

Attachment No. 45

**District's Letter to SMLAFCo,
dated December 22, 2022**

Ronald J. Scholar
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REPLY TO:
 ROSEVILLE ONTARIO

December 22, 2022

VIA E-MAIL AND U.S. MAIL
RBARTOLI@SMCGOV.ORG

Rob Bartoli, Executive Director
San Mateo Local Agency Formation Commission
455 County Center, 2nd Floor
Redwood City, California 94063-1663

Re: LAFCo File No. 22-09: East Palo Alto Sanitary District's Response and
Opposition to the Proposal to Establish the East Palo Alto Sanitary District as a
Subsidiary of the City of East Palo Alto

Dear Mr. Bartoli:

As you know my office represents the East Palo Alto Sanitary District ("EPASD" or "District") with respect to the pending proposal before the San Mateo Local Agency Formation Commission ("LAFCo") by the City of East Palo Alto ("City") to establish the EPASD as a subsidiary of the City.

In response to your November 17, 2022 letter to San Mateo County Affected agencies regarding LAFCo File No. 22-09: Proposal to Establish the East Palo Alto Sanitary District as a Subsidiary of the City of East Palo Alto ("Proposal"), EPASD submits the following comments in response and opposition.¹

On December 8, 2022, the District, by unanimous vote of the District Board, adopted Resolution No. 1327 objecting to and opposing the Proposal.² As set forth in this letter and the referenced documents, LAFCo should reject the Proposal for the following main reasons.

1. For over 80 years, the District has provided its customers with low cost high quality service while building a reserve fund to help pay for structural improvements.

¹ On December 12, 2022 the District discovered that LAFCo determined additional information from the City was required prior to the application being deemed complete. In light of this, Ronald J. Scholar, legal counsel for the District requested that LAFCo provide additional time to prepare a single response to the application after it was completed by the City. While additional time to respond to the initial Proposal was provided, the request to submit a unified response was denied. Therefore, EPASD, in submitting these initial comments, reserves the right to provide additional or amended comments in the future.

² Attachment 1 (EPASD, *Resolution No. 1327*, December 8, 2022)

2. For profit, new development, not existing customers, should be required to pay for the increased District capacity and expansion new development requires.
3. The City's Proposal, which is based upon flawed and incomplete data, will balance the increased capacity required by new development on the backs of EPASD's current customers in the form of increased rates.
4. The City will not even run its new subsidiary district opting instead to contract the service out to a for profit contractor. As the community has experienced with City water, this has resulted in poor service quality with increased costs to cover contractor profits and unrestricted use City fees, while failing to reinvest in infrastructure needs.

A. BACKGROUND AND HISTORICAL INFORMATION

Established in 1939, the EPASD is an independent, community owned and operated public agency. It's mission is provide safe, efficient and cost effective wastewater collection and treatment services to customers in the City of East Palo Alto ("City") and a portion of the City of Menlo Park. The District is governed by a duly elected five member Board of Directors whose sole focus is to ensure that the District fulfills its mission. This provides District customers with the benefit of control and management of a single public service, without distractions and comingling of interests caused by competing services.

The District operates and maintains a gravity based collection system in compliance with the State Water Resources Control Board. Its customer base is primarily residential with several commercial and industrial parcels. The District's high quality of service is exemplified in that it has not experienced any sanitary sewer overflows ("SSO") for at least 16 years while building a reserve fund of approximately \$23 million for structural repairs and improvements and keeping service costs down.

With respect to growth and expansion, the EPASD is not against development within the District. However, it strongly believes that for profit development should be funded by the developers and not at the expense of EPASD's customers in the form of higher rates, costs and/or fees.

B. EPASD RESPONDS TO THE CITY'S 2035 GENERAL PLAN AND DEVELOPERS SEEKING WILL SERVE LETTERS

The City published its 2035 General Plan in March 2017. Thereafter, in or about 2020, several large commercial developers approached the District for Will Serve Letters for their various for profit, mostly commercial development projects. A Will Serve Letter is a document issued by the District confirming that the applicant's property is within the District service area and that, subject to specified terms and conditions, it is able to provide wastewater services to the property.

1. EPASD Assesses Its Capacity And Amends Its Master Plan To Account For New Development Projects

Because the new development projects would impose substantial new burdens on the District's then existing capacity, the EPASD retained the civil engineering firm of Freyer & Lauretta, Inc. ("F&L"), to perform a hydraulic impact assessment and prepare an Addendum to the March 2015 District Master Plan.³ The purpose of the assessment was to review the existing system, evaluate the impacts of the proposed development identified in the City's 2035 General Plan and identify capital improvements. The conclusion reached by F&L was that the District lacked the capacity to serve these development projects without substantial upgrades.⁴ This includes a restoration of the trunk sewer pipeline to its existing operating conditions by constructing a parallel pipeline made necessary by the additional system load caused by new development.⁵

The 2021 Amendment to the Master Plan prepared by F&L concluded that in order to service the new development projects, the District will be required to implement a Capital Improvement Plan in excess of \$35 million in order to expand and upgrade the existing sanitary system.⁶

2. The 2022 Capacity Charge Study

The new development projects will require new connections to the system. As part of determining the cost of the additional burdens caused by the new development projects, the District needed to reassess its current connection fee, also known as a Capacity Charge. A Capacity Charge is the one-time charge paid by new development for capacity in the sanitary system. This includes both collection and treatment facilities. The previous fee amount of \$6,060 per equivalent dwelling unit ("EDU"), was based upon the findings of a 2018 Capacity Charge Study conducted prior to the 2021 Sewer Master Plan Amendment.⁷

The District retained Hildebrand Financial Services, LLC, ("Hildebrand") to conduct a Capacity Charge Study taking into account the 2021 Amendment to the 2015 Sewer Master Plan. The purpose of the Capacity Charge Study was to review the District's existing Capacity

³ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021.)

⁴ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021, pp. 4-9)

⁵ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021, pp. 6-7)

⁶ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021, p. 7, Table 17)

⁷ Attachment 3 (Bartle Wells Associates, *Wastewater Capacity Charge Update*, December 7, 2018)

Charges and update those charges to incorporate the costs to expand the sewer system's capacity to accommodate the new development projects as described in a 2021 Amendment to the 2015 Sewer Master Plan. Following an analysis, which included the current capacity of the District, the differential in service costs based upon sewer strength (waste concentration), a new, second trunk line, required only because of the expansion, applicable financing costs and that the driving force behind the projects is expansion and not rehabilitation, Hildebrand determined the new Capacity Charge in order to serve all of the new development projects to be \$14,464 per EDU.⁸

3. The Developers Response

Once the new connection fee was determined, EPASD notified the developers and offered them their Will Serve Letters. To date, only one developer has shown any interest paying the Capacity Charge fee and receiving a Will Serve Letter.

In an effort to foster a better understanding of the District's position, allow the developers an opportunity to share any concerns they had and engage the development community in dialogue, developers were invited to an October 6, 2022, meeting with District consultant Government Financial Strategies, Inc. Very few developers attended the meeting.

Rather than engage in dialog with the District about paying their fair share for their for profit development, the developers appear to have decided that it would be more cost efficient for them to prompt the City to engage in the now pending hostile takeover of the District. As discussed below, rather than pay the Capacity Charge, the City, with its developer backers, will instead balance the increased capacity equation on the backs of EPASD's current customers in the form of increased rates.

4. The City's Refusal To Work With The District

Until recently, the City had worked cooperatively with the District through an intergovernmental committee where representatives of the two organizations met approximately once a month to coordinate projects. That intergovernmental cooperation was ended by the City when it stopped attending the meetings.

Additionally, in September 2022, the District requested that the City engage in a Joint Special Study Session regarding infrastructure financing to assist the City in approving new development.⁹ The City never responded.

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⁸ Attachment 4 (Hildebrand, *Capacity Charge Study*, September 7, 2022, pp. 1, 2, 4-6)

⁹ Attachment 9 (EPASD, *Letter from Board President Bethzabe Yanez to City*, September 2022)

C. EPASD STRUCTURAL UPGRADES WITHOUT NEW DEVELOPMENT BURDENS

As part of its review of its system, the District retained Sierra West Consultants, Inc. (“Sierra”) to conduct a closed circuit television (“CCTV”) surveys of the District’s wastewater collection system.¹⁰ Presently, approximately 75 percent of the District’s pipes have been surveyed. Based on these results, the District has approximately \$53 million in structural upgrades and repairs upgrades to the system that would be required without the additional burdens of the new development. This includes \$9.1 million in capacity upgrades that will be made to those pipes that have structural issues requiring replacement.¹¹

D. EPASD CAPACITY ONLY UPGRADES REQUIRED DUE TO NEW DEVELOPMENT BURDENS

Isolating costs associated with capacity only upgrades required by new development under the 2021 Amendment to the 2015 Master Plan reveals required additional expenditures in excess of \$12.9 million.¹² This figure only represents part of costs associated with adding system capacity for new development as Sierra West still has 25 percent of the system to survey before a final figure can be calculated. Further, this figure neither includes the \$13 million cost of restoring the trunk sewer pipeline to its existing operating conditions by constructing a parallel pipeline, nor does it include the \$5 million purchase of additional treatment plant capacity from the Palo Alto Regional Water Quality Control Plant (“RWQCP”) made necessary by the additional system load caused by new development.¹³ Thus, the total financial burden, at least as it can be currently calculated is approximately \$40 million.¹⁴

D. EPASD MANAGEMENT AS COMPARED TO THE CITY’S PROPOSED MANAGEMENT

The EPASD has served its customers well for over 80 years. The District’s high quality of service is exemplified in that it has not experienced any sanitary sewer overflows (“SSO”) for at least 16 years while building a reserve fund of \$23 million for structural repairs and improvements while keeping service costs down. The District is currently in the process of awarding approximately \$10 million from the reserve fund for construction to rehabilitate sewer infrastructure. Further, unlike the City, which has multiple departments calling for its attention and dollars, District customers enjoy the benefits of control and management of a single public service.

¹⁰ Attachment 5 (Sierra, *CCTV Survey Evaluation*, October 31, 2022)

¹¹ Attachment 5 (Sierra, *CCTV Survey Evaluation*, October 31, 2022, pp. 2, 9)

¹² Attachment 5 (Sierra, *CCTV Survey Evaluation*, October 31, 2022, p. 4)

¹³ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021, pp. 6-7); Attachment 6 (Government Financial Strategies, Inc. (“GFSI”), *Memorandum: Financing Sanitary System Infrastructure*, December 14, 2022, p. 3)

¹⁴ Attachment 6 (GFSI, *Memorandum: Financing Sanitary System Infrastructure*, December 14, 2022, p. 3)

The City's Proposal states that it will not even run the subsidiary sanitary district. Under the pretense of providing better service in the public interest, the City proposes to absorb the District and then promptly contract it out to an unidentified third party public entity or for profit company. To date, neighboring West Bay Sanitary District has shown no interest in taking over the District on behalf of the City. Instead, the City is expected to do what it already does with its water service since rather than run its own water service, the City contracts that vital service out to a for profit corporation.

The City and its for profit contractor's failures to provide clean, safe and drinkable water to its residents is well known throughout the community where many residents buy bottled water to avoid drinking City water. Even the most cursory online search for issues with City water reveals numerous negative responses with citizens complaining of water that burns their eyes, tastes bad, has a strong odor and comes out of the tap brown. Additionally, the City is already working under a Corrective Action Plan with the State Water Resources Control Board. Only this year has the City finally begun to address its water issues through the development of a 2022 Water System Master Plan.¹⁵

The City's current water contract dates back to 2001. It is with Veolia North America, LLC ("Veolia") which assumed the agreement in January 2021.¹⁶ According to the agreement, Veolia is guaranteed "an after-tax rate of return of eight percent (8%) on Gross Revenues."¹⁷ In addition to the eight percent in profits paid to Veolia, the City itself is guaranteed to receive "an annual Lease Payment in an amount equal to six percent (6%) of the annual Gross Revenues generated by the Water System" and "an annual Franchise Fee in an amount equal to five percent (5%) of the annual Gross Revenues generated by the Water System."¹⁸ Thus, the City has turned its public water utility into a for profit enterprise not just for its contractor, but also for the City. In so doing, it has taken what would have otherwise been protected funds to be reinvested back into the water system and converted them into general funds to use as the City deems fit. Put another way, the City is required to charge its water customers an additional 19 percent in fees to cover the for profit nature of its water utility. Given the problematic issues with City water, one is left to wonder what improvements for the benefit of its residents the City could have done had it reinvested over 20 years of profits back into the water system.

Past performance is an indicator of future success. In this regard, the District has a proven track record of providing excellent service at a reasonable cost. It does so without the added burdens of managing other services, paying guaranteed percentage based profits and profiting from its own system to pay for other services like the City does with its water service.

¹⁵ Attachment 11 (City of East Palo Alto Staff Report, *2022 Water System Master Plan*, October 4, 2022)

¹⁶ Attachment 7 (City of East Palo Alto, *Resolution No. 56-2020*, April 21, 2020)

¹⁷ Attachment 8 (City of East Palo Alto, *Agreement for Lease of Real Property (Water System)*, April 9, 2021, p. 6 [Section 8.A.]

¹⁸ Attachment 8 (City of East Palo Alto, *Agreement for Lease of Real Property (Water System)*, April 9, 2021, p. 4 [Sections 5.A and B.]

E. ANALYSIS OF THE CITY'S APPLICATION

Section A.3

The City claims that making the District a City subsidiary will result in more efficient operation, coordinated planning, transparency, accountability, and environmental health. There are no facts in the proposal indicating that the District is not successfully accomplishing these goals. To the contrary, as described above, the District has a long history of providing efficient and effective service at a reasonable cost. There have been no public health issues and as a public agency, the District remains transparent and directly accountable to the voters. The District has responded to impending growth and development by studying its capacity and formulating a plan that requires new development to pay its own way instead of funding expansion on the backs of existing, mostly residential ratepayers. The District tried to work with the City and development community but with few minimal exceptions, those efforts were ignored. The factors listed by the City are non-issue catchphrases made without any factual basis.

The City's Proposal begs the question of how the City can run the sanitary system better than the District. This is left a mystery in the Proposal as the City cannot even identify who or what entity will actually be running the District. The City has no expertise or experience in running a sanitary district. It states that it will contract the service out to either another public entity or a private, for-profit company. Neighboring West Bay Sanitary District has no interest in taking over the EPASD. Therefore, the most likely result is the City will do with the District what it has done with its water service and contract with a for profit company. This way, the City can reap the benefits of leasing and franchise fees paid for by District customers who will also be paying guaranteed profits to the contractor.

Section C.4

The City claims it has not been able to issue building permits without confirmation of capacity from EPASD. The City's claim is vague and undefined. It is also incorrect. EPASD, after studying and identifying the additional capacity that will be required to accommodate new development projects, calculated a new Capacity Charge in the amount of \$14,464 per EDU. The Capacity Charge is consistent with the District's philosophy that new development is welcome, but should pay for the increased capacity burdens it will impose on the system. The City and development community are well aware that the District has offered Will Serve letters provided the Capacity Charge is paid.

Section C.10

EPASD is already in the process of implementing structural repairs and is ready to increase capacity, provided those that are demanding capacity pay the Capacity Charge.

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F. ANALYSIS OF THE CITY'S PLAN FOR PROVIDING SERVICES

Section B.2

The operating and maintenance budget presented by the City is inaccurate because West Bay Sanitary District ("WBSD") data was used. The two systems are not the same. WBSD is part gravity and part forced main system whereas the District is gravity only. As such, the maintenance requirements are different. Additionally, the systems employ different treatment plants that utilize different wastewater treatment technology. As such, they are not comparable on a budgetary basis. These differences result in an underestimation of operating and maintenance costs in an effort to justify diverting reserve funds from needed structural improvements to increased capacity costs from new development.

Section B.4

In the Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update, F&L determined that the District lacked the capacity to serve these development projects without substantial upgrades.¹⁹ This included a restoration of the trunk sewer pipeline to its existing operating conditions by constructing a parallel pipeline made necessary by the additional system load caused by new development.²⁰ This will cost approximately \$13 million.²¹ The current plan by the City omits this necessary, increased capacity related expenditure. Doing so raises the risk of SSO events. This places the District at increased risk of imposition of substantial fines from the State Water Resources Control Board and mandatory repairs on accelerated timelines which add extra costs. Thus, contrary to the City's assertions, its plan will actually increase the risks to public health and safety.

Section B.5

Proposed Operating and Maintenance Plan

The City's plan will result in a private, for profit company operating the District. This will increase costs in the form of guaranteed profits for the operating company and unrestricted lease and franchise fees to the City. Also, the City's proposed budget is based on ratios calculated using the WBSD Balance Sheet. This is inaccurate and misleading as the two systems are not the same. As discussed above, the sewer systems and liabilities associated with each are different.

¹⁹ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021, pp. 4-9)

²⁰ Attachment 2 (F&L, *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021, pp. 6-7)

²¹ Attachment 6 (GFSI, *Memorandum: Financing Sanitary System Infrastructure*, December 14, 2022, p. 3)

Annual Sewer Service Charge

The Annual Sewer Service Charge (“ASC”) included in the Proposal includes an immediate 15 percent increase of the ASC from \$600 to \$690 with five percent annual increases until it reaches \$1,171. Thus, the City proposes to nearly double the ASC over the next 8 years. Further, these figures only hold true if the Capacity Charge limitations that are part of the Proposal are accurate. As discussed throughout this letter, the City’s Capacity Charge analysis is deeply flawed and will result in substantial shortfalls that will need to be made up through more rapid and greater increases in the ASC. This means that the District’s current ratepayers will be required to pay for development capacity expansion.²²

Connection Fee (Capacity Charge)

The Proposal recommends that the Capacity Charge be kept virtually the same at \$6,060 with five percent annual increases. The analysis is flawed for several reasons. First, it sets the total cost of improvements due to development at \$9.5 million. This is a gross understatement of the financial liabilities associated with development driven new capacity. Capacity only upgrades required by new development under the 2021 Amendment to the 2015 Master Plan, when factoring in the remainder of the pipe Sierra West still needs to study via CCTV, the new \$13 million trunk line and the \$5 million purchase of additional treatment plant capacity from the RWQCP at least as it can be currently calculated is approximately \$40 million.²³ After taking into account the current capacity of the District, the differential in service costs based upon sewer strength (waste concentration), a new, second trunk line, required only because of the expansion, applicable financing costs and that the driving force behind the projects is expansion and not rehabilitation, Hildebrand determined the new Capacity Charge in order to serve all of the new development projects to be \$14,464 per EDU.²⁴

Annual Budget Cash Flow

The City’s analysis of the District’s cash flow is also flawed. No sensitivity analysis was performed to determine how budgetary issues might change depending upon changed economic conditions. Further, F&L’s assumptions relating to the reserve fund are incorrect. The reserve fund is currently at \$23 million, but the District is currently in the process of awarding approximately \$10 million from the reserve fund for construction to rehabilitate sewer

²² Attachment 10 (EPASD, *Technical Memorandum in Response to Sanitary Sewer Capital and Improvement Plan Prepared by F&L*, December 3, 2022)

²³ Attachment 6 (GFSI, *Memorandum: Financing Sanitary System Infrastructure*, December 14, 2022, p. 3)

²⁴ Attachment 4 (Hildebrand, *Capacity Charge Study*, September 7, 2022, pp. 1, 2, 4-6)

infrastructure. The analysis also fails to properly account for the effect of the approximately \$40 million in development driven capacity upgrades.²⁵

Section B.6

The City’s takeover of the EPASD will not make it “whole as a land use agency and utility provider” as it claims because the City does not run its water utility and it will not be running the sanitary district. Instead, the City is content to contract out these vital public services to for profit corporations in return for license and franchise fees which it can use as it pleases.

The Draft MSR, upon which the City relies, is a flawed and biased report. The District believes that the funding source for the Draft MSR is related to the same developers behind the EPASD takeover attempt. Further, it was prepared without any engineering input from any entity, including the District and the District’s comments submitted after it was published have been ignored. It also contains factual inaccuracies intimating that the District cannot properly serve its customers such as the claim that citizens cannot obtain Will Serve letters for Accessory Dwelling Units. This is false. The District has issued Will Serve letters for all ADU applications in the past five years.

G. CONCLUSION

Since 1939, EPASD has provided its customers with low cost high quality service while building a reserve fund to help pay for structural improvements. It has responded responsibly in recent years to the prospects of new development by studying the matter, offering to engage with the development community and the City and establishing updated, accurate Capacity Charges.

As a matter of philosophy and good government, the District believes that for profit, new development, not existing customers, should be required to pay for the increased District capacity and expansion new development requires. The City’s Proposal, which is based upon flawed and incomplete data, will balance the increased capacity required by new development on the backs of EPASD’s current customers in the form of increased rates. Indeed, the City will not even run its new subsidiary district opting instead to contract the service out to a for profit contractor. As the community has experienced with City water, this has resulted in poor service quality with increased costs to cover contractor profits and unrestricted use City fees, while failing to reinvest in infrastructure needs. As such, the City’s Proposal to make the EPASD a subsidiary district should be rejected.

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²⁵ Attachment 10 (EPASD, *Technical Memorandum in Response to Sanitary Sewer Capital and Improvement Plan Prepared by F&L, December 3, 2022*)

Rob Bartoli, Executive Director
San Mateo Local Agency Formation Commission
December 22, 2022
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Sincerely,



Ronald J. Scholar
COLE HUBER LLP

RJS/kgm
Attachments
cc: Client



ATTACHMENTS

1. East Palo Alto Sanitary District, *Resolution No. 1327*, December 8, 2022
2. Freyer & Laureta, Inc., *Addendum to the March 2015 East Palo Alto Sanitary District Master Plan Update*, April 28, 2021
3. Bartle Wells Associates, *Wastewater Capacity Charge Update*, December 7, 2018
4. Hildebrand Financial Services, LLC, *Capacity Charge Study*, September 7, 2022
5. Sierra West, *CCTV Survey Evaluation*, October 31, 2022
6. Government Financial Strategies, Inc., *Memorandum: Financing Sanitary System Infrastructure*, December 14, 2022
7. City of East Palo Alto, *Resolution No. 56-2020*, April 21, 2020
8. City of East Palo Alto, *Agreement for Lease of Real Property (Water System)*, April 9, 2021
9. East Palo Alto Sanitary District, *Letter from Board President Bethzabe Yanez to City*, September 2022
10. East Palo Alto Sanitary District, *Technical Memorandum in Response to Sanitary Sewer Capital and Improvement Plan Prepared by Freyer and Lauretta, Inc.*, December 3, 2022
11. City of East Palo Alto Staff Report, *2022 Water System Master Plan*, October 4, 2022