

February 17, 2009

TO: Members, Local Agency Formation Commission

FROM: Martha Poyatos, Executive Officer

SUBJECT: Municipal Service Review and Sphere of Influence Update for
the East Palo Alto Sanitary District

Attached please find the municipal service and sphere of influence update and recommended determinations for the East Palo Alto Sanitary District. LAFCo is required by State law to complete municipal service and sphere of influence reviews for all cities and special districts in the County by taking three actions: adopt Municipal Service Review Determinations pursuant to Government Code Section 56430 (Attachment B to this memo); adopt Sphere Influence Determinations pursuant to Government Code Section 56425 (Attachment C); and reaffirm or amend the sphere of influence.

The attached determinations and recommendation to reaffirm the sphere of influence for the East Palo Alto Sanitary District have been prepared for consideration based on information provided and limited comments received on the report. However, it should be noted that since continuance at your January 21, 2009 hearing, the service review was not placed on the East Palo Alto Sanitary District agenda for consideration of formal comment. LAFCo did request and receive additional information from the District based on questions at the January meeting and today received the attached comments from the District's General Manager. In addition, LAFCo received the February 18, 2009 agenda of the District's Public Information and Governmental Affairs Committee that includes discussion of LAFCo related issues. If the Commission desires to have additional comments beyond comments received today, the Commission may wish to continue consideration again in the event the District will place the report on the District's agenda for formal comment.

Comments from East Palo Alto Sanitary District

The District General Manager comments received today are summarized as follows: a request that the report acknowledge 70 years of continuous operations; states that the report should include financial condition of City of East Palo Alto and West Bay Sanitary District including debt and pending lawsuits; the report lacks historical information regarding community representation resulting from reorganization; that after twenty years of a sphere of influence other options should be considered; consideration of local control of ratepayers of board membership and board sensitivity to the customers that would be adversely affected by the LAFCo recommendations; (fiscal) impact to rate payers that support feasibility of reorganization; and in general, the information in the report is limited and inadequate to support conclusions. (Attachment A)

First Municipal Service Review for East Palo Alto Sanitary District

It merits emphasis that while LAFCo has been required to adopt and review spheres of influence since 1985, municipal service reviews are a newer requirement. This is the first municipal service review being completed on East Palo Alto Sanitary District (EPASD). While the service review contains fiscal information on district operations and provides discussion of governance alternatives, it is not intended to be a comprehensive analysis of detailed fiscal impacts that would result from reorganization. It affords the opportunity to identify potential areas of savings and shared resources, in some cases through consolidation and in some cases by comparison of best practices of similar agencies. While study from an outside agency in the context of broader state policies may not be welcome, the LAFCo municipal service review expands the discussion of maximizing resources beyond agency boundaries.

Discussion in the LAFCo report is in the context of State policies that favor multipurpose agencies or regional agencies over several layers of limited purpose agencies, particularly in urban areas. In the context of sewer service provided wholly within cities, the report offers alternatives for achieving efficiencies in service through consolidation of service providers. And equally important, when considered at the special district board meeting, affords the opportunity for dialogue regarding rates in the long term, potential areas of savings, best practices and allocation of resources.



EAST PALO ALTO SANITARY DISTRICT

BOARD OF DIRECTORS

Glenda Savage, President
Edrick Haggans, Vice President
Joan Sykes-Miessi, Secretary
Bethzabe Yañez, Director
Goro Mitchell, Director

901 Weeks Street
P. O. Box 51686
East Palo Alto, CA 94303
Phone: (650) 325-9021
Fax: (650) 325-5173
www.epasd.com

Leroy Hawkins, General Manager

February 12, 2009

Martha Poyatos, Executive Officer
San Mateo LAFCo
455 County Centers, 2nd Floor
Redwood City, CA 94063

Dear Ms Poyatos:

This year, the East Palo Alto Sanitary District will be celebrating over 70 years of continuous operations providing sanitary sewer services to the East Palo Alto and East Menlo Park communities. Our financial statements consistently report a cost efficient operation with adequate reserves and a plan toward the future. It was unfortunate you had to discuss your draft municipal review report while I was unavailable. It was my understanding, that you were delaying comment to your February 18, 2009 meeting.

It's certainly appropriate and timely that LAFCo perform municipal service reviews, however, I have to question the limited amount of data and analysis utilized to reach the conclusions presented in your report.

Please note the following comments:

- Your list of advantages and disadvantages should include more information on current cost and efficiencies of District operations. After all, 70 years of continuous operations should at least be mentioned in a final report.
- The scope of review not clearly defined so we can never be sure if the conclusion reached are credible- it would help to know the financial condition of the Westbay Sanitary District and the City of East Palo Alto, how much debt do they have are there current or pending lawsuits which could adversely effect a merger, etc., what is the short term (five year (5)) financial outlook for these agencies when compared to the District?

- Lack of important historical data which could influence the final recommendation. Some communities have typically been underrepresented; will a dissolution/merger result in disenfranchisement of our customers in the political process?
- Each sphere of influence issued for the past 20 years or more say the same thing with little or no deviation. After such a long period reaching the same conclusions, it maybe time to expand the scope of the municipal review process and consider other options.
- We all want what is best for our customers and community. A report that values local control and participation would benefit all citizens. Currently the district is controlled locally and ratepayers can decide who sits on the board of directors. Local control is important to the future growth of our community and currently, we enjoy a sensitivity of our customers that could be adversely affected by your recommendations.
- Finally, any proposal for dissolution and/or merger must have at its core, the impact on District ratepayers as a primary measure for the feasibility for such a decision. The economy of scale argument is not sufficient when some customers or asked to shoulder debts not of their making.

Again, your report appears to be based on a cursory review of financial data submitted while the information is good, it is limited and inadequate to support the conclusions you have reached.

If you have any questions please call me at (650)325-9021.

Sincerely,

Lee Hawkins
General Manager

C: Naomi Patridge, City Member, Vice Chair
Iris Gallagher, Special District Member
Rich Gordon, Board of Supervisors, Chair
Adrienne Tissier, Board of Supervisors
Howard Jones, Public Member
Robert Craig, Special District Member
Sepi Richardson, City Member
David Altscher, Alternate Special District Member
Rose Jacobs Gibson, Alternate for Supervisors
Barbara Pierce, Alternate for City Member
Linda Craig, Alternate for Public Member

Draft
February 12, 2009
Municipal Service Review Determinations
East Palo Alto Sanitary District

Determinations pursuant to Government Code Section 56430:

1. **Regarding infrastructure needs and deficiencies:**
 - a) The East Palo Alto Sanitary District contracts for sewage treatment at the Palo Alto Water Quality Control Plant by agreement with City of Palo Alto.
 - b) Sewer infrastructure identified in the Municipal Service Review includes approximately 30 miles of sewer pipelines and 560 manholes. The District also owns District offices and maintenance facilities.
 - c) The District has an adopted capital improvement plan and is responsible for a proportionate share of capital improvements at the City of Palo Alto Water Quality Control Plant.

2. **Regarding growth and population projections for the affected area, the Commission determines:**
 - a) Population growth estimates by the year 2030 for the area served by East Palo Alto Sanitary District range from 27% to 49%

3. **Regarding financing constraints and opportunities and opportunities for rate restructuring, the Commission determines:**
 - a) The District board is the rate-setting body for sewer service.
 - b) The Bartle Wells 10-Year Financial Plan and Rate Projections indicate the need to adjust the current residential rate of \$415 per year annually to \$520 per year by July 2011.
 - c) Sewer districts that offset sewer rates with property tax have the opportunity to adjust rates to provide for eventual allocation of property tax for non-enterprise activities or the event that property tax revenues are no longer available to enterprise districts.

4. **Regarding cost avoidance opportunities and shared facilities, the Commission determines:**
 - a) The Sewer District practices cost avoidance and shared facilities through participation in the City of Palo Alto Water Quality Control Plant.

- b) Other opportunities for cost avoidance and shared facilities exist through reorganization of the district as a subsidiary district, consolidated with West Bay Sanitary District to achieve efficiencies and economies of scale and eliminate redundant costs associated with dual administration and governance in overlapping areas.
- c) Under current governance, cost avoidance opportunities appear to exist when board compensation and travel expenditures are compared to neighboring agencies. In this regard, the District board is encouraged to consider and adopt best practices in compensation for similarly sized districts.

5. Regarding evaluation of management efficiencies, the Commission determines:

- a) See Number 6 below.

6. In regard to government structure options, including the advantages and disadvantages of consolidation or reorganization of service providers, the Commission determines:

- a) Given the relatively small size of the EPASD service territory located wholly in cities and adjacent to a regional sewer district, options for consolidation with either the City of East Palo Alto or West Bay Sanitary District offer potential for efficiencies and economies of scale for operations and rates, streamlined planning for infrastructure, efficient and timely decision making by a fewer number of elected boards. In general disadvantages of reorganization include the short-term cost and effort of implementing organizational change and a less focused governance approach and representation for a single municipal service.
- b) Governance Alternatives include:
 - 1. Establishment as a subsidiary district of the City of East Palo Alto
 - 2. Dissolution of the District and annexation of the service area to West Bay Sanitary District
 - 3. Reorganization of the EPASD & WBSD, dissolving EPASD and reorganizing sewer service through annexations and detachments that would place territory in the City of East Palo Alto under sewer service authority of the City and placing all territory in City of Menlo Park under service authority of West Bay Sanitary District
 - 4. Continued existence of the district

7. Regarding local accountability and governance, the Commission determines:

- a) The District adopts a budget that includes proposed expenditures and revenues.
- b) The District is encouraged to include on the District Website, prior year budget, audited financial statements and the LAFCo Municipal Service Review.
- c) District public meetings are televised on local cable television.

Draft Recommended Sphere of Influence Determinations
East Palo Alto Sanitary District

- (1) The present and planned land uses in the area, including agricultural and open-space lands.**

Consisting primarily of residential, commercial, and institutional land use designations, land use in district boundaries is varied and the under the jurisdiction of the Cities of East Palo Alto and Menlo Park.

- (2) The present and probable need for public facilities and services in the area.**

The area within District boundaries consists primarily of residential, commercial, institutional land use requiring basic municipal services and there is a demonstrated need for continued delivery of sanitary sewer services.

- (3) The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.**

Services provided by EPASD include sanitary sewer service through District boundaries. The Board of Directors approved a Capital Plan for replacement of sewer mains identified in the September 2002 Master Plan Update. The report identifies deficiencies and makes recommendations for improvements. Since adoption, the District reviews the plan each year to incorporate capital improvements with City of East Palo Alto redevelopment.

- (4) The existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency.**

The District serves most of City of East Palo Alto and portions of City of Menlo Park. While the service area includes customers served by a single wastewater collection system that flows to a separate sewage treatment plant in the City of Palo the neighborhoods served share a community of interest with their respective cities and an economic interest in a long-term plan for efficient and affordable Municipal services.

**Municipal Service Review and
Sphere of Influence Update**
East Palo Alto Sanitary District
February 16, 2009

Introduction

This municipal service review and sphere of influence update for the East Palo Alto Sanitary District is being completed as required by Government Code Sections 56425 and 56430 which require the Local Agency Formation Commission (LAFCo) to prepare and update spheres of influence in conjunction with, or after, preparing a municipal service review. This updated report includes information and comments provided in response to circulation of a draft document. Since the draft was circulated, LAFCo received the District's Bartle Wells Associates 10-Year Financial Plan and Rate Projections and the District's June 2008 Audited Financial Statements. Budget data has been updated to reflect 2006-07 and 2007-08 actual budgets based on San Mateo County Controller's Schedule 16.

A municipal service review is an analysis of public services in which determinations are made regarding adequacies or deficiencies in service, cost effectiveness and efficiency, government structure options and local accountability. Once adopted by LAFCo the spheres of influence serve as the plan for governance and boundaries of special districts. This is the first municipal service review completed on EPASD.

Local Agency Formation Commission (LAFCo)

Created by the State legislature in 1963, the Local Agency Formation Commission (LAFCo) is a State-mandated, independent commission with countywide jurisdiction over the boundaries and organization of cities and special districts including annexations, detachments, incorporations, formations, consolidations and dissolutions. LAFCo adopts sphere of influence as plans for probable boundaries of cities and special districts. LAFCo operates pursuant to the Cortese Knox Hertzberg Local Government Reorganization Act of 2000 (Government Code Section 56000 and 57000 et seq.) LAFCo has two members of the Board of Supervisors, two city council members of the cities in the county, two directors of independent special districts in the county, a public member, and four alternate members (county, city, special district and public). As an independent

commission, LAFCo adopts its own budget and contracts with the County of San Mateo for staff, facilities and legal counsel. The Executive Officer serves in the administrative capacity, which includes staff review of each proposal, municipal service reviews and sphere of influence studies and assistance to local agencies and the public. LAFCo's net operating budget is apportioned in thirds to the County of San Mateo, the 20 cities and the 23 independent special districts. For additional information on LAFCo please visit www.sanmateolafco.org.

East Palo Alto Sanitary District

East Palo Alto Sanitary District (EPASD) was formed in 1939 pursuant to the Sanitary District Act of 1923 (Health & Safety Code 6420) in order to provide sewer services to increased development in what is now City of East Palo Alto and portions of City of Menlo Park. (Please see Map #1) As noted on the District's website, the initial sewer lines were installed as a Federal Works Progress Administration (WPA) project and construction began after the treatment contract with the City of Palo Alto was signed in 1940. District facilities were put into operation on September 8, 1942. Services authorized under Section 6420 et seq. include collection, treatment and disposal of garbage, storm water and sewage. EPASD provides sewage collection and contracts for treatment with the City of Palo Alto.¹ Under the contract EPASD owns 7.64% of capacity rights at the City's treatment plant, is responsible for a proportional share of construction costs amortized at \$85,421 per year² and annual operating costs based on proportional flow to the plant, budgeted at \$1.5 million for 2007-2008.

EPASD has approximately 3,300 single residential connections, 3,500 multi-family connections and 300 commercial, industrial and institutional connections including hotels, school/churches, retail, office and medical. The District charges sewer service fees and connection fees and receives approximately \$180,000 annually in property tax. The District is governed by a five-member board of directors, serving four-year terms. A General Manager, appointed by the Board, manages District operations. The following table provides an overview of East Palo Alto Sanitary District.

¹ Stormwater and garbage collection are under the jurisdiction of respective cities.

² City of Palo Alto cites amortization at approximately \$75,311

EAST PALO ALTO SANITARY DISTRICT

901 Weeks Street
East Palo Alto, 94303

Contact Person: Leroy Hawkins

650/325-9021 FAX 650/325-5173
Website: www.epasd.com

Date of Formation: August 28, 1939

Enabling Legislation: Section 6400 State Health & Safety Code

Governing Board: Five-member board of directors elected to four-year terms

- a. Membership and Term Expiration: Joan Sykes-Miessi, President (11/09), Edrick Haggans (11/09), Goro Mitchell (11/11), Glenda Savage-Johnson (11/11), Bethzabe Yañez(11/11)
- b. Compensation: \$264.00 per regular meeting
\$100.00 per other meeting,
- c. Public Meetings: First Thursday of the month at 7:00 p.m.
901 Weeks Street, East Palo Alto

Services Provided: Sanitary Sewer Collection

District boundaries: The majority of East Palo Alto and a small portion of Menlo Park

Estimated Population: 28,000 persons
(census 2000)

Contractual Arrangements: Sewage Treatment with the City of Palo Alto

Number of Personnel: 9 full-time: Management 1, Supervisory 2, Administrative 2.5, Maintenance 3.5

Sphere of Influence: Zero, indicating services could be assumed by another agency

Service review criteria as set forth in Government Code Section 56430 are examined below.

Infrastructure needs or deficiencies

District offices: District facilities include the District's office at 901 Weeks Street, East Palo Alto, which the District lists in very good condition. The District is in the process of remodeling 2,680 square feet of the second floor at an estimated cost of \$210,000. The District is in the process of negotiating a lease with tenants that will occupy this space.

Capital Plan: The District maintains approximately 30 miles of sewer mains and about 560 manholes. Sewage is transported via gravity mains to the City of Palo Alto Water Quality Control Plant. The Board of Directors approved a Capital Plan for replacement of sewer mains identified in the September 2002 Master Plan Update. The report identifies deficiencies and makes appropriate recommendation for improvements. Since adoption, the District reviews the plan each year to incorporate capital improvements with City of East Palo Alto redevelopment. In the 2007-2008 Fiscal Year, the District repaired and replaced sewer mains located on Woodland, Runnymede and Poplar. Anticipated annual expenditures for repairs and replacement of sewer mains in the next five years is \$1,500,000.

The District's agreement with City of Palo Alto and associated and sewage treatment fees include non-major capital improvement costs. The City of Palo Alto is in planning stage of the Ultraviolet Disinfectant Facility projected to cost \$12 million. EPASD's share is estimated at \$69,000 per year, with first loan payments projected to begin in Fiscal Year 2012.

Sewage Treatment Capacity: The District comments that the City of East Palo Alto Redevelopment Agency has indicated a need for an additional sewage treatment capacity of approximately 1.4 million gallons per day (mgd), in effect increasing by 33% the District's average 2.9 mgd dry weather flow capacity. Along with Town of Los Altos Hills and Stanford University, EPASD purchases sewage treatment capacity from the City of Palo Alto, which is a joint owner, along with Mountain View and City of Los Altos, of the Palo Alto Water Quality Control Plant. EPASD estimated flow to the Palo Alto Water Quality Control Plan is 1.8 mgd, of the 2.9 mgd capacity included in the District's agreement with Palo Alto. Any additional capacity would need to be purchased from

the City of Palo Alto, City of Mountain View or City of Los Altos.

Water Conservation Program: The District is working with the City of East Palo Alto (California American Water Company) to help homeowners replace inefficient toilets with new low flow, high-efficient toilets.

Lateral Replacement Program: The District is planning a Lateral Replacement Program to assist homeowners in replacing broken sewer laterals in order to decrease infiltration/inflow³ into sewer mains.

Growth and population projections for the affected area.

The EPASD territory includes the majority of the City of East Palo Alto and a portion of the City of Menlo Park as shown in Map #1. The estimated Census 2000 population of the District is 28,000. In regard to growth projections, the City of East Palo Alto 2006 Urban Water Management Plan states that East Palo Alto's population grew by 26 percent through the 1990s, and estimated that with population growth trends of approximately 2.5% per year, by 2030 East Palo Alto's population was expected to grow by 27% reaching 32,712 persons.⁴ Growth by the year 2030 within EPASD boundaries is anticipated to range from 27% to 49% in City of East Palo Alto and up to 15% for areas in City of Menlo Park boundaries. As noted above, EPASD estimated flow to the Palo Alto Water Quality Control Plant is 1.8 mgd, of the 2.9 mgd average dry weather capacity included in the District's agreement with Palo Alto. Any additional capacity would need to be purchased from the City of Palo Alto, City of Mountain View or City of Los Altos.

Financing constraints and opportunities and Opportunities for Rate Restructuring

The District's budget for the current and previous two fiscal years is summarized in the table below:

³ Infiltration/inflow refers to intrusion of clean water into sanitary sewer mains from the ground through defective laterals, mains or manholes.

⁴ In contrast, Association of Bay Area Governments (ABAG) policy based forecasts, project that the City of East Palo Alto will grow by 49% by 2030 reaching 44,000 persons. Projections for City of Menlo Park indicate that by 2030, the City's population will grow by 15% from the Census 2000 population of 35,254 to 40,400 persons.

East Palo Alto Sanitary District General Fund Revenues ⁵			
	2006-2007 Actual	2007-2008 Actual	2008-2009
Beginning Fund Balance	724,331	1,939,755	2,099,107
Cancellation of Prior Year Reserves	1,144,676		
Property Taxes	285,482	334,497	180,000
Homeowner Property Tax Relief	4,372	4,481	
Interest Earnings	68,105	93,386	62,800 ⁶
Sewer Service Charges	2,920,967	2,962,768	3,244,000
Connection Charges	0	32,625	
Miscellaneous Revenue	65,902	201,496	-
All Other Misc. Revenue	0	10,978	
Plan/Inspection Fee	2,050	3,800	
Stale-dated Checks	(1,219)	321	
ERAF Rebate	122,577	105,536	
Total Available Funds	\$4,232,488	\$5,159,267	\$5,585,907
Based on annual residential rate of:	\$380	\$380	\$415
	Actual 2006-07	Actual 2007-08	Adopted 2008-09
Salaries & Benefits			
Salaries & Wages ⁷	418,814	532,714	680,000
Directors' Fees	50,126	56,594	76,800
Benefits	170,530	286,622	290,000
Sub-Total	639,470	875,930	\$1,046,800
Operation & Maintenance			
Supplies	834	3,469	4,700
Office Expense	22,121	31,703	21,500
Election Expense	-	-	-
Memberships	9,394	16,129	17,500
Publications & Legal Notice	7,532	9,270	9,500
Gas, Oil & Fuel	5,060	7,061	9,504
Repairs & Maintenance	30,922	38,232	30,000
Rents & Leases	-	-	500
Utilities	28,106	28,527	26,000
Travel & Meetings	43,865	80,871	72,000
Training & Education	12,231	17,250	20,000
Contract Sewage Service	1,359,005	1,190,961	1,310,000
Contractual Services	97,520	72,275	88,200
Engineering & Management Services	33,432	27,322	35,000
Professional & Accounting	74,500	78,600	82,000
Professional Services	6,610	19,533	20,000
Research & Monitoring	-	-	400
Operating Expenses	1,205	2,549	3,396
District Special Expense ⁸	5,037	6,002	45,500
Total Services and Supplies	1,737,015	1,629,753	1,795,700
<i>Continues next page</i>			

⁵ Actuals for 06-07 and 07-08 from San Mateo County Controller's Schedule 16.

⁶ Under projection of property tax revenue according to actual property tax reported in Schedule 16

⁷ Increases in the salaries and benefits reflects the District changing from 32 hour to 40 hour week and addition of health club benefits

⁸ For 2008-09 includes funds for celebration of 70 Years of District operation and to cover educational materials.

Other Charges			
Retirement of Long Term Debt	75,412	75,220	85,000
All Other Insurance	9,077	42,647	43,500
Legal Services	40,514	41,900	35,000
Sub-Total Other Charges	119,950	159,766	163,500
Capital Expenditures			
General Facilities	282,589	282,303	283,000
Equipment	136,124	75,892	192,000
Sub-total	418,714	358,195	475,000
Transfers Out	50,000	0	0
<i>Sub-total</i>	2,915,149	3,023,644	3,481,000
<i>General Reserves</i>			3,103,082
Total Expenditures	\$2,915,149	\$3,023,644	\$6,584,082

The District's General Fund provides unrestricted funds and supports operating cash flow. The table above reflects actuals for 2006-07 and 2007-08 as reported in the San Mateo County Controller's Schedule 16 and 2008-09 as shown in the District's adopted budget.

The District makes quarterly payments to the City of Palo Alto for sewage treatment and receives revenues via tax apportionment twice a year in December and April. The District maintains a general fund balance to address cash flow given sewer fees are distributed twice a year when expenditures are bi-weekly, monthly and quarterly.

The General Fund fund balance as of June 2008 is \$2,099,107. Restricted funds and fund balances include: Connection Fee Fund \$1,348,000; Construction Replacement Fund \$981,900; Rate Stabilization Fund \$25,803; Lateral Replacement Fund \$15,231; Treatment Plant Fund⁹ \$596,998.¹⁰

Long Term Debt:

Long Term Debt as of June 30, 2008, as summarized in the District's Audited Financial Statement (June 2008), totals \$2,424,225 and includes:

- 2000 Installment Sale of Bonds, Maturing in 2014, \$1,619,400

⁹ This fund is restricted for unanticipated maintenance costs for the City of Palo Alto Treatment Plant in proportion to each agency's actual use.

¹⁰ As a participant in the County of San Mateo Investment Pool, EPASD experienced one-time net losses related to the Lehman Bros. Bankruptcy that are not reflected in the adopted budget. The losses for each of the accounts are as follows: General Fund (\$133,260), Construction and Replacement (\$23,251), Lateral Replacement (\$735), Reserve (\$28,812), Rate Stabilization (\$1,245).

(discharge of 1990 Installment Sale Agreement used to finance acquisition and construction sewer system improvement

- Palo Alto 1990 Utility Revenue Bonds, Maturing in 2024, \$356,680 (represents EPASD portion of City of Palo Alto debt related to City of Palo Alto treatment plant.)
- City of Palo Alto 1999 Utility Revenue Bonds, Maturing in 2024, \$435,098

Opportunities for Rate Restructuring

As an enterprise district, the District's primary revenue sources are sewer service charges and connection fees. The District has the ability to adjust rates to cover the cost of providing service, subject to ratepayer approval according to the provisions of Proposition 218. The following illustrates historic residential sewer service charges.

Annual Fee History-Residential

2008-09	\$415
2007-08	\$380
2006-07	\$380
2005-06	\$350
2004-05	\$320

The East Palo Alto Sanitary District's sewer rates are reviewed and adjusted annually and calculated to recover the District's projected costs related to share of maintenance, operation and minor improvements of the City of Palo Alto Water Quality Control Plant, the District's share of debt service for major capital improvements at the Treatment Plant, maintenance and operation of the District's sewage collection system and general administration of the District. The current residential rate is set at a flat rate of \$415.00 per year and commercial rates are charged based on annual use of water with a minimum commercial rate of \$415.00 per year. Based on adopted rates, projected sewer service revenues for 08/09 are \$3,244,000 compared to \$3,481,000 in projected expenditures including debt service and capital improvements for the City of Palo Alto Treatment Plant.¹¹ The difference is funded by other revenues including fund balance carry over, interest and property tax revenues.

¹¹ Future rate adjustments will also include the District's anticipated share of the Palo Alto Water Quality Control Plant Ultraviolet Disinfectant Facility costs estimated at \$69,000 per year for 20 years with payments projected to being in Fiscal Year 2012.

A 10-Year Financial Plan and Rate Projection prepared for the District in June 2008 provides the District a ten-year financial projection and recommendation for phase in of future sewer rates as follows:

2009-10	\$450
2010-11	\$485
2011-12	\$520

In regard to property tax revenues, since implementation of Proposition 13, the District has received a share of the 1% property tax, which is projected by the District in the current year at \$180,000. The District underestimates property tax revenue in preparing current year budget, with actuals for 2006-07 and 2007-08 reported as \$248,597 and \$297,077 respectively. In implementing Proposition 13, the State legislature recognized that many special districts had the ability to raise revenue through user charges and fees and that their ability to recognize revenue directly from the property tax for district operations was eliminated by Proposition 13. Government Code Section 16270 states the intent of the Legislature that enterprise districts rely on user fees and charges and that such districts were encouraged to begin the transition to user fees and charges in the 1978-79 fiscal year with implementation of Proposition 13. Adjustment of rates or reduction of operating costs to eliminate reliance on property tax would provide for use of property tax for other non-enterprise municipal services.

Cost avoidance opportunities

The District comments that as a small entity with a small budget, has limited opportunities for cost avoidance. The board of directors reviews the District budget and makes adjustments annually.

Opportunities for shared facilities.

As noted above, EPASD effluent flows to the Palo Alto Sewage Treatment Plant allowing the District to participate in regional sewage treatment. The District cites no other practice for shared facilities, but noted District consideration of a memorandum of understanding with the City of East Palo Alto to provide capital planning, code enforcement and public education in shared service areas.

Government structure options, including advantages and disadvantages of consolidation or reorganization of service providers.

Section 56430 requires discussion of government structure options including advantages and disadvantages of consolidation or reorganization of service providers in a municipal service review. This analysis is not a proposal to reorganize service providers, rather it identifies alternatives that may be further examined by the District, rate payers and affected agencies. For the purposes of this report, government structure options include:

- a) status quo (continued existence of the District),
- b) b) establishing the district as a subsidiary district of the City of East Palo Alto with sewer service becoming a public works function of the City, or
- c) dissolution of the district and annexation of the service area to West Bay Sanitary District
- d) a variation of Alternative C that would reorganize both EPASD and WBSD to align boundaries of the districts with city boundaries.

These options are discussed below. As noted above, the purpose of the discussion is to allow affected agencies and communities to consider and comment on governance alternatives. This section of the report does not represent a proposal by LAFCo or any affected agency for the organizational changes discussed.

A. Status Quo-Continued Existence of the District

Continued existence of the District would require no action to initiate a change and provide for focused governance and management over service to a relatively small area. As an independent special district with approximately 6,300 residential customers and 300 commercial/industrial customers, the District's ability to achieve economy of scale and share resources will continue to be limited, underscoring the need for the District to seek efficiencies and reduce operation costs wherever possible.

B. Establishment of the District as a subsidiary district of the City of East Palo Alto

Because East Palo Alto Sanitary District boundaries include territory outside the City of East Palo Alto, dissolution and transfer of service responsibility to the City of East Palo Alto

would require that the district be established as a subsidiary district¹² of the City, with the City Council acting as ex officio board of directors of the District.

Transfer of sanitary sewer services to the City of East Palo Alto would be consistent with recent activities in consolidating utility services under the City Public Works Department. In recent years the City has assumed operation of municipal water operations (via contract a private utility company), the drainage maintenance District and the street lighting district, previously operated by the County of San Mateo. City of East Palo Alto Public Works services include: various city engineering functions, traffic signalization management and street signage, park and City facility maintenance, street maintenance and repair, and storm drain management. The Public Works Department also maintains the Senior Center, Joel Davis Park, O'Connor Street Pump Station, Shuttle Services, and street trees.

In subsidiary district scenario, sewer service responsibility would be transferred to the City as a public works function. The City of East Palo Alto would be party to the agreement for sewage treatment with the City of Palo Alto. The City Public Works Director would oversee sewer operations and positions that do not exist as public works positions at the City such as Sanitary Sewer Maintenance positions, would be transferred to the City to perform these functions. The City Council as governing body would adopt the budget and set rates.

Potential advantages to establishment as a subsidiary district include savings in the cost of providing service through economy of scale and elimination of redundant administration and governance in overlapping areas and in the case of service provided in City of East Palo Alto boundaries, comprehensive oversight by a single city for both water and sewer utilities in particular as it relates to growth and development in the City. Salary and benefit savings by including sewer service under the governance, management and administration of the City savings would depend upon the level to which existing city positions could absorb additional duties or would be augmented to handle

¹² A subsidiary district may be established when both 70% of the territory of a district and 70% of the population of the district are located with the City. An example of such a subsidiary district in San Mateo County is North San Mateo County Sanitation District, which is a subsidiary district of the City of Daly City that provides sewer service to Daly City, Unincorporated Broadmoor and Colma and the Town of Colma.

administration, billing, etc. Other areas of potential savings include but are not limited to elimination of Board of Directors fees budgeted at \$76,800 in the adopted 2008/09 Budget, potential savings in travel & meeting expenditures (currently budgeted at \$72,000), and costs associated with separate audit reporting and general contractual services. Under subsidiary district status offices currently used exclusively for sanitary sewer administration and operations, could under City governance, potentially be used for additional city functions.

Also, because EPASD collects property tax as an enterprise district, an alternative to the subsidiary district subsidizing sewer rates with property tax would be to transfer property tax to respective cities for the purpose of non-enterprise municipal services such as police, parks and administration, with sewer rates being adjusted to reflect the cost of sewer service and treatment.

The effect of establishing a subsidiary district would be to transfer all assets and liabilities to the City. Establishing the District as a subsidiary district of the City would also give the City authority over the majority of the sewer service in the City, enhancing the City's ability to coordinate sewer capital improvements related to redevelopment.

Potential disadvantages include costs of the transition from an independent special district to subsidiary of the City. A subsidiary district would also result in the territory located in the City of Menlo Park being part of the service territory of the subsidiary district but registered voters outside the City of East Palo Alto would not have the ability to vote for the East Palo Alto City council members who would serve as the governing body of the city governed sewer district.

The process for establishment as a subsidiary district would involve application by either 10% of the EPASD registered voters, or by resolution the City or the District. If an application is submitted by resolution of either the District or the City and both the City and the District consent to establishment of a subsidiary district, LAFCo may approve the proposal without an election if less than 25% of the registered voters submit protest at conducting authority proceedings. However, if the City or the District adopt resolutions of opposition, the LAFCo approved application must be submitted to the voters of the agency that has submitted a resolution of

opposition, and would require simple voter majority approval at the election.

C. Dissolution of EPASD and annexation to WBSD

Because the East Palo Alto Sanitary District and West Bay Sanitary District share common boundaries and are formed under the same enabling legislation, dissolution of the smaller district and annexation of the service area to West Bay Sanitary District is an alternative that would offer potential for savings in governance and management. This alternative would require an interest on the part of West Bay Sanitary District and would require that WBSD become party to the sewage treatment contract with the City of Palo Alto.

Similar to a subsidiary district, potential advantages of dissolution of EPASD and annexation of the EPASD service area to WBSD include savings in the cost of providing service through economy of scale and in the case of service provided in City of East Palo Alto boundaries simplification of sewer service providers. Potential savings by consolidating service for approximately 6,700 residential customers and a variety of commercial/industrial customers with WBSD include payroll costs associated with management and administration depending upon the level to which positions could be reduced while absorbing administration, billing, etc. of an expanded district. Areas of potential savings include, but are not limited to, reduction of costs in administration and governance of two board of Directors, general managers and administrative offices. Examples of areas in which savings would be achieved by reduced and shared expenditures for the combined service area include but are not limited to the following (based on 08/09 budgets):

	EPASD	WBSD
Salaries & Wages	\$680,000	\$2,376,016
Benefits	\$290,000	\$ 862,879
Board Compensation	\$ 76,800	\$ 28,365
Travel & Meetings	\$ 72,000	\$ 39,500

Unlike the subsidiary district scenario in which customers of the subsidiary district outside City of East Palo Alto boundaries would not be able to vote for city council members governing the subsidiary district, all registered voters in the

area annexed to WBSD would be eligible to vote for District board members that would govern sewer service and set rates.

Also, as noted above, because EPASD collects property tax as an enterprise district, an alternative in dissolution and annexation to WBSD would be to transfer property tax to respective cities for the purpose of non-enterprise municipal services such as police, parks and administration, with sewer rates being adjusted to reflect the cost of sewer service and treatment.

Effect of annexation would be transfer all EPASD assets and liabilities to the West Bay Sanitary District. Like establishment of a subsidiary district, potential disadvantages include costs of the transition in consolidation/annexation.

The process for dissolution of EPASD and annexation of the service area to WBSD would involve application by 25% registered voters of EPASD, or resolution of the District. If an application is submitted by resolution of the District and both the EPASD and WBSD consent to dissolution and annexation, LAFCo may approve the proposal without an election if less than 25% of the registered voters submit protest at conducting authority proceedings. However, if either District adopts a resolution of opposition, the LAFCo approved application must be submitted to the voters of the agency that has submitted a resolution of opposition, requiring simple majority voter approval.

- D. Reorganization of East Palo Alto Sanitary District and West Bay Sanitary District involving dissolution of the East Palo Alto Sanitary District, annexation and detachment of territory from/to West Bay Sanitary District and establishing the City of East Palo Alto as successor for sewer service in City of East Palo Alto boundaries and the West Bay Sanitary District as successor to sewer service in City of Menlo Park boundaries

This alternative would align jurisdictional authority for sewer service with the city boundaries in the areas served by East Palo Alto Sanitary District and West Bay Sanitary District. As shown on the attached map, East Palo Alto Sanitary District serves the majority but not all of City of East Palo Alto and also includes territory in south eastern Menlo Park bounded by Menalto, San Francisquito Creek and the East Palo Alto boundary. West Bay Sanitary District includes the northern portions of City of East Palo Alto and the majority of City of Menlo Park.

As noted elsewhere, the boundaries of the sanitary districts were based on flow to sewage treatment plants and were established prior to establishing city boundaries. East Palo Alto Sanitary District flows to the City of Palo Alto Water Quality Control Plant and West Bay Sanitary District flows to a West Bay pump station and is pumped to the South Bayside Treatment Plant.

As two separate sewer systems with separate agreements for sewage treatment, a reorganization to align sewer jurisdiction with city boundaries would simplify service area boundaries but involve complex agreements for sewage treatment and a comprehensive assessment of condition of infrastructure to be assumed by the two entities. Reorganization could only be cost effective if systems could remain intact and agreements for sewage treatment could be amended to account for the reorganized sewer service in East Palo Alto City boundaries and West Bay Sanitary District boundaries. Simply put, if all territory outside of East Palo Alto is annexed to WBSD and all territory in City of East Palo Alto would be detached from WBSD and/or transferred to City of East Palo Alto by dissolution of EPASD, either the City of East Palo Alto and WBSD would need to enter into agreements for allocation of sewage treatment for areas transferred or City of Palo Alto and SBSA would need to amend agreements to include City of East Palo Alto and WBSD for their proportional shares of flow to the respective plants.

Given the separate systems, gravity flow and separate sewage treatment agreements, informal comment from District engineers and city staff indicate that it is unlikely that this alternative simplify service or improvement administration. Implementation of this scenario would require, at a minimum:

- Support on the part of City of East Palo Alto, West Bay Sanitary District, City of Palo Alto and the South Bayside System Authority and amendment of agreements to include agencies and proportional shares of sewage treatment that would be transferred.
- Assessment of sewer mains and infrastructure that would be transferred to successor agencies which would include assessing sewer mains using Closed Circuit Television
- Potential transfer of EPASD & WBSD fund balances proportionally to address capital improvements and debt service at respective sewage treatment plants.

In regard to advantages and disadvantages, while reorganizing sewer service according to city boundaries would on face value simplify sewer service delivery in the cities of Menlo Park and East Palo Alto because each city would be served by one sewer agency and not two, because sewer infrastructure was established prior to city boundaries and based on topography and proximity to sewage treatment plants, reorganization to focus on city boundaries and not systems would not necessarily make service delivery by successor agencies more efficient because each agency would then operate and maintain portions of two separate systems and be party to two separate sewage treatment agreements.

Evaluation of management efficiencies

This section examines the ability of an agency to provide efficient and effective service by meeting service demands and maintaining adequate staffing levels given the resources available.

The District is governed by a five-member board and has nine employees including General Manager, Director of Administration, Accountant Assistant, receptionist, Maintenance Supervisor, Senior Maintenance Worker and three maintenance workers. District board members attend monthly board and committee meetings. The District retains legal counsel, an accountant, auditing firm, district engineer and personnel consultant.

As a separate entity serving territory wholly within the Cities of East Palo Alto and Menlo Park, the District's board duplicates governance and management that exists in the cities. As a relatively small, single-purpose special district, EPASD has limited opportunities for economies of scale offered by a larger organization.

Local accountability and governance.

This section examines the degree to which an agency keeps affected residents and property owners informed about district services, budget, programs, anticipated changes in service; effectiveness of the district in responding to requests for information and the degree to which the district encourages public participation in decision making. As a special district, the District is subject to the Ralph M. Brown Act governing public meetings. As noted above, the District has a five-member board elected by district voters. District meetings are held the

first Thursday of the month at 7:00 p.m. at the District office, 901 Weeks Street, East Palo Alto, with an agenda prepared and circulated prior. The District maintains a website (www.epasd.com). The District adopts a budget annually and the budget is posted on the website. District Board meetings are aired on Public Access Cable. District office hours are 8:00 a.m. to noon and 1:00 p.m. to 5:00 p.m., Monday to Thursday. The District contracts with an answering service when staff is not available.

Sphere of Influence Review and Update

Government Code Section 56425 specifies that in determining the sphere of influence of each local agency, the Commission shall consider and prepare a written statement of its determinations with respect to each of the following:

1. *The present and planned land uses in the area, including agricultural and open-space lands*
2. *The present and probable need for public facilities and services in the area.*
3. *The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.*
4. *The existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency.*

This sphere of influence update incorporates information and determinations in the municipal service review as well as changes that have taken place since the sphere of influence was originally adopted, and provides for public input. Comments to LAFCo by affected agencies, organizations individuals are requested in order to be included in the Executive Officer's report to the Commission.

EPASD Sphere and Service Area:

The LAFCo adopted sphere of influence designation for the EPASD is for dissolution and annexation of the territory to WBSD. The Municipal Service Review, Governance Alternatives Section examines the alternatives of transferring service responsibility to City of East Palo Alto as a subsidiary district, as well as to West Bay Sanitary District by annexation upon dissolution of EPASD. Changes since the sphere was adopted include significant growth and economic development in the City of East Palo Alto,

which is served primarily by EPASD. Also, as noted in the Municipal Service Review, in recent years the City has assumed responsibility for municipal water operations (via contract a private utility company), the drainage maintenance District and the street lighting district, all previously operated by the County of San Mateo.

Sphere of Influence Determinations:

Section 56425 requires the Commission to make determinations concerning land use, present and probable need for public facilities and services in the area, capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide and existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency. The following section discusses these areas of determination.

The present and planned land uses in the area, including agricultural and open-space lands

Consisting primarily of residential, commercial, and institutional land use designations, land use in district boundaries is varied and the under the jurisdiction of the Cities of East Palo Alto and Menlo Park.

The present and probable need for public facilities and services in the area

The area within District boundaries consists primarily of residential, commercial, institutional land use requiring basic municipal services and there is a demonstrated need for continued service and in some areas expanded sanitary sewer services. Services provided by other agencies include: water service by City of Menlo Park, City of East Palo Alto via contract with a private utility, and two mutual water companies; fire and emergency response by Menlo Park Fire Protection District and police service by Cities of East Palo Alto and Menlo Park in their respective jurisdictions. Services are more specifically described below.

Service Responsibility	City of East Palo Alto	City of Menlo Park
Police		
Fire	Menlo Park Fire Dist.	Menlo Park Fire District
Sewer	East Palo Alto Sanitary District (majority) West Bay Sanitary District (portion)	West Bay Sanitary District (majority) East Palo Alto Sanitary District (portion)
Water	City of East Palo Alto Palo Alto Park Mutual (Partial) O'Connor Tract Mutual (partial)	City of Menlo Park California Water Service Co. O'Connor Tract Mutual (Partial)
Streets	City of East Palo Alto	City of Menlo Park
Animal Control	Peninsula Humane Society via contract with Animal Control Joint Powers Agreement	Peninsula Humane Society via contract with Animal Control Joint Powers Agreement
Park & Recreation	City of East Palo Alto	City of Menlo Park
Library	County Library System	County Library System
Garbage Collection	Allied Waste via Joint Powers Agreement	Allied Waste via Joint Powers Agreement

The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide

Services provided by EPASD include sanitary sewer service through District boundaries. The Board of Directors approved a Capital Plan for replacement of sewer mains identified in the September 2002 Master Plan Update. The report identifies deficiencies and makes recommendations for improvements. Since adoption, the District reviews the plan each year to incorporate capital improvements with City of East Palo Alto redevelopment.

The existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency

The District serves most of City of East Palo Alto and portions of City of Menlo Park Communities served by the District are defined by their respective city jurisdictions and are not their sanitary sewer provider. However, they share an economic interest in a long-term plan for efficient and affordable sewer service, similar to surrounding areas.

Discussion:

The East Palo Alto Sanitary District was formed to provide reliable sewer service to developing areas. In 1983 the City of East Palo Alto incorporated and the Commission subsequently adopted a 'zero' sphere of influence for EPASD indicating at the time that EPASD could be dissolved and West Bay Sanitary District could assume sanitary service via annexation. Changes that have occurred since the sphere was adopted include increased service demand with significant development in the City of East Palo Alto and as noted above, the City of East Palo Alto has assumed responsibility for several utility services previously provided by the County.

While there now appear to be two (instead of one) potential successor agencies, there have been no significant changes that merit amendment of the sphere of influence of EPASD. Advantages to consolidation of sanitary sewer service with either the City of East Palo Alto or West Bay Sanitary District and limited opportunities for cost savings and shared resources as a small single purpose special district as discussed in the municipal service review indicate that reaffirming the sphere of influence of dissolution would serve to further state policies promoting efficient service delivery, economies of scale and orderly boundaries based on local conditions.

Draft Recommended Sphere of Influence Determinations

Based on the foregoing, the following section includes sphere determinations that could be adopted by the Commission.

- (1) The present and planned land uses in the area, including agricultural and open-space lands.**

Consisting primarily of residential, commercial, and institutional land use designations, land use in district boundaries is varied and the under the jurisdiction of the Cities of East Palo Alto and Menlo Park.

- (2) The present and probable need for public facilities and services in the area.**

The area within District boundaries consists primarily of residential, commercial, institutional land use requiring basic municipal services and there is a demonstrated need for continued delivery of sanitary sewer services.

(3) The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.

Services provided by EPASD include sanitary sewer service through District boundaries. The Board of Directors approved a Capital Plan for replacement of sewer mains identified in the September 2002 Master Plan Update. The report identifies deficiencies and makes recommendations for improvements. Since adoption, the District reviews the plan each year to incorporate capital improvements with City of East Palo Alto redevelopment.

(4) The existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency.

The District serves most of City of East Palo Alto and portions of City of Menlo Park. While the service area includes customers served by a single wastewater collection system that flows to a separate sewage treatment plant in the City of Palo the neighborhoods served share a community of interest with their respective cities and an economic interest in a long-term plan for efficient and affordable Municipal services.

East Palo Alto Sanitary District

