

Regarding water rate differentials, the report is accurate in stating that South County users currently pay roughly half the amount paid by those in North County. The disparity in water rates is largely due to the difference in the type of services being provided to address the varying needs of the two zones.

South County/Coyote Valley, which has large agricultural users and some municipal users, is served by groundwater managed and recharged by the District as well as some recycled water. The more urban North County, on the other hand, receives a significant portion of its water from three water treatment plants, which is distributed through a complex water conveyance system.

However, South County is changing and growing and so are the District's investments to meet the growing needs of the zone with a comparatively smaller base of ratepayers. These services include recycled water expansion to improve water supply reliability and prepare for the next drought.

Other program enhancements in South County include greater water supply planning efforts in coordination with other South County agencies, development and use of groundwater basin computer models, installation and operation of more monitoring wells to monitor groundwater levels and quality, and increased effort to prevent groundwater quality degradation and resolve contamination cases.

In fact, South County rate increases since 2001 have not kept pace with the cost increases associated with these water supply reliability enhancements. Consequently, annual costs in the South County/Coyote Valley currently exceed annual revenues and are projected to do so for several years. Higher percentage rate increases in South County will continue to be required to bring revenues and costs into balance in the future.

Finding # 7

Outside auditors question some financial practices of the District. Concerns include financing the unfunded balance of the District CalPERS benefits accounts, managing year-end cash balance, and controlling cash flow. Some of these issues could save the District between \$800,000 and \$1.6 million per year. Critics believe the District could safely increase its return on investments.

District response: **Disagree**

The District is unaware of any auditor who has audited the District in conformance with Generally Accepted Government Accounting Standards and has questioned the District's financial practices. The District was neither engaged in any discussion nor presented with any information during the Grand Jury review regarding any of the concerns raised in this finding. Furthermore, the District finds inaccurate the statements related to "...managing year-end cash balances..." and "...District could safely increase its return on investments..."

The Grand Jury review includes a comment stating "...the District has been overdrawn in its general checking account at the close of four of the past six fiscal years." The amounts referenced in each of the District's Comprehensive Annual Financial Reports for the past six fiscal years (FY2000-2005) are the cash balances as recorded on the District's ledgers as of the last day of the fiscal year. These are not the same as the checking account balances which are the actual cash balances at the bank and which have not been overdrawn at the close of the last six fiscal years. The difference between the District's ledger balances and the checking account balances are the outstanding checks and deposits in transit. District staff monitors and reconciles the checking account daily and ensures that funds are adequate to cover all District checks presented for payment. These cash balances are closely audited by the District's external financial auditors annually and there have been no findings or concerns raised about these year-end bank balances.

Similarly, the Grand Jury report on page 20 states, "It has also been suggested that the District might reduce investment costs and increase its yield by combining its investment operations with those of the County, which manages a significantly larger portfolio." The District historically tracks its investment performance as compared to the County. Over the past five fiscal years, the District's average monthly investment yield has exceeded the County's monthly yield by an average of 1.2 percentage points, or 42 percent higher, generating

approximately \$26.5 million more for the District's portfolio than if the District had combined its investments with the County during that period. While past performance is not an indicator of future performance, it is clear that the District's investment yield has already outperformed the County's yield over the past five years.

Finally, as with the vast majority of other public agencies participating in the Cal-PERS benefit program, the District's current unfunded balance status is not uncommon. The District had already begun researching financing options prior to the Grand Jury's review. The potential annual savings that the District may realize is dependent on several factors and involve a certain level of risk that has not been articulated in the Grand Jury report. Hence, it is premature to make any definitive statement of agreement with the suggested savings cited in this finding.

Recommendation # 7

"The District should consult outside financial advisors to be sure it is using best practices to prudently, but optimally, manage the large amount of resources it controls."

District response:

The recommendation for the District to consult with outside financial advisors has already been implemented and has been actively in place since at least fiscal year 2003, and earlier with regards to specific debt issuances. The District regularly consults with its outside financial advisors and underwriters on financing alternatives and other cash management practices. This includes exploring pension-obligation financing and other financing options to optimally manage the District's resources.

In fact, during the past three years, the District has engaged its financial advisors in assisting with refunding more than \$118 million in outstanding debt to take advantage of lower interest rates. Refunding resulted in an additional \$10 million to the District to be used for capital improvements at no additional or reduced debt service cost to the District. In addition, the financial advisors helped secure the District's bond ratings, which are among the highest of water agencies throughout the state.

Recently, the financial advisors assisted the District with its first interest rate lock agreement (SWAP), which essentially locked in current financing rates for future planned long-term debt issuance. As projected by investment firms and economists, interest rates are expected to continue their upward trend at least through next spring when the District plans to issue its long-term debt. This SWAP agreement will protect the District by hedging against rising interest rates and allow the District to plan its future financing costs with more certainty.

The District is also in the process of analyzing pension-obligation financing options with its financial advisors to determine its feasibility and to evaluate this option against other long-term debt-financing requirements identified in the District's financial forecast models. Recommendations on this option are expected to be brought forth in the next four to six months for Board consideration.

Finding # 8

"There have been substantial criticisms that reserves are excessive and inadequately justified. During the last three years, reserves have dropped significantly from \$580 to \$320 million. The District is currently reviewing its reserve management policy."

District response: **Disagree.**

While some parties have questioned the reasons for the District's reserves, this criticism cannot fairly be described as "substantial." In fact, some stakeholders, including members of the Water Commission, have repeatedly raised concerns **that the District's Water Enterprise reserves may not be large enough to maintain the District's extensive infrastructure facilities.**

The District's reserves over the past few years have been accumulated to support specific projects within a growing capital improvement program. This includes more than \$1.7 billion in identified projects over the next 10 years. The CIP identifies both existing reserves as well as future funding requirements that are needed to support these projects. Included in the program is the voter-approved, 15-year Clean, Safe Creeks and Natural Flood Protection special parcel tax to fund specific capital improvements on a pay-as-you-go basis. This was required by the voters when they approved the tax. The plan was approved in November 2000 with funding accumulating during the first half of the 15-year term to finance major construction costs expected to begin in the later years of the program.

The Grand Jury correctly states that the reduction in reserves over the past few years has been attributed mostly to the completion of capital projects, which is consistent with the purpose by which the reserves have been earlier accumulated. The report ignores the fact that almost a third (\$97 million) of the estimated \$320 million in reserves is restricted for contractual obligations, bond covenant requirements or other legal restrictions.

Recent benchmark surveys show that the District's contingency reserves for its Water Utility are, as a percentage of total operations, significantly lower than comparable agencies.

The District believes that there is adequate documentation to substantiate its reserve level and requirements.

Recommendation #8

"The District should clearly document its reserve management policy and justify its reserve levels to stakeholders and the public. It should also reconsider and justify the balance between pay-as-you-go and debt funding of capital projects to reduce the requirements for large reserve holdings."

District response:

The recommendation requires further analysis. As stated in our response to Finding # 8, the District is in the process of reviewing and updating its reserve management policy to incorporate recommendations that have been identified by the California State Auditor in its June 2004 report on California's Independent Water Districts. The District has been gathering additional benchmark data to support recommendations for what levels of minimum and maximum reserve amounts should be set in the policy. In addition, the District is awaiting final recommendations on reserve policies from the comprehensive performance audit currently near completion. Final recommendations for reserve policy updates are expected to be completed within two to three months.

It should be noted that the preliminary draft findings from the performance audit indicate that the Water Utility's current long-term financial plan (which shows an equity/debt financing ratio increasing to 30/70 percent, and a debt coverage ratio dropping to 2.0), is reasonable and consistent with industry best practices.

Finding # 9

"The District is implementing a number of performance measurement and improvement programs that impose extra workload on the staff. The Office of Performance Excellence had a 2005 budget of over \$1.2 million."

District response: **Agree**

Recommendation #9

"The District needs to refine and coordinate its various performance measurement efforts into a smaller number of focused, cost-effective programs that can offer the most useful and tangible results to influence District operational efficiency and to define objectives."

District response

The recommendation is being implemented with the development of a CEO work plan that defines the District's performance expectations and priorities. The work plan, to be deployed throughout the organization by September 2006, will allow the District to prioritize performance measurement efforts.

One of the challenges facing public agencies is identifying what standards of excellence to hold itself to. The District's approach is to hold itself to the highest

standards by using proven methodology. The effort has not gone unnoticed by the Grand Jury, which states in its report that it “applauds SCVWD efforts to emphasize management and quality standards.”

The District’s performance-measurement efforts — such as the internationally recognized ISO certification and Malcolm-Baldrige National Quality Program — and the CEO’s work plan, are part of an integrated effort to improve the efficiency and effectiveness of its operations, driven by the District’s “vision” of Getting Cleaner, Greener and Leaner.

However, in its search for ways to attain more efficiency, the District continues to consider whether the programs are cost-effective in terms of resource allocation.

September 18, 2006

Mr. Thomas C. Rindfleisch, Foreperson
Santa Clara County Civil Grand Jury
Superior Court Building
191 North First Street
San Jose, CA 95113

Dear Mr. Rindfleisch:

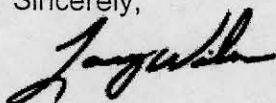
The Santa Clara Valley Water District (District) has completed its review of your report, "The Santa Clara Valley Water District – What's Beneath the Surface?" The District Board of Directors (Board) appreciates your acknowledgement of the District's positive role in providing water, protecting watersheds, and implementing flood control in Santa Clara County as reflected in the first finding, "The District generally does a commendable job of providing water, protecting watersheds, and implementing flood control in Santa Clara County." Our specific responses to the report's findings and recommendations are attached.

As evidenced by the many interviews and considerable information gathered throughout the process, we also appreciate the comprehensive and deliberative approach taken by the Grand Jury members. The report clearly reflects the members' thoughtful consideration of the complexities associated with District operations.

Upon careful consideration of the findings and recommendations in the report, the District finds points of agreement and points of disagreement. In particular, we are disappointed that the Grand Jury did not acknowledge the confusing, antiquated and duplicative nature of the current relationship that exists between the District and the County. The District is firmly convinced that the community is best served by clear, transparent and accountable government that answers directly to the voters. To this end we pressed forward with our legislative efforts, thus ensuring the District's accountability to the voters and on September 14, 2006, the Governor signed AB2435, the District and County co-sponsored measure to amend the District's act. We also continue our considerable outreach practices, providing opportunities in public forums for feedback and dialog with all stakeholders, general voters, community organizations, and local, state and federal agencies alike.

On behalf of the District Board, thank you for the considerable time and effort taken to review the District's operations.

Sincerely,



Larry Wilson
Chair/Board of Directors

Attachment
cc: Board of Directors (7) S. Williams
lw:jz:mf

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OF DIRECTORS**

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