



Costa Mesa Sanitary District

...an Independent Special District

June 2, 2016

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The Honorable Shawn Dewane
President, Board of Directors
Mesa Water District
1965 Placentia Avenue
Costa Mesa, CA 92627

DISTRICT MANAGEMENT

Dear President Dewane:

Thank you very much for agreeing to postpone awarding a contract at your June 9th Board meeting for a study on a possible consolidation of our agencies. I believe a joint effort will be insightful and intriguing, but I want to reiterate from my May 23, 2016 letter to you that I believe this process should be performed meticulously and with patience. There are many factors to be considered.

For instance, there are other agencies that will be impacted by a consolidation. Therefore, they should be included in this process and the study. CMSD provides wastewater services to Irvine Ranch Water District, City of Newport Beach and Mesa Water District customers, as well as solid waste services to the Cities of Costa Mesa and Newport Beach, and unincorporated areas of Orange County. All of these agencies need to be involved in the process since they will be required to agree to assume providing services if there were a consolidation with Mesa Water. The power of a County Water District to provide sanitation services is set out in the California Water Code Section 31100. You may want to verify if the code allows for County Water Districts to provide solid waste collection services or not.

Thank you for sharing the preliminary Request for Proposals (RFP) with me. I have reviewed the RFP and will discuss it with my fellow board members at our June 14th Study Session. Since there is no urgent need to complete the study by a specific date and if it is to be a joint study, CMSD would like the following issues addressed and considered as part of this process:

- Would an election be held so that the constituents could elect board members to the newly formed agency or would all existing board members be consolidated to form the new board?
- Review salaries and health benefits for both agencies to identify where savings might be realized or increases would occur.
- Determine what positions would be eliminated due to duplication and what would be the cost of layoffs.

Board of Directors

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- Determine whether the newly formed agency's employees should be at-will.
- Review the financial stability of each agency. Since both agencies operate from Enterprise Funds whose resources cannot be utilized to finance the other Funds' activities, where would savings from a consolidation be realized?
- CMSD has no debt. The consultant would need to prove to the CMSD constituents the benefits of consolidating with an agency with \$40,800,000 of debt.
- CMSD has less than \$270,680 of unfunded pension liability. The consultant would need to prove to the CMSD constituents the benefits of consolidating with an agency with \$6,316,538 of unfunded pension liability.
- Review the services that are outsourced by both agencies. Outsourcing services can be a cost effective and efficient way for agencies to provide certain services. In fact, 80% of our operations are currently outsourced. However, we have also found for certain services that we receive a better level of service that is more cost effective if it is done in-house. What would happen to existing employees in the event services are outsourced?
- Review contract services to determine where overlaps exist.
- The consultant should conduct a rate study to determine how the current rates compare to other Orange County agencies. This would ensure that the constituents of the separate agencies are getting the best services for a reasonable price and that rates would not increase after consolidation.
- Review each agency's policies for infrastructure maintenance and replacement to ensure that each Enterprise Fund is maintaining its infrastructure so that a new agency is not assuming the potential liability of a worn-out system.
- If it was determined that a duplicate asset needed to be disposed of, for example two headquarters buildings, how would it be determined which asset was sold? The proceeds from the sale of an Enterprise Fund's asset can only be used by the Fund which bought the original asset.

- Review the reserve policies for each Enterprise Fund to determine whether it covers at least the operating expenses of that Fund for a specified period of time.
- Review all Management Letters and Housekeeping Comments from each agencies auditors for the prior three fiscal years.
- As advocated by the Orange County Local Agency Formation Commission (LAFCO), will the consultant consider "shared services" as part of their organization evaluation? CMSD has agreements with the Orange County Sanitation District, City of Costa Mesa and Irvine Ranch Water District for a variety of shared services.

As you can see, there is a tremendous amount of information that needs to be discussed by our two agencies and possibly other agencies before a study can begin. These issues will take time to fully develop and gain consensus from both agencies so that a well thought-out study can be conducted and the results can be meaningful. Both agencies working together in an open and transparent manner will yield the best results which will benefit our constituents. The RFP Scope of Work needs further discussion between our two agencies. Therefore, we would request that you postpone the award of the study at this time. If this is truly a joint venture, then a committee should be formed consisting of board members and staff of both agencies to fully discuss the development of an RFP.

I believe my Board would welcome participating in your Executive Committee for the justifications you mentioned in your letter dated May 27, 2016, and for the reasons stated in this letter. However, we cannot meet with your committee prior to our June 14th Study Session because my Board has not yet appointed two directors to represent CMSD on the Committee. There should also be some discussion of staff appointments to the Executive Committee as well. If my Board decides to partner with Mesa Water on this study then they will make appointments on June 14th.

Thanks again for your cooperation and willingness to share with us the RFP and I look forward to discussing this issue further with you and your Board.

Sincerely,



Michael Scheafer
CMSD Board President

C: CMSD Board of Directors
Mesa Water Board of Directors
Scott Carroll, CMSD General Manager
Paul Shoenberger, Mesa Water General Manager