

## FOREWORD

This report includes a review of wastewater service delivery for the Commission to consider as it makes its decisions with respect to the Municipal Service Review (MSR) and Sphere of Influence (SOI) determinations for the Covelo Community Services District (CCSD). The information included in this report meets the information and review requirements for Government Code Sections 56430 (Municipal Service Reviews), 56425 (Sphere of Influence Determination) and 56378 (Maximum Service Area).

This Report may be used as a resource for future decisions for changes of organization; however, this report is not a substitute for reports required for discretionary decisions regarding changes of organization yet to be made by the Commission or for the reports mandated by law for those discretionary decisions. The decision whether or not to accept this report or to approve or disapprove any policy options, with or without amendments, wholly partially or conditionally, rests entirely with the Commission.

Covelo CSD staff was given the opportunity to review the Administrative Draft of this report. Their comments, clarifications, and corrections were incorporated into the public draft that was used for the workshop. Once this was accomplished, a copy of the public draft was provided to each member of the Covelo Board of Directors for their review for a future workshop on the public draft.

LAFCO held a workshop on December 7, 2009 to review the public draft SOI/MSR Report. This Report developed for the Public Hearing for adoption contains the suggestions, changes, updates and directions from the Commission that were developed at that workshop.

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So that the reader may have context for the information provided within this report, the body of report is organized in the following way:

- Chapter 1, provides an overview about LAFCO and the requirements for the SOI/MSR process
- Chapter 2 provides an overview of the Principal Act for the CCCSD
- Chapter 3 provides an overview of the CCSD and its services
- Chapter 4 provides information about the Wastewater Treatment System;
- Chapter 5 provides an overview of the finances of the District and makes comparison to other similar sized districts in California.
- Chapter 6 contains the MSR determinations as required by G.C. Section 56430;
- Chapter 7 contains the SOI Determinations and Maximum Service Area determination
- Chapter 8 reviews the environmental review used for the SOI determination and finally;
- The Appendix contains a Glossary and the full context of the Principal Act for the District

## **COVELO CSD SOI/MSR REPORT**

### **Chapter One: LAFCO Explained**

#### **Introduction**

This explanation and overview is meant to provide information as to the role of LAFCO, information as to some of its policies and requirements of law, a summary of the Sphere of Influence (SOI) and Municipal Service Review (MSR) requirements and an explanation of the determinations or decisions required by law. It is meant to provide information and an explanation about LAFCO and the SOI/MSR process such that the reader will have context for this report.

#### **Cortese-Knox-Hertzberg**

On January 1, 2001, AB 2838—the Cortese-Knox-Hertzberg (C-K-H) Local Government Reorganization Act of 2000—became the governing law of LAFCO. C-K-H changed the role of LAFCO and the requirements of law as to the application process. It expanded LAFCO's powers, authority and role as overseer of local government boundaries, and added the responsibility of review of districts and cities as to service provision. C-K-H strengthened the powers of LAFCO to control growth by elevating and reinforcing requirements of discouraging urban sprawl, preserving open space as well as agricultural and resource lands, and by requiring LAFCO to make decisions regarding agency boundaries that provide for the orderly and efficient extension of government services. [G.C. 56000-57000]

#### **What is LAFCO?**

The Local Agency Formation Commission is a state mandated independent agency with quasi-legislative authority whose decisions have planning affect. Each county has a LAFCO and LAFCOs have county wide jurisdiction in carrying out their responsibilities. LAFCO is not a part of the County government nor is it part of State government. While LAFCO is an independent agency, Commissioners are appointed by and from the county, cities and special districts with jurisdiction in Mendocino County. Commissioners, who sit as independent members, are required by law to exercise their independent judgment on behalf of the interests of residents, property owners and the public of Mendocino County as a whole, in furthering the requirements of LAFCO. While serving on LAFCO, commissioners exercise responsibility with a regional or countywide perspective in decision making while relying on their own expertise and experience. [G.C. 56325.1]

#### **Current Membership**

The present membership of LAFCO is as follows: Jere Melo, Chair and city representative, City of Fort Bragg; David Colfax, Board of Supervisor (BOS) representative; John McCowen, BOS representative; Mari Rodin, city representative, City of Ukiah; Richard Shoemaker, special district representative, Russian River Flood Control and Water Conservation Improvement District; Guinness McFadden Potter, special district representative, Potter Valley Irrigation District and; Michael Kisslinger, public member.

Alternate members are: John Pinches, BOS representative; Holly Madrigal, city representative, City of Willits; Tony Orth, special district representative, Brooktrails Community Services District; Gerald Ward, public member representative. Alternate members are not allowed to vote, unless a regular member in the category they represent is absent or have disqualified themselves from participating in the meeting. Under LAFCO policy, alternate members are encouraged to take an active role in LAFCO business including discussions and deliberations on project proposals, and participating in policy development and other working groups, trainings, workshops and standing committees.

### **Other Requirements of Law for LAFCO**

As indicated above, Mendocino LAFCO primarily operates under the rules and requirements of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000. This Act is found in the Government Code Sections 56000 - 57000. However, this part of the Government Code does not comprise all of the requirements of law that LAFCO must meet. Other elements of the law such as the California Environmental Quality Act (CEQA), Revenue and Taxation Code, Election Code, Brown Act, Public Records Act and other parts of the Government Code, principal acts of districts, case decisions, state policies, and the Policy and Procedures of LAFCO, also affect the decision making and responsibilities of LAFCO.

### **Purpose and Responsibilities of LAFCO**

In essence, LAFCO has four primary responsibilities. The first is to function as a boundary commission for the creation of agencies or for changes in agency boundaries, which is the historical role of LAFCO. The second is to control growth, protect open space as well as agriculture and resource lands, and assure the efficient extension of government services, primarily through boundary decisions and the determination of an agency's Sphere of Influence once every five years, as required by Government Code Section 56425. The third responsibility is to provide a review of the service provision of districts and cities, primarily through meeting the requirements of Government Code Section 56430, Municipal Service Reviews. The fourth responsibility is to determine the Maximum Service Area and service capacity of an agency. [G.C. 56100, 56301, 56425, 56430, 56378]

### **LAFCO'S Jurisdiction**

LAFCO's jurisdiction includes cities, most special districts and certain parts of the County known as County Service Areas. Jurisdiction does not include the State, the County as a whole, a school district or community college district, a special assessment district, an improvement district as defined by G.C. 56041, a Mello-Roos Community Facilities District, a road division, an air quality management district or zones within a special district. (G.C. 56036 & 56100)

Some districts under LAFCO oversight have been provided exceptions to the total jurisdictional requirements of Cortese-Knox-Hertzberg. The following districts are under LAFCO jurisdiction for all aspects of LAFCO requirements except for the proceedings for protest hearings as specified by G.C. 57000 et sequens:

- A union high school or high school library district
- A bridge and highway district
- A joint highway district

- A transit or rapid transit district
- A metropolitan water district
- A separation of grade district.

A protest hearing conducted for these agencies is required to be conducted according to the Principal Act of the agency instead of G.C. 57000 et seq. [G.C. 56036(b)]

The following districts are under LAFCO jurisdiction for all aspects of LAFCO requirements except that LAFCO can choose whether to follow the requirements of LAFCO law for protest hearings as specified by G. C. 57000 et seq. or the Principal Act:

- A flood control district
- A flood control and floodwater conservation district
- A flood control and water conservation district
- A water conservation district
- A water replenishment district
- The Orange County Water District
- A water agency
- A county water authority or a water authority.

These agencies can request that LAFCO conduct protest hearings according to the Principal Act. [C.C. 56036(c), 56127 & 56128]

### **Sphere Defined**

A Sphere of Influence (SOI) is defined as a “*plan for the probable physical boundaries and service area of a local agency, as determined by the Commission.*” Every decision on changes of organization or reorganization made by LAFCO is required to be consistent with the sphere of influence of the agency. [G.C. 56076 & 56375.5] A sphere of influence is primarily a planning tool that will:

1. Serve as a master plan for the future organization of local government within the county by providing guidelines for the efficient provision of services to the public.
2. Discourage duplication of services by two or more local government agencies.
3. Guide the Commission when considering individual proposals for changes of organization.
4. Identify the need for reorganization studies and provide the basis for recommendations to particular agencies for government reorganizations.

### **Sphere Requirements**

In “developing and determining” the sphere of influence of any agency (city or district) LAFCO is required to prepare a written report and statement of 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 service 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.

Upon determination of a sphere of influence, the commission is required to adopt the SOI at a noticed public hearing and is required to review and update, as necessary, the adopted sphere not less than once every five years. When adopting, amending, or updating a sphere of influence for a special district, LAFCO is required do all of the following:

1. Require existing districts to file written statements with the commission specifying the functions or classes of services provided by those districts.
2. Establish the nature, location, and extent of any functions or classes of services provided by existing districts.” [G.C. 56425]

### **LAFCO’s Policies on Determining a Sphere**

LAFCO’s policies on determining Spheres of Influence include the following statements:

1. Territory that is currently receiving services from a local agency shall be considered for inclusion in that agency’s sphere.
2. Territory that is projected to need services within the next 5-to-10 years may be considered for inclusion within an agency’s sphere, depending on a number of factors that will require review by LAFCO.
3. Territory will not be considered for inclusion within a city’s sphere of influence unless the area is included within the city’s general plan land use or annexation element.
4. A special district that provides services, which ultimately will be provided by another agency (e.g. mergers, consolidations), will be assigned a zero sphere.
5. When more than one agency can serve an area, agency service capabilities, costs for providing services, input from the affected community, and LAFCO’s policies will be factors in determining a sphere boundary.
6. If additional information is necessary to determine a sphere boundary, a partial sphere may be approved and a special study may be designated.
7. A local agency may be assigned a coterminous sphere with its existing boundaries if:
  - There is no anticipated need for the agency’s service outside its existing boundaries.
  - There is insufficient information to support inclusion of areas outside the agency’s boundaries in a sphere of influence.
  - The agency does not have the service capacity, access to resources (e.g. water rights) or financial ability to serve an area outside its boundaries.
  - The agency’s boundaries are contiguous with the boundaries of other agencies providing similar services.
  - The agency’s boundaries are contiguous with the sphere of influence boundaries previously assigned to another agency providing similar services.
  - The agency requests that their sphere of influence be coterminous with their boundaries.

Given the requirements of C-K-H, the policies of the State and LAFCO, the definition of a Sphere of Influence, and Section 56425(f) that requires the Commission to review and update a Sphere of Influence once every five years as necessary, it is reasonable to assume that:

1. A Sphere of Influence generally should not be set larger than that area for which the agency would have the potential to grow within the next 5 to 10 years.
2. A Sphere of Influence for growth inducing agencies, such as sewer and water providers, should not encroach on open-space or agricultural and resource lands without strong justification. Agencies that respond to growth such as fire service providers, hospital districts, cemetery districts, etc., may include open-space, agriculture and resource lands.

3. If an agency presently has substantial areas of unserved territory within its boundaries, which if developed would eliminate the ability, capacity and resources to serve a larger territory, then enlarging the agency's territory would not be appropriate and would be in opposition to the requirements of Sections 56001, 56301, 56377, 56425.
4. If an agency is presently unable to provide services to substantial areas within its existing territory due to lack of capacity or availability of resources, then enlarging the agency's territory would make little sense and would be in opposition to the requirements of Sections 56001, 56301, 56377 and 56425.
5. Under the conditions or circumstances of 3 and 4 above, providing for a Sphere of Influence larger than the agency's boundary would be difficult to justify.
6. Under the conditions or circumstances of 2, 3 and 4 above, providing for an extended Sphere of Influence would be difficult to justify.
7. All Spheres of Influence must be determined based on local conditions and circumstances and the agency's relationship to those local conditions and circumstances.
8. There may be specific conditions or circumstances that support a decision contrary to the general statements in 1 through 5 above.
9. For land use authorities such as a city, it is necessary for LAFCO to consider the requirements of C-K-H, land use planning issues, and the general plan in determining the size of a Sphere of Influence for a city.
10. Even if territory is included in an agency's Sphere of Influence, there is no guarantee that the agency will be allowed to annex any part of the territory included in the Sphere of Influence. In making a decision on an application, the Commission must review all the requirements of law before a decision can be made to approve an annexation. Consistency with the Sphere of Influence is only one aspect of the many issues that must be examined when a boundary change is requested by an agency.

### **Maximum Service Area**

In addition to completing an MSR study and a Sphere of Influence study for an agency LAFCO is also required to complete a study to determine the Maximum Service Area and Service Capacity of that agency. Government Code Section 56378 provides the following: "*In addition to its other powers, the commission shall initiate and make studies of existing governmental agencies. Those studies shall include, but shall not be limited to, inventorying those agencies and determining their maximum service area and service capacities. In conducting those studies, the commission may ask for land use information, studies, and plans of cities, counties, districts, including school districts, community college districts, and regional agencies and state agencies and departments. Cities, counties, districts, including school districts, community college districts, regional agencies, and state agencies and departments, shall comply with the request of the commission for that information and the commission shall make its studies available to public agencies and any interested person. In making these studies the commission may cooperate with the county planning commission.*" (underline added)

As seen by the underlined words, this code section provides mandatory direction to LAFCO. Rather than conduct a separate study, Mendocino LAFCO's policy is to include the requirements of this section in the same study/report as that for the Sphere of Influence and the Municipal Service Review. This approach prevents excessive study efforts, minimizes costs to the agencies and it provides to the public, a report available in one location that details comprehensive information about the agency.

### **Requirement for Conducting a MSR**

To develop or update a sphere of influence for an agency, LAFCO is required to conduct a review (known as a Municipal Service Review or MSR) of the agency's ability to provide services within its present jurisdictional boundaries and its proposed Sphere. This MSR is an adjunct study to the Sphere of Influence study process and is to occur "before, or in conjunction with" the Sphere of Influence determination. On the basis of this study, LAFCO is required to make judgments known as determinations about the agency in six categories: [G.C. 5425 & 56430]

1. Growth and population projections for the affected area
2. Present and planned capacity of public facilities and adequacy of public services including infrastructure needs or deficiencies.
3. Financial ability of agency to provide services
4. Status of, and opportunities for, shared facilities.
5. Accountability for community service needs, including government structure and operational efficiencies.
6. Any other matter related to effective or efficient service delivery, as required by commission policy.

Determinations are "decisions", "judgments" or "statements" of the Commission. LAFCO's "determinations" should be supported by appropriate information, understanding and analysis. This analysis will be a product of the information received or developed, understanding of the requirements of law, industry best practices and comparisons to other similar agencies.

Information can be obtained from existing records (agendas, minutes, budgets, contracts, audits, etc.), various agency resource documents (such as RFPs, Master Plans, Capital Improvement Plans, engineering reports, EIRs, Finance Studies, etc.) from public meetings, individual comments, state and regional agency information (permits, reviews, communications, regulatory requirements, etc.), specific returns to requests for information and other means of accessing information (inventories, field investigations, personal interviews, etc.). Under the law, each agency is required to provide the data and information as judged appropriate by LAFCO. [56425, 56430, & 56378]

### **Overview of Determinations**

The following overview provides some examples of how the informational requirements to support the determinations required by Section 56430 could be fulfilled:

#### **Determination 1—Growth and Population Projections for the Affected Area**

This evaluation category focuses on projected short- and long-term demand for services within a particular area, as measured by current and future populations and their relationship to land use plans and programs.

#### **Determination 2—Present and Planned Capacity of Public Facilities and Adequacy of Public Services Including Infrastructure Needs or Deficiencies**

This evaluation category focuses on the adequacy of existing and planned public facilities in accommodating existing needs and future growth and the efficient delivery of services. Infrastructure can be evaluated in terms of capacity, condition, availability, quality and

correlation with operational needs, capital improvement plans and financial plans. It is recognized that there may be unmet infrastructure needs due to budget constraints or other factors; however, identification of deficiencies may promote public understanding and support for needed improvements.

#### Determination 3—Financial Ability of Agency to Provide Services

Under this evaluation category, LAFCO can identify financing conditions and practices and weigh community public service needs against the resources available to fund the services. This category also may relate to service duplication, inefficiencies related to overlapping boundaries, high administration to operation costs, sharing of underutilized equipment, buildings or facilities, and other practices or circumstances which may increase service costs. Cost reduction opportunities related to economies of scale, shared facilities, transferring service obligations, financing opportunities, and infrastructure upgrades may be identified or suggested. Additionally, this category may relate to timely rate reviews, rate setting methodologies, conditions that could impact future rates, variances among rates, fees, taxes, charges, etc., and may identify, if applicable, opportunities to modify rates through governmental reorganizations or intergovernmental cooperation without adversely affecting service quality or other factors.

#### Determination 4—Status of, and Opportunities for Shared Facilities

Under this evaluation category, LAFCO may identify and evaluate capacity, staff and infrastructure needs to identify opportunities for agencies to reduce costs by sharing facilities and eliminating duplication. In this same category, LAFCO would identify ongoing existing efforts of the agency to share facilities, training, equipment, and staff with other agencies.

#### Determination 5—Accountability for Community Service Needs Including Government Structure and Operational Efficiencies

This category could focus on the visibility and accessibility of the decision-making body to their constituents, accessibility of staff, involvement of the public in the agency decision-making process, public participation in elections, publicly disclosed agency budgets, programs, adherence to requirements of law both in the principal act and in general requirements of the law such as the Brown Act, CPRA and others, plans of the agency and participation of the public in the consideration of plans and other work of the agency.

There is no clear definition of the term “operational efficiencies.” The term may be considered to be referential to the following items: Adequate training for staff; advance planning; implementation of effective strategies for budgeting, managing costs, utilizing personnel; customer service; community’s involvement with the agency; ability to provide service over the short and long term; provision of public services with the lowest necessary expenditure; circumstances involving gross mismanagement or fraudulent management; compliance with accepted standards; maintenance of adequate reserves and any other conditions or circumstances of the service provider management with consideration for local conditions, circumstances and resources.

LAFCO may adopt written determinations with respect to government structure options that could improve service or service conditions. The objective is to provide LAFCO with sufficient information to render informed decisions regarding a possible reorganization. Although service reviews are required to review and update Spheres of Influence, LAFCO is also directed to study a variety of feasible and reasonable options for reorganization. LAFCO is empowered (after

studies) to initiate certain reorganizations such as district consolidation, dissolution, mergers and establishment of subsidiary districts. While LAFCO can initiate such actions, it considers it best to encourage service providers to consider alternative structures that improve service provision and to support mutual decisions.

**Determination 6—Any Other Matter Related to Effective or Efficient Service Delivery as Required by Commission Policy**

Other “matters” could relate to the Service Review Objectives, the potential SOI determination, additional effort to review a potential advantages or disadvantages of consolidation or reorganization. During the gathering of information for the service review, LAFCO may become aware of additional matters that will require some response or referral to another agency.

**Service Review Objectives**

The primary reason for LAFCO to conduct a Municipal Service Review is because the law says that this study must be completed so as to provide information to support the development and determination of the Sphere of Influence for an agency. Therefore, it is a support study that has multiple objectives:

1. It is an evaluation of the agency’s present and future ability to provide services within the agency’s existing jurisdiction and within its proposed Sphere of Influence.
2. It is an informational document for the public to understand the provision of services, and the performance of the District’s Board of Directors and the District’s management.
3. It is a performance review of the agency. At its most extensive form, it can be thought of as a performance audit of the District.
4. It is a study of regional influences on the agency and the services it provides within its boundaries and within its Sphere of Influence.
5. It will be used as an informational document for determining the Sphere of Influence of each agency.

**Definitions of Services**

Section 56430 does not define services. However, Government Code Section 56074 states: “Service means a class established within, and as part of, a single function, as provided by regulations adopted by the commission.” Function is defined by Section 56040 as “any power granted by law to a local agency or a county to provide designated government or proprietary services or facilities for the use, benefit, or protection of persons or property.”

In the review for every proposal, including SOI determinations or updates, the Commission is required to account for all of its responsibilities under the law. For changes of organization, it is required to include the factors to be considered found in Government Code Section 56668 in its analysis, review and decision-making. Section 56668 defines services in this way: “*Services, as used in this subdivision, refers to governmental services whether or not the services are services which would be provided by local agencies subject to this division, and includes the public facilities necessary to provide those services.*”

### **Why LAFCO Began the Service Review**

LAFCO is required to complete MSRs for all independent special districts and all cities in Mendocino County. By statute and policy, LAFCO will not allow sphere of influence determinations or amendments, annexations or other organizational changes until the Municipal Service Reviews have been completed for the agencies requesting changes.

At this time, LAFCO is primarily working on SOI/MSRs for agencies that are seeking boundary changes or sphere of influence updates. At the time of this draft, there are two proposals for a change of organization (Travis Application & CCSD application) for the District. If these applications are approved by LAFCO, the CCSD is proposing that its SOI be coterminous with its then jurisdictional boundaries.

### **Consolidation and/or Reorganization**

Government Code Section 56430 requires LAFCO to review and make a determination regarding the “government structure” of an agency. In seeking to make this determination, LAFCO can include a review of the advantages and disadvantages of consolidation or reorganization of service providers. LAFCOs are also authorized to initiate proposals for consolidation of special districts, dissolution of special districts, mergers of special districts with a city, establishment of subsidiary districts to cities, or reorganizations that includes any of the preceding changes of organization. [56375(a), 56378, and 56425]

**Note:** While the SOI/MSR process provides that the Commission may make determinations regarding the need for consolidation, the SOI/MSR process does not require LAFCO to initiate changes of organization based on SOI/MSR findings; it only requires that LAFCO make determinations per the provisions of G.C. Sections 56425 and 56430. However, LAFCO, local agencies, and the public may use these determinations as a basis to pursue changes to local jurisdictions or Spheres of Influence. There are no proposals by LAFCO for consolidation of the CCSD and other districts.

## COVELLO CSD SOI/MSR REPORT

### Chapter Two: Principal Act

#### District Definitions

A Community Services District (CSD) is considered a “district of limited powers.” A “district” or “special district” means an agency of the state, formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries. An “independent special district” includes any special district having a legislative body all of whose members are elected by registered voters or landowners within the district, or whose members are appointed to fixed terms, and excludes any special district having a legislative body consisting, in whole or in part, of ex officio members who are officers of a city, county or another local agency or who are appointees of those officers other than those who are appointed to fixed terms. “Legislative body” means the governing board of directors of a district. An “independent special district officer” means the presiding officer or a member of the legislative body of an independent special district. [G.C. 56036, 56037, 56044, 56045& 56053]  
(Note: Unless otherwise indicated all citations are from the Government Code.)

#### Principal Act Defined

A Principal Act means, in the case of a district, the law under which the district was formed; it is the statutory authority for the existence of the district. The Principal Act is the primary controlling authority for a district; it provides the ground rules for the actions of the board of directors and the authority for the functions of the district. The Principal Act for a Community Services District (CSD) is found in Government Code Sections 61000 – 61226.5. [G.C. 56065]

The primary way for the public to understand the actions and service provisions of a district is through the lens of the Principal Act. Reviewing the provision of services and activities of the district through the lens of the Principal Act is also one of the better ways that LAFCO can accomplish its mandates for the SOI/MSR process. Therefore, in prelude to a detailed review of the service provisions of the CCSD, a summary of the Principal Act is provided below; the full content of the Act is provided in the Appendix.

#### Recent Legislative Changes

Effective January 1, 2006 CSD law was substantially changed by SB 135. With this change the Legislature declared that a CSD may be either (1) a permanent form of government that can provide local facilities and services; (2) a effective form of government for combining two or more special districts that serve overlapping or adjacent territory into a multifunction special district; (3) a form of government that can serve as a alternative to the incorporation of a new city; or (4) a transitional form of government as the community approaches cityhood. [61000]

Additionally, with the enactment of this new CSD law the Legislature indicated that it was their intent to encourage local agency formation commissions to use municipal service reviews, spheres of influence, and boundary powers, where feasible and appropriate, to combine special districts that serve overlapping or adjacent territory into multifunction community service districts. And, that residents, property owners, and public officials use the powers and procedures

provided by the Community Services District Law to meet the diversity of local conditions, circumstances and resources in their community.

### **Initiation of District Formation**

A CSD formation may be initiated either by petition to LAFCO or by a resolution of application to LAFCO by an existing local government legislative body.

#### **By Petition**

A proposal to form a new district may be made by petition signed by no less than 25 percent of the registered voters residing in the area to be included in the district as determined by LAFCO. The petition shall do all of the things required by Sections 56700 and 61011. Before circulating a petition, the proponents shall publish a notice of intention as required by Section 61012. Within five days of publication the proponents shall file with the executive officer of LAFCO of the principal county a copy of the published notice with an affidavit of publication from the newspaper. Once filing with LAFCO has been accomplished, the petition may be circulated for signatures. [61011 & 61012]

#### **By Resolution**

A proposal to form a new district may also be made by adoption of a resolution of application by the legislative body of any county, city or special district that contains any of the territory proposed to be included in the district. Adoption of the resolution is required to occur at a noticed public hearing with LAFCO receiving notice at least 20 days prior to the hearing. Upon adoption of the resolution, the clerk of the legislative body shall file a certified copy of the resolution with the executive officer of LAFCO. Except for the provision as to signers, signatures and proponents the resolution shall contain all of the matter specified for the petition. [61011, 61013 & 56700]

### **Cost of Formation**

The proponent(s) will pay to LAFCO all costs of the formation of a CSD including environmental review costs and costs required by other agencies. The executive officer will determine the estimated costs for the formation. The estimated costs will be due upon initiation of the application to LAFCO. "Proponent" means the person or persons who file the notice of intention to circulate a petition with the executive officer or the local agency that adopts the resolution of application. [56068]

### **LAFCO Review**

Once the proponents have either filed a sufficient petition or a legislative body has filed a resolution of application and has completed LAFCO's application process (including fees), LAFCO can proceed according to its requirements of law and its policies. The executive officer of LAFCO is required to review the application and prepare a report on the application including his or her recommendation. Factors to be included in the review of the proposal are indicated in Section 56668 and the Principal Act. An environmental review will need to be completed, also. LAFCO must conduct a 21-day noticed public hearing whereby it will hear and receive any oral or written protests, objections, or evidence and shall consider the report of the executive officer.

At the public hearing, LAFCO may approve or disapprove the proposal for formation. [56652, 56658, 56660, 56665, 56668]

#### Sufficient Revenues

LAFCO cannot approve the formation unless it determines the proposed district will have sufficient revenues to carry out its purposes. However, provided that a proposed tax will generate sufficient revenues, LAFCO can condition its approval on the concurrent approval at an election of the formation of the district and approval of special taxes or benefit assessment by two-thirds of the voters in the territory of the proposed district. If the two-thirds approval for the tax does not occur then the proposed district will not be formed. [61014 & 56668]

#### Voter Approval

If LAFCO approves the formation of a CSD, its decision is subject to review and ratification by the voters of the proposed district territory through two distinct processes: (1) A protest hearing, known as a conducting authority proceeding and; (2) A mandatory election if majority protest does not occur at the protest hearing.

#### Protest Hearing

After the public hearing where approval by LAFCO is given for the formation of the district, LAFCO is required to conduct another noticed public hearing known as a conducting authority proceedings or protest hearing. If a majority protest is received according to Section 57078 the commission is required to abandon the proceedings. Section 57078 indicates that for inhabited territory, if 50% or more of the voters within the territory protest, the formation proposal is abandoned. In the case of uninhabited territory, a majority protest is landowners owning 50% or more of the assessed value of land within the territory. Inhabited territory means territory within which there reside 12 or more registered voters. [61014, 56078, 56046, 57000 et seq.]

#### Election

If a majority protest does not occur at the protest hearing, LAFCO is required to either (1) order the formation subject to majority approval by the voters at an election, or; (2) order the formation subject to two-thirds approval by the voters of a special tax or the approval by the property owners of a special benefit assessment at an election. [61014]

#### Appropriations Limit—Gann Limit

Local agencies that receive taxes are subject to certain spending limits (Gann Limit or Proposition 4). Annual appropriations that are subject to spending limits may not exceed an appropriations limit based on a calculated limit for fiscal year 1978-1979, adjusted annually for population and cost of living increases. On or before July 1<sup>st</sup> of each year the board is required to adopt its appropriation limit and make other necessary determinations for the following fiscal year pursuant to Article XIII B of the California Constitution and Government Code Section 7900 et seq. [61113(b)]

Not all appropriations are subject to this limit. The limit only applies to tax revenues. The limit does not apply to proceeds from user charges, user fees or other such assessments provided that these revenue sources do not exceed the costs reasonably borne in providing the product or service for which the fee or assessment is imposed. The limit does not apply to a district which

existed on January 1, 1978 and which did not as of 1977-1978 fiscal year levy an ad valorem tax on property in excess of 12½ cents per hundred dollars of assessed value.

#### Provisional Appropriation Limit

LAFCO will determine the provisional appropriations limit for a proposal for the formation of a district in accordance with Section 7902.7 and Article XIII B of the California Constitution. The Commission will determine the provisional appropriation limit by (1) estimating the amount of tax revenue received in the first full fiscal year of operation and by (2) estimating the amount determined in (1) for the estimated change in the cost of living, population and any other changes that may be required by Article XIII B. After formation, the board of directors shall determine the proposed permanent appropriations limit to be submitted to the voters. The permanent appropriations limit shall be set by the voters at the first district election that is held following the first full year of operation. [56811]

#### District Territory

Subject to LAFCO approval, the boundaries of a district may include incorporated or unincorporated territory, contiguous or non-contiguous territory and may be in one or more counties. [61007]

#### Annexation

After the district has been formed, the boundaries of the district may be altered and contiguous or noncontiguous unincorporated territory may be annexed to the district. Incorporated territory that is contiguous to the district may be annexed to the district with the consent of the affected city. Proceedings are to be initiated pursuant to Section 56000 et seq. of the Government Code. Any territory annexed to a district shall be subject to the collection of any previously authorized taxes, benefit of assessment, fees or charges of the district. [56886(t) & 57330]

#### Governing Body—Board of Directors

The initial governing body of a community services district known as the board of directors shall be elected unless there are conditions as specified in Section 61022(a). Directors may be elected at large, by divisions or from divisions. The Board of Directors shall consist of five members. The term of office is four years or until his or her successor qualifies and takes office. No person shall be a candidate for the board of directors unless he or she is a voter of the district; if directors are elected by division the candidate must be a voter of that division. A board member cannot be a general manager, treasurer or any other compensated employee of the district, except for volunteer firefighters as provided by Section 5227. A vacancy in the office of a member elected to the board shall be filled pursuant to Section 1780. Members of the board may be recalled. [61020, 61025, 61040, 61042 & 61045]

The officers of a board of directors are a president and vice-president. A board may create additional offices and elect members to those offices provided that no member shall hold more than one office. A regular meeting of the board shall be held at least once every three months. Meetings are subject to the Brown Act (Section 54950 et seq.). [61042 & 61044]

A majority of the board constitutes a quorum. Except as otherwise provided by law (e.g. where a two-thirds vote or four-fifths vote is required by law), a majority of the total membership of the board is required to take action. The board may act only by ordinance, resolution or motion and the minutes shall record the ayes and no votes. Legislative acts of the board may be disapproved by the voters by referendum. The board is required to keep a record of all of its actions including financial transactions. The board may appoint one or more advisory committees to advise the board about finances, policies, programs or operations. [54952.6, 61043, 61044, 61045 & 61048]

All members of the board are required to exercise their independent judgment on behalf of the entire district. The board of directors shall establish policies for the operation of the district; the implementation of those policies is the responsibility of the general manager. Policies shall include but not be limited to, administrative policies, fiscal policies, personnel policies and purchasing policies and bidding regulations. [61040, 61045 & 61063]

A board may provide by ordinance or resolution that each of its members may receive compensation for up to six days of service not to exceed \$100 per day. The board can provide by ordinance or resolution that its members may receive their actual and necessary traveling and incidental expenses incurred while on official business. [61047]

### **District Officers**

The board shall appoint a general manager and set his or her compensation. The county treasurer of the principal county shall serve as the treasurer of the district unless the board designates an alternative depository for its funds pursuant to Section 61053. If this is the case, the board shall appoint a district treasurer who shall serve in place of the county treasurer. The board may appoint the same person to be the general manager and treasurer. The board may require the general manager to be bonded and shall require the treasurer to be bonded. The district is required to pay the cost of the bonds. [61050 & 61053]

The general manager shall be responsible for (1) implementation of the policies established by the board; (2) appointment, supervision, discipline and dismissal of district employees consistent with the employee relations systems established by the board; (3) supervision of district's facilities and services; and (4) supervision of district's finances. [61051]

### **General Powers**

A district has perpetual succession and has all rights and powers, expressed and implied, necessary to carry out the purposes of the principal act. It can adopt ordinances and enforce rules and regulations for the administration, operation, use and maintenance of the facilities and services that it provides. A district can sue and be sued. A CSD may acquire real or personal property within or outside the district and has all the rights consistent with ownership of property; it can also obtain property by eminent domain. The district can hire or appoint employees; engage counsel and other professional services; enter into contracts including joint powers agreements; provide insurance pursuant to Section 980; provide training to board of directors; construct any works across or along any street or public way; adopt a seal and take any and all actions necessary for or incidental to, the powers expressed or implied in the principal act. Violation of any rule, regulation, or ordinance adopted by the board of directors is

misdeemeanor punishable pursuant Section 19 of the Penal Code. [61060, 61061, 61062, 61063, & 61064]

A district may contract with any local agency, state department or agency, federal department or agency, or any tribal government for the provision by or to the agency of any facilities, services, or programs authorized by the principal act, within or without the district. If it is without the district, the contract is subject to approval by LAFCO. [61070, 61101 & 56133]

### **Specific Powers**

Within its boundaries, a district may do any of the following:

- (a) Supply water for any beneficial uses, in the same manner as a municipal water district, formed pursuant to the Municipal Water District Law of 1911. [61100 (a)& Water Code 71000 et seq.]
- (b) Collect, treat, or dispose of sewage, waste water, recycled water, and storm water, in the same manner as a sanitary district, formed pursuant to the Sanitary District Act of 1923. [61100(b) & Health and Safety Code 6400 et seq.]
- (c) Collect, transfer, and dispose of solid waste, and provide solid waste handling services, including, but not limited to, source reduction, recycling, composting activities. [61100© & Public Resources Code 4000 et seq. & PRC 41821.2]
- (d) Provide fire protection services, rescue services, hazardous material emergency response services, and ambulance services in the same manner as a fire protection district, formed pursuant to the Fire Protection District Law. [61100(d) & Health and Safety Code Section 13800 et seq.]
- (e) Acquire, construct, improve, maintain, and operate recreation facilities, including, but not limited to, parks and open space, in the same manner as a recreation and park district formed pursuant to the Recreation and Park District Law. [61100(e) & Public Resources Code 5780 et seq.]
- (f) Organize, promote, conduct, and advertise programs of community recreation, in the same manner as a recreation and park district formed pursuant to the Recreation and Park District Law. [61100(f) & Public Resources Code 5780 et seq.]
- (g) Acquire, construct, improve, maintain, and operate street lighting and landscaping on public property, public rights-of-way, and public easements. [61100(g)]
- (h) Provide for the surveillance, prevention, abatement, and control of vectors and vectorborne diseases in the same manner as a mosquito abatement and vector control district formed pursuant to the Mosquito Abatement and Vector Control District Law. [61100(h) & Health and Safety Code Sections 2000 et seq.]
- (i) Provide police protection and law enforcement services by establishing and operating a police department that employs peace officers. [61100(i) & Penal Code 830 et seq.]
- (j) Provide security services, including, but not limited to, burglar and fire alarm services, to protect lives and property. [61100(j)]
- (k) Provide library services, in the same manner as a library district. {61100(k) & Education Code Section 19400 et seq. or 19600 et seq.]
- (l) Acquire, construct, improve, and maintain streets, roads, rights-of-way, bridges, culverts, drains, curbs, gutters, sidewalks, and any incidental works. A district shall not acquire, construct, improve, or maintain any work owned by another public agency unless that other public agency gives its written consent.

- (m) Convert existing overhead electric and communications facilities, with the consent of the public agency or public utility that owns the facilities, to underground locations, [61100(m) & Streets and Highways Code 5896.1]
- (n) Provide emergency medical services pursuant to the Emergency Medical Services System and the Prehospital Emergency Medical Care Personnel Act. [61100(n) & Health and Safety Code 1797 et seq.]
- (o) Provide and maintain public airports and landing places for aerial traffic, in the same manner as an airport district formed pursuant to the California Airport District Act. [61100(o) & Public Utilities Code Section 22001 et seq.]
- (p) Provide transportation services.
- (q) Abate graffiti.
- (r) Plan, design, construct, improve, maintain, and operate flood protection facilities. A district shall not plan, design, construct, improve, maintain, or operate flood protection facilities within the boundaries of another special district that provides those facilities unless the other special district gives its written consent. A district shall not plan, design, construct, improve, maintain, or operate flood protection facilities in unincorporated territory unless the board of supervisors gives its written consent. A district shall not plan, design, construct, improve, maintain, or operate flood protection facilities within a city unless the city council gives its written consent. [61100®]
- (s) Acquire, construct, improve, maintain, and operate community facilities, including, but not limited to, community centers, libraries, theaters, museums, cultural facilities, and child care facilities. [61100(s)]
- (t) Abate weeds and rubbish [61100(t) & Health & Safety Code Section 14875 et seq.]
- (u) Acquire, construct, improve, maintain, and operate hydroelectric power generating facilities and transmission lines, consistent with the district's water supply and waste water operations. The power generated shall be used for district purposes, or sold to a public utility or another public agency that generates, uses, or sells electrical power. A district shall not acquire hydroelectric power generating facilities unless the facilities' owner agrees. [61100(u)]
- (v) Acquire, construct, improve, maintain, and operate television translator facilities. [61100(v)]
- (w) Remove snow from public streets, roads, easements, and rights-of-way. A district may remove snow from public streets, roads, easements, and rights-of-way owned by another public agency, only with the written consent of that other public agency.
- (x) Provide animal control services pursuant to Section 30501 of the Food and Agricultural Code.
- (y) Control, abate, and eradicate pests, in the same manner as a pest abatement district. [61100(y) & Health and Safety Code Section 2800 et seq.]
- (z) Construct, maintain, and operate mailboxes on a district's property or rights-of-way.
- (aa) Provide mail delivery service under contract to the United States Postal Service.
- (ab) Own, operate, improve, and maintain cemeteries and provide interment services, in the same manner as a public cemetery district, formed pursuant to the Public Cemetery District Law. [61100(ab) & Health & Safety Code Section 9000 et seq.]
- (ac) Finance the operations of area planning commissions formed pursuant to Section 65101.
- (ad) Finance the operations of municipal advisory councils formed pursuant to Section 31010.

- (ae) Acquire, own, improve, maintain, and operate land within or without the district for habitat mitigation or other environmental protection purposes to mitigate the effects of projects undertaken by the district.

A district may provide the facilities and services authorized by Section 61100 outside its boundaries subject to LAFCO approval. [61101 & 56133]

### **Latent Powers**

As indicated above, SB 135 consolidated the provisions for CSDs into a list of 31 services and facilities plus a few special provisions. Under the old CSD statutes, “latent powers” were those powers authorized by the principal act when the district was formed, but are not currently being exercised, provided that any powers not designated in the petition for the formation of the District may not be exercised if the voters in the District must activate the power.” Effective January 2006, SB135 changed the definition of latent powers for a CSD. SB 135 redefined “latent powers” as those services and facilities authorized by the new Principal Act for CSDs that LAFCO determines that a CSD did not provide before January 1, 2006. With this law change, all powers authorized for CSDs but not being exercised by the District became “latent powers”, regardless of the initial formation petition.

If a board of directors desires to exercise a latent power, the district must first receive approval of LAFCO. LAFCO will review the proposal for raising the latent power at a 21 day noticed public hearing. The district is required to demonstrate its ability to fund the proposed service or facility; lacking a credible financial plan would be a reason for LAFCO disapproval. LAFCO cannot approve a district’s proposal to exercise a latent power if another agency already provides substantially similar services or facilities to the territory in question. [61106, 61107 & 56824.10 et seq.]

Note: Because CSD law allows a CSD, upon LAFCO approval, to assume the powers of various other districts (e.g. Municipal Water District, Sanitary District, Fire Protection District, Recreation and Park District, Mosquito and Vector Control District, Library District, Airport District & Cemetery District); a Community Services District potentially has extremely broad powers, if it is providing those types of services. To fully understand the extent of the laws that may apply to a CSD, one must also review the principal acts for these types of Districts as well as the Principal Act for a CSD, provided that the District is authorized to provide these services. Therefore, in any application before LAFCO to raise the latent power of a CSD, LAFCO would also need to review the potential demands and impacts of the Principal Act for the service which the application is being made.

### **Budget**

On or before July 1 of each year (every other year if the district is on a biennial budget cycle) the board of directors must propose a final budget for the upcoming year or it may adopt a preliminary budget that conforms to generally accepted accounting and budget procedures for districts. The budget may be divided into the following categories: (1) Maintenance and Operation; (2) Services and Supplies; (3) Employee Compensation; (4) Capital Outlay; (5) Interest and Redemptions for Indebtedness; (6) Designated Reserve for Capital Outlay; (7)

Designated Reserve for Contingencies. On or before September 1 of each year (every other year if the district is on a biennial budget cycle) the board of directors shall adopt at a noticed public hearing a final budget that conforms to generally accepted accounting and budgeting procedures for districts. After adoption of the final budget, the general manager is to forward the budget to the county auditor. [61110]

#### **Notice for Budget Hearing**

On or before July 1 of each year (every other year if the district is on a biennial budget cycle) the board of directors shall publish a notice stating the following: (1) Either it has adopted a preliminary budget or that the general manager has prepared a proposed final budget which is available for inspection at a time and place within the district; (2) The date, time and place when the board of directors will meet to adopt the final budget and that any person may appear and be heard regarding any item on the budget or regarding additions to the budget; (3) The notice shall be published at least two weeks in advance of the hearing in at least one newspaper of general circulation in the district pursuant to Section 6061. The hearing may be continued from time to time as thought appropriate by the board except that the budget must be adopted by September 1. [61110]

#### **Amending the Budget**

At any regular meeting or properly noticed special meeting, the board of directors may adopt a resolution amending the budget and ordering the transfer of funds between categories other than transfers from dedicated reserves. The board of directors may also authorize the general manager to transfer funds between categories other than dedicated reserves. [61111]

#### **Reserves**

The board of directors may establish a designated reserve for capital outlay and designated reserve for contingencies. When a reserve is established, the board must declare the exclusive purpose for which the funds in the reserve may be spent and those funds can only be expended for the established purpose. If the board finds that the funds in the reserve are no longer required for the established purpose, the board may by a four-fifths vote of the total membership of the board discontinue the reserve and transfer the reserve funds to the general fund of the district. [61112]

In a duly proclaimed state of emergency (fire, flood, storm, epidemic, riot, drought, sudden or severe energy shortage, plant or animal infestation, earthquake, volcanic eruption, etc.) the board of directors may temporarily transfer funds from a designated reserve or capital outlay or designated reserve for contingencies to the district's general funds. The board shall restore those funds to the reserves when feasible. [61112 & 8558]

#### **Grants and Indebtedness**

A district can accept revenue, money, grants, goods or services from any government agency and any person for lawful purposes of the district. Local governments can use "dry period loans" or working capital loans to borrow money against future revenues. A district may borrow money and incur indebtedness pursuant to Sections 53820-53833, 53840-53844, 53850-53858 and

53859-53859.08 of the Government Code. A local agency can loan any of its available funds to a district. [61116]

### **Audits and State Controller Reports**

Special districts must have regular, independent audits. The board of directors is required to provide for regular audits of the district's accounts pursuant to Section 26909 of the Government Code. In addition, the district is required to provide an annual financial report to the State Controllers Office. [61118 & 53890 et seq.]

### **District Fees and Taxes**

Special districts ability to raise revenue is usually restricted to fees-for-service or some form of a tax against property.

#### **Fee-for-Service**

The board of directors may charge a fee to cover the cost of any service which the district provides or the cost of enforcing any regulation for which the fee is charged. By resolution, the board can establish rates or other charges for services and facilities. No fee can exceed the reasonable cost borne by the district in providing the service. If the fee exceeds the reasonable cost of providing the service, it is a special tax requiring a two-thirds vote of the district electorate. Before imposing or increasing any fees for property related services, the board must follow the procedures in Section 6 of Article XIII D of the California Constitution. Residents or taxpayers of the district may be charged fees which are less than charged non-residents or nontaxpayers. The board of directors can authorize the waiver of fees if in their opinion payment would not be in the public interest. A CSD may charge standby charges for water and sewer services. [61123, 61124, 50076, 54984 & 66016]

#### **Collection of Fees**

The district can provide for collection and enforcement of the imposed fees by providing that the charges for any of these services or facilities may be collected with the rates and charges for any other services or facilities. If all or part of a bill is not paid the board can assess a penalty of 10% plus 1% a month for nonpayment of charges and penalty assessment. The board may provide that any charges and penalties be collected on the tax roll in the same manner as property taxes. The board can place a lien against property for nonpayment of charges and penalties. The board may also discontinue service if all charges are not paid. [61115 & 61123]

#### **Taxes**

A "general tax" is an involuntary charge against an individual, landowner, or business without regard for benefit and is for general use of the taxing agency. All taxes are subject to the approval of the voters in the district. A general tax requires majority voter approval. A "special tax" is one restricted for special or specific purpose as opposed to a general tax. A special tax requires two-thirds voter approval. A "benefit assessment" is an involuntary charge on property owners to pay for public works that directly benefit property. [California Constitution Articles XIII A, §4 and XIII C, §2, Government Code §50075 et seq., §53722, et seq., & §53970, et seq., R&T 95]

Unlike cities, districts cannot install a sales tax or a transient occupancy tax (hotel or room tax) but they can impose various forms of a property tax subject to agreement of the voters. Pursuant to Government Code Section 50075 et seq. and subject to two-thirds voter approval a district may levy special taxes which must be applied uniformly to all taxpayers or all real property. For certain public capital facilities and services, pursuant to G.C. Section 53311 et seq. a district may form a Mello-Roos District which is a form of a special tax district. A district may levy a benefit assessment consistent with the requirements of Article XIII D of the California Constitution pursuant to the Improvement Act of 1911, the Improvement Bond Act of 1915, the Municipal Improvement Act of 1913 and the Landscaping and Lighting Assessment Act of 1972. [61121 & 61122]

### **Capital Financing**

The board of directors may incur debt for the purpose of capital improvements. It may issue general obligation bonds for the acquisition or improvement of property; provided the debt does not exceed 15% of the assessed value of all taxable property in the district at the time the bonds are sold. [61125 & 61126]

A board may finance any enterprise by issuing revenue bonds. It may finance facilities and issue bonds pursuant to Mello-Roos Community Facilities Act of 1982. A district may levy benefit assessment to finance facilities consistent with the requirements of Article XIII D of the California Constitution. A district may acquire and improve land, facilities or equipment and issue securitized limited obligation notes. [61127, 61128, 61129, 61130, 54300 et sequens, 53311 et sequens, 53835]

Upon four-fifths vote of the total membership of the board, a district can issue promissory notes to borrow money and incur indebtedness for any lawful purpose including the payment of current expenses. However, the total amount of indebtedness via promissory notes cannot exceed 5% of the district's total enterprise and nonenterprise revenues in the preceding year and must be paid back within five years. [61131 & 53530 et sequens]

### **District Zones**

An "improvement district" is an area or zone within a CSD formed for the sole purpose of designating an area which is to bear a special tax or assessment for an improvement benefiting that area or zone. The board of directors may form one or more zones within a specific area of the district to provide different services, to provide different level of services, to provide different facilities or to raise additional revenue. The services provided within the zone can be any service that the district may provide in the district as a whole. The district can levy special taxes, benefit assessment, rates, fees, charges, standby charges, issue bonds or notes which are intended solely for the support of services or facilities within a zone. It can issue promissory notes or incur general obligation bonded indebtedness for the benefit of a zone provided that it does not exceed 5% of the assessed value of all taxable property in the zone at the time the bonds were issued. [56041 & 61140-61143]

Ordinarily, LAFCO has no power to review and approve or disapprove a proposal to form a zone or change the boundaries of a zone within a district. However, if the District is seeking to raise its latent powers and proposes to fund this new power with an improvement or assessment

district within the district boundaries, then LAFCO would review this proposed internal district as part of the review of “plan for services” for this proposal. [56824.10 et sequens] (See “Latent Powers” in Section Three of this Chapter)

**Force Account Limits**

State law spells out bidding and contract procedures for local government including districts. A force account limit is the amount over which local government must use private forces (labor) instead of public forces (employees) or must seek bids for materials. The Local Agency Public Construction Act (P.C.C. Sections 20100 et seq.) provides the specific requirements for various local governments. The force account limits for a CSD are: (1) \$25,000 for the purchase of materials and supplies on the open market for the construction or completion of any building; and (2) \$25,000 to construct or complete any building structure or improvement with its own forces. [Public Contract Code Sections 20682 & 20682.5]

## COVELO CSD SOI/MSR REPORT

### Chapter Three: District Information

#### Brief Description and Location of CCSD

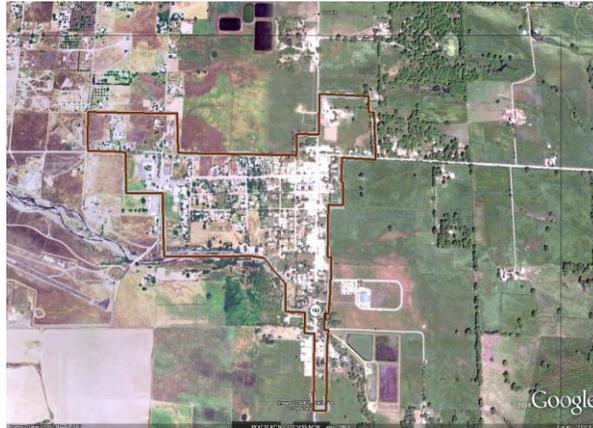
Round Valley is a north-south trending valley located in the north-central portion of Mendocino County approximately 35 miles northeast of Willits. The Valley is located in the upper Eel River basin above the confluence of the North Fork Eel River with the Eel River. Round Valley (approximately 23 square miles) is surrounded by rugged mountains and is the most “isolated” location with 1000 or more residents in the County. The community of Covelo is the main community in the Valley; it is located in the west-central part of the Valley.

Covelo CSD was formed on April 5, 1960. The initial collection system and treatment plant were completed in 1961; major upgrades to the treatment plant occurred in 1978-79.

Covelo CSD is located within the central portion of the community of Covelo. Much of the developed area of Covelo is within the Covelo CSD Boundary. However there are numerous structures and small parcels around the District’s boundaries that are not within the District at this time.

The CSD’s jurisdictional boundaries encompass about 150 acres which is approximately 1% of Round Valley’s total area.

**Figure 1** is a Google Earth image of Covelo; Covelo CSD’s territory is the outlined red shape in the middle of the valley at the intersection of the valley’s main roads. As can be seen, CCSD occupies a relatively small amount of Round Valley.

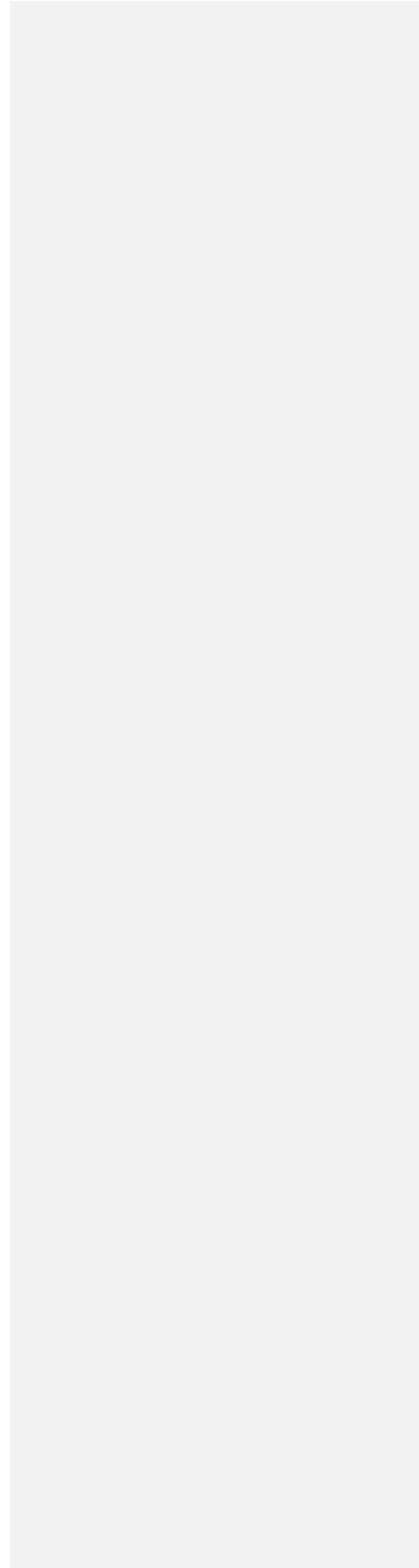


**Figure 1 - Covelo & CSD Boundaries**

The District’s waste water facility is seen on this image to the right (east) of the lower (southern) extension of the District. It is not within the boundaries of the District.

An 11 X 17 map of the District jurisdictional boundaries as it exists at the time of this Report, prior to any annexation decisions that are scheduled for LAFCO review on Sept. 6, 2010 is provided on the following page.

Insert 11 x 17 map of district here



### **District Governance**

The District is governed and operates under the Community Services District law per Government Code Sections 61000 – 61226.5 (See Chapter 2.).

The CCSD is an independent special district, which means that the members of the Board of Directors are to be elected to serve overlapping four year terms. In order to be elected to the Board, candidates must be registered voters residing within the District boundaries. If there are insufficient candidates for election for the vacancies on the board or if the number of filed candidates is equal to the number of vacancies then board members may be appointed in lieu of election by the Board of Supervisors [Elections Code 10515].

### **Principal Office**

Covelo CSD  
 PO Box 65  
 76270 Grange Street  
 Covelo, CA 95428  
 (707) 983-6888  
[covelocsd@hotmail.com](mailto:covelocsd@hotmail.com)

### **Board of Directors**

Board members elect the President and Vice-President of the District and may appoint a board member as secretary for the Board. The President serves as chair of meetings of the board. Per CSD law, additional officers may be created provided that no member of the board holds more than one office. Three of the present District Board members have been appointed in lieu of election; Directors Littlehales and Tucker were elected. The Board has not established additional officers of the board.

<b>Chair:</b> Dane Downing PO Box 1096 Covelo, CA (707) 983-6749	November 2009		<b>Vice-Chair:</b> Joe Gander PO Box 301 Covelo, CA (707) 983-1018	November 2009
Paul Filler PO Box 321 Covelo, CA (707) 983-8275	November 2009		Crispin Littlehales PO Box 1106 Covelo, CA (707) 983-6083	November 2011
Tony Tucker PO Box 788 Covelo, CA (707) 983-1018	November 2011			



**Image 1 - Board and Staff - CCSD**

Left to right: Tim Dennis, Joe Gauder, Crispin Littlehales, Catherine Towers, Paul Filler, Tony Tucker, Dane Downing

Note: Any vacancy on an “appointed governing board” (dependent district) must be filled according to the requirements of Government Code Section 1778 & 1779, which essentially provides that the Board of Supervisors shall make the appointment within 90 days. Any vacancy in the “elective office of the governing board” of an independent district shall be filled according to the requirements of G.C. 1780, which essentially allows the remaining majority of the Board of Directors to appoint someone within 60 days, provided that the District has noticed County Elections and has posted a notice of the vacancy in three or more conspicuous locations in the district at least 15 days before the Board makes the appointment. Additionally, whenever an unscheduled vacancy occurs in the board a special vacancy notice is required to be posted at the office of the clerk of the board and at the designated local library not earlier than 20 days before or not later than 20 days after the vacancy occurs [G.C.

**Management and Staff**

The District has 2 employees and two contracted professionals.

General Manager/ Chief Staff Official: Timothy Dennis	Attorney Christopher Neary 110 South Main Street #C Willits, CA 95490
Office Manager Catherine Towers	Auditor/CPA V. James Sligh 413 West Standley Street, Suite A Ukiah, CA 95482

**Board Meetings, Functions and Procedural Information**

The Covelo Community Services District regular public meetings are held on the first Thursday of each month, beginning at 6:00 p.m., in the business office of the District at 76270 Grange Street, Covelo, California. CCSD meetings are open to the public, and the District encourages public participation. The District via the MSR questionnaire reports that meeting locations are ADA accessible.

The Board meetings must meet the requirements of the Brown Act. CCSD agendas are posted at the meeting location which is also the principal office of the District, and at three conspicuous places within the District including the Covelo Volunteer Fire Department, Redwood Oil and Gas Station, and the Post Office.

The Board may act only by ordinance, resolution or motion and a majority of the Board constitutes a quorum. A recorded majority vote of the total membership of the board is required of each action and a record is required to be kept of their meetings. The District keeps minutes of every meeting of the full Board. Minutes are available at its principal office.

The Board has established one standing committee - Budget. Agendas are published for this committee; minutes are kept and are available at the District's principal office.

New Board members receive an orientation session with the General Manager which includes a review of the treatment plant and other infrastructure.

**Policies and Procedures**

The board of directors is required to establish policies for the operation of the district; the implementation of those policies is the responsibility of the general manager. Policies shall include but not be limited to, administrative policies, fiscal policies, personnel policies and purchasing policies and bidding regulations. [61040, 61045 & 61063]

The District reports via the MSR questionnaire that it has a written Policies and Procedures Manual that was last updated in January 2009 and that is provided to the Directors.

Note: Board policies 5120, 5040, 5060, 3040, 3042 & 3080 address the requirements of G.C. 61040, 61045 & 61063.

**Board Compensation**

A board may provide by ordinance or resolution that each of its members may receive compensation for up to six days of service not to exceed \$100 per day. The board can provide by ordinance or resolution that its members may receive their actual and necessary traveling and incidental expenses incurred while on official business. [61047]

The District has indicated that CCSD board members do not receive compensation for meetings and do not receive compensation for expenses incurred while on board business

### **Budget Meetings of the Board**

By law, the District is required to adopt a preliminary budget by July 1<sup>st</sup> and a final budget by August 30<sup>th</sup>. The CCSD Board of Directors holds noticed public hearings for adoption of the final budget in June. Copies of the budget are available at the District office. The District does not have a website to provide public information.

### **Conflict of Interest, Economic Interest and Ethics Policies**

The District General Manager provides new board members with an informational orientation session. According to the General Manager, copies of the Brown Act, FPPC requirements and public disclosure of conflict of interest requirements are provided to each board member. The District does not hold periodic reviews of these requirements.

#### **Conflict of Interest**

According to the District, Conflict of Interest requirements training are provided to each board member and there have been no violations of these requirements in the past five years.

#### **Statement of Economic Interest Filings**

Under the Political Reform Act all public agencies are required to adopt a conflict of interest code. A code designates the positions required to file annual Statements of Economic Interest forms and assigns disclosure categories specifying the types of interest to be reported. The District has adopted a conflict of interest code and filed it with the County Clerk on September 22, 1997. Under the CCSD code, all board members are required to file annual FPPC Statement of Economic Interest disclosure statements. This seems consistent with the requirements of G.C. 87200. All filings for board members have been made as required. Filings are made to County Clerk's office in Ukiah and are available there.

According to the District's code, the General Manager and legal counsel are not required to file. FPPC Regulation 18730 indicates that designated employees that "make or participate in the making of decisions which may foreseeably have a material effect on economic interests" should be considered for filing.

**Note:** Presumably, the General Manager and Counsel would have some ability to influence or participate in the making of the Board's decisions regarding economic or financial issues. In that it is foreseeable that their recommendation could have a material effect on economic or financial decisions of the Board, the Board may want to reconsider its requirements for the filing of FPPC statements for the General Manager and Counsel.

#### **Ethics Training**

Government Code §53234, et seq. requires that elected and key appointed officials must take biennial ethics training courses if they receive any form of compensation including reimbursement for expenses. This law requires training about conflict of interest, prohibition of use of public resources, prohibition against gifts of public funds, prohibition against acceptance of free transportation, laws about transparency of operations such as the Brown Act, Public Records Act and others.

**Note:** While the Board does not receive any form of compensation, it has had ethics training twice; April 8, 2006 conducted by Best, Best and Krieger at Brooktrails and again on June 6, 2009 conducted by Jeanine B. Nadel, Mendocino County Counsel at Covelo.

### **Complaints and Investigations**

LAFCO does not have on file any complaints about the District. The District reports that there have been no violations of the Brown Act, violations of FPPC requirements or conflict of interest laws in the last five years.

The District reports it was subject to a Grand Jury investigation within the past five years. However, the most recent Grand Jury Report we could find on CCSD was in 1993. The District reports it was investigated as a result of a “River Watch” (a regional environmental law organization) law suit filed in 2001. The result of the lawsuit was a “Consent Decree” to which the CCSD agreed to and has abided by.

The District reports it has received formal citizen complaints regarding the District’s recent increases in sewer rates.

### **Current Services**

Per the requirements of SB 135 and G.C. 56425, LAFCO determined that Covelo CSD was performing the following functions or services:

1. Collection and treatment of sewage, wastewater, recycled water and storm water in the same manner as a Sanitary District.

### **Cooperative Arrangements with Other Agencies**

CCSD shares office space with the Round Valley County Water District and the Round Valley branch of the Mendocino County Superior Court.

**COVELO CSD SOI/MSR REPORT**

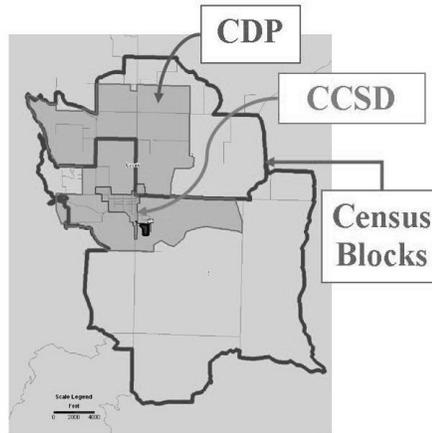
**Chapter Four: Population, Demand and Waste Water System**

**Population**

Census information is not kept by the boundaries of the District. Thus, there is no direct information available for determining the population of the Community Services District, as one would find for a city. One way the Census Bureau geographically organizes and presents data is by Census Designated Places (CDP). Census Designated Places are Census Bureau estimates of what an incorporated city boundary would be if a concentrated population area were a city. **Figure 2:** The Covelo CDP is much larger than the Covelo CSD; however it does not include all of Round Valley.

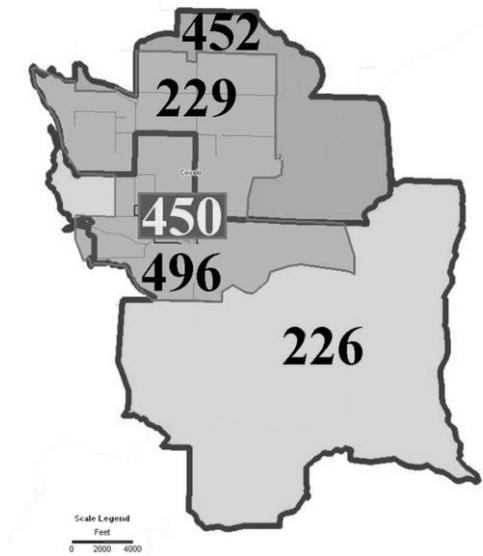
The territory of the Covelo CSD is a relatively small area within the CDP but one can assume that information available from the CDP would generally apply to the territory of the CSD. The general census data for the Covelo CDP indicates that as of the 2000 census 1,175 people resided within the CDP providing a population density of 164.9 people per square mile. By comparison the average population for Mendocino County is 24.16 persons per square mile.

**Figure 3:** Our projection, based on year 2000 CDP data, is that there are approximately 450 people living within the Covelo Community Services District Boundaries.



**Figure 2**  
**Covelo Census Block Groups, Census Designated Place (CDP), & Covelo CSD**

a population density of 164.9 people per square mile.



**Figure 3 - Residential Population - 2000**

Round Valley North of CDP	452
CDP North of CCSD	229
CCSD	450
CDP South-East-West-North of CCSD	496
Round Valley South of CDP	226
TOTAL ROUND VALLEY	1853

In response to a questionnaire, Covelo CSD initially estimated that there are 430 residents within its boundaries, so our estimate seemed to reasonably coincide with theirs. A later communication from the General Manager indicated that he performed a census of the District at the request of the USDA and he counted a population of 410 people as of July 9, 2009.

### **Households and Residential Housing Units**

**Table 1:** As of the census of 2000, there were 442 households, and 301 families residing in the CDP. Of the 442 households, 29.4% had children under the age of 18 living with them, 43.2% were married couples living together, 20.1% had a female householder with no husband present, and 31.7% were non-families. 26.0% of all households were made up of individuals and 7.5% had someone living alone who was 65 years of age or older. The average household size was 2.66 and the average family size was 3.17.

The area within the District has the smallest household population in the Round Valley region.

**Table 1 - Population, Housing, Average Household Size - 2000**

	Population	Housing Units	Average Household Size
Round Valley North of CDP	452	161	2.81
CDP North of CCSD	229	90	2.54
CCSD	450	212	2.12
CDP South-East-West-North of CCSD	496	210	2.37
Round Valley South of CDP	226	92	2.46
TOTAL ROUND VALLEY	1853		2.42

### **Population Growth**

Census Tract 010100 overlays the northeastern corner of Mendocino County. The Round Valley area contains about 80% of the total population in this Census Tract. **Table 2** shows the growth of population in that Census Tract; the changes in growth mostly reflects changes in Round Valley - Covelo.

**Table 2 - Population Change - NE Mendocino County**

	1970	1980	1990	2000
Census Tract 010100	1,898	2,137	2,066	2,374
Percent Change		13%	-3%	15%
County Percent Change		30%	21%	7%

The area grew considerably slower than the County in the 1970-1990 decades, but then had a growth rate twice that of the County at large in the 1990-2000 decade.

Official State estimates indicate a growth rate of 6.25% for 2000-2009 in the unincorporated part of Mendocino County. If this held true for the northeast part of the County population would have grown to about 2522 - of which 1990 or so would be in Round Valley - and increase of around 140 people.

The 15% growth rate over ten years for the Census Tract from 1990 to 2000 equates to a 1.4% annual growth rate. SHN Engineers in their report used an annual growth rate in the District's service area of 1.7%. This would produce an 18% growth rate over 10 years. Instead of an increase of 140 residents suggested above this growth rate would produce 170 new residents.

Obviously, these projections are reasonably similar. However, by their nature any percentage projections based on such a small population may have a wide range of possible errors; an increase in residents that would not be statistically significant in a large city could have a very significant impact on Covelo's growth rate.

**Non-Residents**

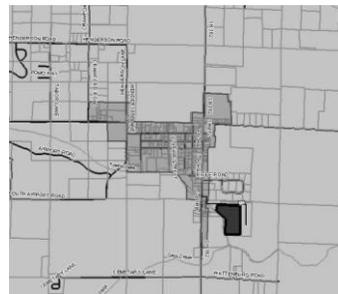
As indicated, the analysis for this MSR indicates a residential population of 430 - 450 people. The District encompasses the main community and institutional service locations in Round Valley, including a commercial district, primary and secondary public schools, offices, etc. As such the need for sewer and wastewater services is not solely based on resident population.

In the previously cited June 2006 report, SHN Consulting Engineers & Geologists provided analysis that the current inflow to the wastewater treatment plant indicates a population equivalent of 850<sup>1</sup>. This is not only an estimate of the number of residents whose homes are served by the District, but also the number of people who "contribute" to the sewer system from non-residential facilities served by the District, such as commercial, industrial and institutional facilities. It appears the non-residential facilities served by the District roughly double the input to the system provided by residents

**Future Demand**

In the decade ending in 2000 Covelo's population appears to have increased by somewhere around 15%. Further, a relatively large number of residents of the Valley live just outside the District today. The District has received occasional requests by property owners of parcels adjacent to the District requesting annexation. It is likely that the District will continue to receive requests for annexation and therefore be faced with gradually growing demand.

**Figure 4** shows Assessors Parcels in close proximity to CCSD. The dark block in the lower right hand quadrant indicates the location of the WWTP.



**Figure 4 - CCSD and Assessor's Parcels**

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<sup>1</sup> Covelo Wastewater Facilities Improvement Project, Amended USDA Preliminary Engineering Report, June 2006 page 25

There are a number of parcels just outside the District of similar size as those within, and several which could be subdivided for development. Census Block data indicates around 200 people live within 1000 feet of the District - nearly half the population inside the District.

At present the District is initiating an application for requesting the annexation of approximately 35 acres of mostly developed land that is presently being served by the District. At the time of this Report the completed application had not yet been received; the map and legal description have not been completed. In addition, a completed annexation application for four single family parcels has been received (Travis application) from a landowner which the District is in agreement.

Upon approval of the annexation requests, the District is requesting that its Sphere of Influence (SOI) be determined to be coterminous with its new jurisdictional boundaries. This request is based on the District's awareness of the present limits of its capacity and the need for additional upgrades to the system. If LAFCO agrees with this request, any future annexation requests will require a request for a Sphere of Influence amendment along with the annexation request.

**Note:** Given Covelo's relatively isolated location, it's unlikely to experience significant population increases in the next few decades. Further, significant industrial or commercial development is also unlikely within the District's boundaries. However, based on some population increases and some possible requests for annexation, it seems reasonable to conclude that growth in underlying demand for sewage services could, at most, grow at a rate of .5 to 1.5% percent a year, which would be in line with recent past County wide growth

## Section Two: Collection System

### Sewage Treatment System

In general, a sewage system is comprised of three main elements: (1) the sewer pipeline system known as the collection system; (2) the treatment plant and; (3) the disposal system for the treated water and sludge (biosolids) that are discharged from the treatment plant

### Collection System

A collection system channels wastewater from the source to the wastewater treatment plant. A sewer collection system consists of pipes that run from each house or building to a sewer main in the street. The street sewer mains will connect to progressively larger pipes until the Waste Water Treatment Plant (WWTP) is reached. Household mains are usually 4 inches in diameter. Street mains vary in size with the smallest being 6 inches in diameter. The District has 20,000 feet (approximately 3.75 miles) of six, eight, ten and twelve inch sewer lines and one pump station.

In designing a system, engineers determine the volume of sewage likely, the route of the system, and the slope of the pipe to ensure an even flow by gravity that will not leave solids behind. The smaller mains in a collection system are usually laid following street patterns; larger mains that lead to the treatment plant may follow central streets or roads or may follow streambeds which naturally flow downhill. Periodically, a vertical pipe will run up from the main to the surface where it is covered by a manhole cover. Manholes allow access for inspection, cleaning and maintenance and are often located at junctions of mains.

In an ideal case, a sewer collection system will be completely gravity powered; for this reason the Waste Water Treatment Plant (WWTP) will usually be located at the lowest elevation of the collection system territory. In regions where gravity flow cannot be utilized, pumping stations known as lift stations are needed. Lift stations may simply be used to adjust elevations between two gravity lines or pumping stations may be used to pump effluent by a pressurized main known as a force main.

The previously cited SHN report dated June 2006 described the Covelo collection system as follows:

*“The CCSD sewer system consists of four major collection basins; three of them north of Town Creek, and the other south of the creek. The smallest of the three northern basins lies along East lane within the northeast corner of the CCSD. Wastewater in this basin flows by gravity to a lift station near the northern limit of the Commercial Street sewer main. The lift station pump ... lifts collected wastewater to the terminal manhole on the Commercial Street main where it joins wastewater generated in the largest northern collection basin situated within and west of Commercial Street.*

*The largest collection basin located north of Town Creek and primarily west of Commercial Street includes contributors from parcels near the intersection of Howard Street and Crawford Road at the extreme northwest side, and from the contributors within the more urban area bounded by Howard Street on the north and Commercial Street on the east. All wastewater from these two northern collection basins flows by gravity toward Town Creek, and passes under the creek through an inverted siphon. A main interceptor sewer line located just south of Town Creek conveys collected wastewater east to the wastewater treatment plant.*

An area known as the “Business Park” comprises the third collection basin located north of Town Creek. **This collection area is presently not included within the District boundary.** ... An independent gravity sewer line conveys wastewater from the Business Park directly to the treatment plant influent pump station on the north side of Town Creek. **The District is currently investigating the annexation process to determine if currently served areas located outside the CCSD boundary can be incorporated into the community services district.**<sup>2</sup>

The fourth sewage collection basin is located entirely south of Town Creek. This collection area is smaller in size than the combined areas located north of Town Creek, but potentially serves a lot of developable area between the Round Valley Airport on the east and Highway 162 on the west. The wastewater generated within this basin flows north and joins wastewater generated within the main northern basins on the south side of Town Creek before being conveyed through the main sewage interceptor to the treatment plant. The main interceptor includes a second inverted siphon below Town Creek, just upstream of the influent pump station at the treatment plant.

The overall collection system serves a geographic area of about 185 acres, including approximately 35 acres that lie outside of the existing district boundary. The collection system service area contains approximately 200 residential users, 51 commercial users, 9 institutional users, 2 public uses, and 2 other uses that do not fit a standard user category. The sewer main piping comprising the collection system in the largest of the three northern basins includes approximately 3,900 linear feet of 8-inch diameter and 14,575 linear feet of 6-inch diameter asbestos-cement pipe (transite pipe). There are approximately 45 manholes and 10 mainline cleanouts in this portion of the overall system.

The Business Park collection system is the second largest of the three northern sewer basins, and consists of 2,200 linear feet of 6-inch diameter pipe, 1,085 linear feet of 12-inch diameter pipe, and 800 linear feet of 12-inch pipe that terminates within the WWTP property.

The smaller, East Lane basin includes 800 feet of 6-inch diameter sewer main, 4 manholes and 1 mainline cleanout. A lift station raises collected wastewater from the East Lane basin to the north end of the Commercial Street basin.”

#### Recent Changes to the Collection System

As reported by the General Manager:

“Originally, the collection system flowed towards Commercial Street, and flowed south to a point 1500 feet south of Elberle Street where it turned east crossing under Town Creek a second time to the treatment plant. In 2007, the Town Creek Bridge was bypassed with 654 feet of twelve inch line that directs sewage from north of Town Creek straight to the plant. The old line passing under the bridge was plugged.

From the new manhole just north of the bridge to the manhole at Commercial and Howard Streets, 2,064 feet of sewer line were replaced with 10 inch SDR-26 PVC pipe. All 2,657 feet of sewer line on Howard Street was replaced with 8 inch SDR-26 PVC. Sewer line replacement included new manholes.”

An 11 X 17 map of the collection system demonstrating the entire system and recent replacements is provided on the following page.

<sup>2</sup> The District has applied for annexation of for these areas.

Insert Collection System Map here

### **Collection System External Impacts**

Essentially there are two external impacts that can occur to a wastewater collection system that can cause harm to either the environment or to the ability to process the wastewater: (1) Infiltration and Inflow and; (2) Exfiltration.

#### **Infiltration and Inflow (I&I)**

Soil infiltration is the process by which rain water enters the substructure of the soil to become groundwater. Soil infiltration is governed by two forces: gravity and capillary action. The rate of infiltration is affected by soil characteristics; generally, the soil's ability to absorb and move water. Infiltration into sewers is usually groundwater entering the wastewater collection system from saturated soil through points of entry in the pipe system. Examples of infiltration points of entry are damaged or defective pipe (cracks or holes), weakened or improper pipe joint connections, and cracked or damaged manhole structures. Heavily saturated soil or high water tables significantly increase the potential of infiltration into a collection system.

Inflow is often connected to stormwater surface inputs such as that from around manhole lids and holes in the manhole lids. Often inflow occurs as the result of deliberate connections. Examples of deliberate inflow sources are gutter downspouts, sump pumps, cooling water discharges, yard drains, and catchbasins connected to the sanitary collection system, as well as cross connections between combined sewers and stormwater lines.

Infiltration & Inflow (I&I) is the term used to describe groundwater and stormwater entering into the wastewater collection system. I&I is a major problem because it can overwhelm the existing infrastructure (pipelines and WWTP) with too much water. I&I can significantly reduce the capacity of the wastewater collection system to carry actual wastewater, cause unwanted discharges to the surface or to streams known as Sanitary Sewer Overflows (SSOs), overload a wastewater treatment plant and add to the cost of treating wastewater due to increased volume needing to be treated.

Groundwater is the primary source of water for development within Round Valley. In places, groundwater can be very high within the Valley. Past geologic investigations<sup>3</sup> prior to the construction of the Covelo WWTP indicated that free groundwater occurred at depths ranging from four to eight feet below the ground surface during the summer months around the area of the plant. During the winter time, the groundwater was found to be within a foot or less of the ground surface. However, other parts of the Valley at higher elevations did not have groundwater this close to the surface. (See Important Environmental Constraints, page 42)

#### **Exfiltration**

Exfiltration is essentially the opposite of infiltration. It generally occurs when the groundwater is below the pipe and manholes for the collection system. Or, stated another way, the wastewater surface flow in the pipes is above the elevation of the groundwater. Most factors which can allow I&I are identical to those associated with exfiltration; they both occur through leaks in the piping system. The difference is whether there is a pressure differential between the hydraulic head in the sewer and the groundwater hydraulic head. When the groundwater head is high, infiltration is

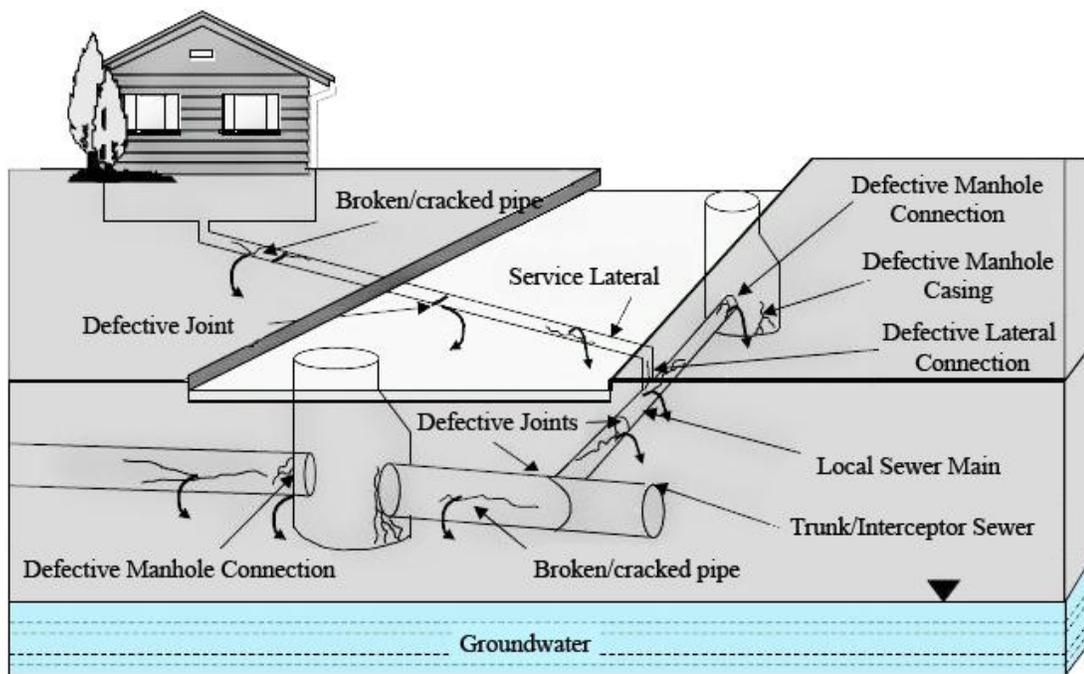
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<sup>3</sup> Leighton and Associates, 1975

the likely outcome. When the groundwater head is low and the hydraulic head in the sewer is high relative to the groundwater, exfiltration is likely to occur.

Factors that contribute to exfiltration include the age and size of the sewer lines, pipe materials and types of joints and the depth of flow in the sewer. Geological conditions that can influence or contribute to exfiltration include groundwater depth, soil type and possible ground movement from faults.

**Figure 5:** The graphic provided below illustrates the groundwater as being below the infrastructure of the collection system thus setting up the conditions for exfiltration. If the reverse were illustrated, that is the groundwater being in line with or above the infrastructure; the conditions for infiltration would then be realized.



**Figure 5—Conditions for Infiltration and Exfiltration**

**Impact of Recent Capital Improvement Projects**

The previously cited SHN Report described aspects of Covelo CSD’s wastewater system that needed improvement. The main deficiency of the sewer collection system as of the date of the SHN Report was inflow and infiltration into the system during the wet season. Since that report, CCSD has installed in excess of 5,000 feet of new sewer lines which represents approximately 25% of the total system. (See Recent Changes to Collection System, page 37)

These newly installed lines will help to substantially reduce I & I into the system. **Table 3** indicates the Average Daily Wet Weather Flow (ADWWF), Average Daily Dry Weather Flow (ADDWF) and the Average Daily Infiltration & Inflow (ADI&IF) for the past six years.

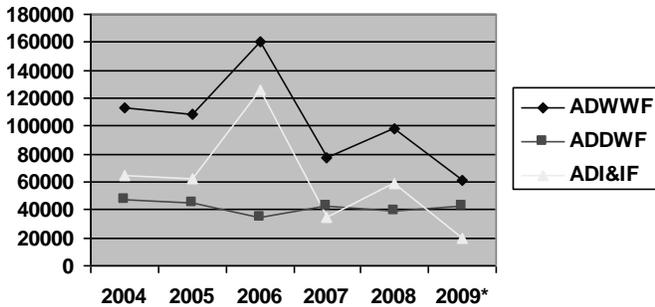
As reflected by the Average Daily I&I, 2006 was a particularly wet year. The following years of 07, 08 and 09 reflect drought years. The 2008 I& I amounts are still high because the construction was not complete until after the wet weather.

**Table 3—I&I Flow Changes**

	<i>ADWWF*</i>	<i>ADDWF*</i>	<i>ADI&amp;IF*</i>
<b>2004</b>	222,604	47,634	64,971
<b>2005</b>	107,910	45,443	62,467
<b>2006</b>	160,814	35,068	125,746
<b>2007</b>	77,214	42,969	34,245
<b>2008</b>	98,424	39,629	58,795
<b>2009**</b>	61,534	42,346	19,187

*\*In gallons \*\*Values through September*

**Figure 6—Changing Flows**



**Figure 6** provides a graphical representation of the above table for the changing flows over the past six years (2009 numbers end in Sept.).

This \$2.3 million dollar pipeline project was funded by a variety of government grants. Mendocino County provided an initial community development block grant to begin repairing the collection system. CCSD then secured a loan from the United States Department of Agriculture (USDA). USDA required CCSD to make several changes including an increase in monthly rates to provide for the loan payments. USDA provided two rounds of funding for \$676,000 and \$692,000. CCSD also secured a \$677,000 loan from USDA.

**Note:** The worst problems of the collection system identified in the SHN Report have been fixed. However, the District recognizes that more needs to be done; plans and funding efforts are being developed. The present District Board and Management are to be commended for its efforts to identify and address problems to the collection system

### **Data Collection and Sewer System Analysis**

In order to analyze a wastewater collection system's problems, data must be collected. The standard approach is to use multiple levels of inspection and investigation. Data obtained can consist of collection system inventory, manhole and pipe inspection information and system hydraulic flow information from flow meters. Close Circuit Television (CCTV) equipment can be utilized to inspect the system in both the wet and dry seasons so as to determine the extent of infiltration and other conditions of the pipe (e.g. sags, intrusions, breaks, blockages, etc.). Smoke testing can also be utilized so as to locate leaking building laterals and other potential sources of deliberate discharge to the system. These inspection efforts can provide knowledge about the effects of rainwater on the system, information about areas with blockage problems (CCTV information), areas with limited or reduced flow and the source of inflow and other extraneous flows. Information gathered for analysis of I&I can provide understanding as to the potential for exfiltration as well.

Once all of the information is collected, it can be stored and analyzed using hydraulic modeling software. The process of collecting and analyzing sewer system information is more efficient if GPS/GIS information is available. The ability to view the results of the hydraulic model and inspection information in a geographic context is not the only reason for using a GIS. The integration of GIS also simplifies the process of entering inventory data and assigning future wastewater flow data. It can also be used to manage the Sewer Management Plan required for all agencies that have more than a mile of pipe.

**Note:** In recent years Covelo CSD staff has expended considerable effort to inspect, investigate and assess the condition of the collection system. Efforts included physical inspection of manhole barrels, benches and covers, smoke testing of laterals and mains and CCTV inspections of the collection system piping. Where possible, repairs were made as appropriate. At this time the District does not utilize GIS for its data gathering and record keeping.

### Section Three: Wastewater Treatment Plant

#### Location and General Description

**Figure 7:** Covelo CSD's Wastewater Treatment Plant is located just outside the District's boundary on the south east corner of the District. It is next to Grist Creek that flows past Covelo in a southeastern direction.

The plant was first constructed in the 1960's, and underwent major construction upgrades as part of the Clean Water Grant Program in 1978-79. The existing facility consists of an influent pump station, headworks, two treatment ponds, two holding ponds, a sand filter, a chlorine disinfection process, and an outfall into Grist Creek<sup>4</sup>.



**Figure 7 - Wastewater Treatment Plant Location**

#### Important Environmental Constraints

A particularly important general issue is that the groundwater water level is much higher under the wastewater treatment plant than in almost all the rest of Round Valley. Tests before the plant was constructed showed free groundwater 4 to 8 feet below the surface during the summer. During winter the groundwater rose to only a foot below the surface. This contrasts to water level fluctuation in the rest of the valley that averages 20 feet in a year.

In general there are two groundwater levels in the general region of the plant. The first - the Covelo Aquifer - extends to a depth of approximately 40 feet. It is easily influenced by surface water and sewage disposal systems.

A "aqualude" between 40 to 60 feet separates and isolates a second groundwater supply - the Round Valley Aquifer. This aquifer receives very little inflow from the surface directly above it; recharge comes from the surrounding hills and terraces. Water quality is good from the lower aquifer. Most well depths in the Valley are in the 100 to 200 feet range.

Coho salmon and steelhead are known to exist in Mill Creek - into which Grist Creek flows. Coho have been observed in Grist Creek itself.

The plant is just outside the 100 year flood zone, but some is within the 500 year zone.

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<sup>4</sup> Covelo Wastewater Treatment Facilities Improvement Project - USDA Amended Preliminary Engineering Report, SHN Consulting Engineers & Geologists, Inc. June 2006. Much of the description of the Wastewater System is derived from this document.

### Treatment Plant Technology

Raw sewage is pumped to a comminutor which unfortunately was no longer operable as of 2006. All sewage bypasses the comminutor through a bar screen. Two oxidation ponds function as semi-mixed, aerobic-anaerobic lagoons. Total surface area of the two ponds is 4.5 acres. The two ponds can accommodate 4.7 and 2.2 million gallons.

Under its NPDES permit the District may discharge into Grist Creek if there is a dilution ratio of 100:1. No discharge is allowed from 5/15 through 9/30 under any circumstances. Holding ponds are designed to store treated effluent subject to these limitations.

Before discharge, treated effluent is filtered through one of four sand filters. Total surface of the filters is 5,330 square feet. Each is used one after the other, after which the rotation is repeated. Then the treated and filtered effluent passes through a disinfection process - a tablet-type chlorination system. Current capacity is 40,000 gallons a day. The existing equipment could be upgraded to double that volume.

### Plant Flows

**Table 4:** The General Manager provided the following information for influent flow to the Plant.

**Table 4 - Influent Flow**

* gallons	2004			2005			2006		
	Peak Daily Flow*	Mean Daily Flow*	Low Daily Flow*	Peak Daily Flow*	Mean Daily Flow*	Low Daily Flow*	Peak Daily Flow*	Mean Daily Flow*	Low Daily Flow*
<b>January</b>	190536	144217	104102	109265	85987	65447	472170	234935	167668
<b>February</b>	416476	182522	104102	104744	84406	64877	333100	170132	107500
<b>March</b>	195259	123086	87391	183157	109118	71877	281672	211114	167936
<b>April</b>	120316	88796	87391	181369	122862	84575	277150	194824	129294
<b>May</b>	98919	64765	53304	146133	100911	74535	128092	95607	66263
<b>June</b>	92760	54478	40801	86460	74916	59880	81216	58271	33042
<b>July</b>	62367	42583	34259	61710	50138	37890	51888	36400	22656
<b>August</b>	67544	46894	34242	45510	37164	27510	39648	31800	25680
<b>September</b>	66592	47237	34804	70920	37214	28710	39564	32365	26377
<b>October</b>	57834	43364	11796	74790	36172	30240	57226	35548	25252
<b>November</b>	75888	51246	38504	53623	37051	30049	66836	35515	30627
<b>December</b>	93406	72241	52330	624700	144173	28312	50648	38779	30976

Comment [FM1]:

*gallons	2007			2008			2009		
	Peak Daily Flow*	Mean Daily Flow*	Low Daily Flow*	Peak Daily Flow*	Mean Daily Flow*	Low Daily Flow*	Peak Daily Flow*	Mean Daily Flow*	Low Daily Flow*
<b>January</b>	75696	49038	21658	270431	127636	77585	44790	40135	30780
<b>February</b>	160882	81588	48070	402000	166013	106106	65256	51786	41333
<b>March</b>	163394	108969	84851	101951	85351	74252	88848	80566	71810
<b>April</b>	98285	82574	68885	84708	75631	63228	77655	67643	44447
<b>May</b>	98285	82574	54392	103758	85334	48904	106956	73460	52290
<b>June</b>	63944	53403	44129	75579	50578	34681	73744	55612	46086
<b>July</b>	62722	41567	33381	60438	42509	34624	100345	47657	35535
<b>August</b>	44690	38376	33828	51636	40864	31104	46219	39214	33499
<b>September</b>	44940	40503	36108	46461	38691	31782	44455	40169	35518
<b>October</b>	56639	43886	35808	47574	37917	34080			
<b>November</b>	45132	40080	30103	40503	37155	33201			
<b>December</b>	91756	64786	41176	60724	40635	15133			

By carefully examining these numbers, one can see the changing inflow through the seasons (highlighted squares) and the impact of wet years (see end of '05 & beginning of '06 highlighted numbers).

It is also possible to see the impact of the three year drought ('07, '08 & '09) on the system. Although the drought is somewhat masking the effect, at the end of '08 and into '09, it possible to see the beginning of the impact on I&I because of the replacement of 5000 feet of leaking lines. The chart and graph on page 46 provides a good graphical representation of the changes in I&I.

**Note:** Peak daily flows are based on metered influent through the collection system; it does not reflect additional influent received via septage haulers. The total monthly influent flow to the system would be the sum from the influent meters plus septage.

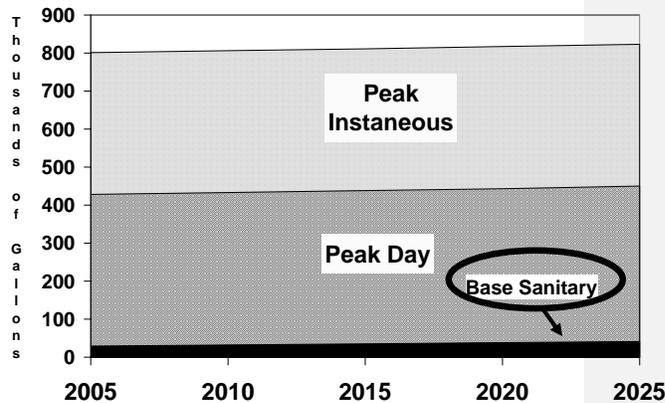
#### Base Sanitary Flow

Base Sanitary Flow is the minimum repeated flow during the driest months. This represents the flow resulting from the use of potable water in the entire system. The Base Infiltration and Inflow is the average amount entering the system during the dry season. The Peak Instantaneous Flow is the highest hourly flow in the year.

**Figure 8** is SHN Engineering's projection of inflow into the Wastewater Treatment Plan through 2025.

The Peak Hour in the year is expected to produce 20 times the inflow than the "Base Sanitary" flow - the minimum consistent daily flow during dry months.

The purpose of this graph is to show that SHN expects very little increase in required capacity over these 20 years. Assuming this is true - which seems reasonable given Covelo's population dynamics - the District faces a very stable and consistent future demand which is a great advantage in planning compared to wastewater systems in high growth areas.



**Figure 8 - Projected Flows**

#### **Sewer System Management Plan (SSMP)**

On May 2, 2006 the State Water Resources Control Board (SWRCB) required that all public wastewater collection system agencies in California with greater than one mile of sewers be regulated under Statewide General Waste Discharge Requirements (WDR). This action applies to Covelo CSD and mandates a Sewer System Management Plan (SSMP) and the reporting of sewer system overflows using an electronic reporting system. The SSMP requirements are similar to requirements by the Regional Water Quality Control Board (RWQCB). The SSMP is required to address the following elements:

1. Goal
2. Organization
3. Legal Authority
4. Operation and Maintenance Program
5. Design and Performance Provisions
6. Overflow Emergency Response Plan
7. Fats, Oils, and Grease (FOG) Control Program
8. System Evaluation and Capacity Assurance Plan
9. Monitoring, Measurement, and Program Modifications
10. SSMP Program Audits
11. Communication Program

A Time Schedule was provided for completion of the SSMP according to the population of the agency. An agency with the population of Covelo CSD was required to complete all sections of the SSMP by August 2, 2010.

Note: General Manager Tim Dennis appears to be the primary developer of the SSMP for Covelo CSD. The General Manager has provided a schedule of his efforts to complete the SSMP by the required date. Based on that schedule it appears that Covelo's SSMP will be completed by July of 2010. Given the demands of his management and operations duties, it is commendable that he is willing to complete this additional task.

### **Wastewater Treatment Plant Deficiencies**

In its 2006 report, SHN Engineers listed a number of plant deficiencies:

- Grit, rocks, rags and other damaging materials were not effectively removed from the effluent flow. Equipment is damaged and ponds fill up with these materials requiring significant dredging.
- Headworks and pretreatment processes were significantly problematic. The headworks structure was much too small to allow proper maintenance of equipment. The comminutor was outdated, doesn't work, and needed replacement. New equipment to remove more of the damaging materials entering the system was needed.
- The septage receiving system at that time relied on self-monitoring of septage haulers regarding quantity, pH, etc. SHN recommended an automated septage receiving system be installed.
- The two oxidation ponds suffer from varying degrees of seepage through their walls caused by rodents, roots, etc. At the time of the report groundwater tests were still being conducted to determine if the seepage through the pond bottoms was significantly affecting groundwater quality.
- Both holding ponds typically dry out during hot summer months, when practically all the treated effluent is evaporated from the oxidation ponds. This has caused the bentonite linings to crack and leak. When the ponds receive treated effluent it leaks uncontrollably into the groundwater. Attempts to keep the bottoms of the ponds moist during the hot months have not been effective because of an inadequate supply of well water and the inability to apply the water evenly across the surface.
- In recent years evaporation and seepage from the oxidation and holding ponds has all but eliminated the need to discharge treated effluent into Grist Creek. As a result the final filtering and disinfection systems have not been used in many years. This has led to significant problems with the pumping, filtering and disinfection systems.

**Note:** Via response to the Administrative Draft, the General Manager has indicated that: (1) It is not necessary to distribute water evenly in the holding ponds and; (2) There is nothing wrong with the pumping system stating, "I can use the effluent pumps, sandbed and disinfection system. They still work."

### **Significant Public Health Risks - Sewer Collection System**

As noted in the SHN report, number of significant public health threats are caused by the District's sewer system.

- Elementary School - raw sewage has overflowed out of the system in front of the school for 30 years.
- Overflow in Other Locations - At least two other locations had occasional overflows out of the system into streets.
- Back up into Homes - homes in two areas of the District occasionally had sewage backing up flowing into their yards.

These problems mostly happen during storms. SHN states that both capital improvements to the system and upgraded maintenance practices are needed to correct these problems.

### **Treatment and Effluent Disposal Issues**

The majority of effluent disposal occurs through percolation into the groundwater beneath the holding ponds, which is in violation of the District's existing NPDES permit<sup>5</sup>. The uncontrolled percolation that is occurring at present does not adequately protect the quality of groundwater underlying the plant area<sup>6</sup>.

### **Future Capital Improvement Projects**

As discussed in the Wastewater Collection System section, CCSD has been busy in recent years correcting numerous problems with their collection system. The remaining system problems noted above create significant constraints on the ability of staff to properly maintain the system. The "solutions" to the indicated problems are mostly investment in upgraded facilities; the difficulty is in obtaining sufficient funds for the "solutions".

**Note:** Via email in July the District Manager indicated the following:

*"The Covelo Community Services District Wastewater Treatment Plant Improvement Project has been approved by the Regional Water Quality Control Board, awarded and construction began on May 18, 2010. It has been funded by the American Recovery and Reinvestment Act of 2009, Proposition 50 funds and by the United States Department of Agriculture Rural Assistance Program. The Project was designed and managed by SHN Consulting Engineers and Geologists, Inc. The Project was awarded to Meyers Earthworks, Inc.*

*The Project consists of lining three ponds, installation of a grit channel and spiral trash screen, an ozone disinfection system, a septage receiving station, wetlands and a percolation pond. The Project is anticipated to be complete by December 4, 2010."*

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<sup>5</sup> SHN Report, p 28

<sup>6</sup> SHN Report, p 29

**COVELO CSD SOI/MSR REPORT****Chapter Five: Financial Analysis****Overview**

When conducting a Municipal Service Review, LAFCO is required by Government Code Section 56430 to provide a review of the “*financial ability of an agency to provide the services*” that they are authorized to provide. This Chapter is meant to address that part of the mandated review.

Section One provides a review and analysis of Covelo’s Financial Statements.

Section Two provides information that allows the reader to compare Covelo CSD to similar sized wastewater districts within California.

Section Three provides some context for key national issues as they may apply to Covelo CSD.

**Data Sources**

Two main data sources were used for this review:

1. Covelo’s audited financial statements for 2004 through 2008.
2. Data for Covelo and several thousand other Special Districts from the State Controllers Office for 2003 through 2006.

**Differences Between Data Source**

There were some significant differences between Covelo’s audited statements and the values the district reported to the State Controller’s Office for the 3 years overlap - 2004 - 2006. This review uses audited statements rather than the SCO data. However, the values shouldn’t vary as much as they do.

**Note:** At the end of this Chapter is an attachment titled Data Differences – Audited Statement of Changes in Net Assets v SCO Special Districts Annual Report that shows the differences

**Financial Information Summary**

On the following page is a summary of the income and operating expenses for Covelo CSD for Fiscal Years 2004 through 2008; following that is a review and explanation of the information in the Statement.

<b>Section One: Covelo Financial Statement Analysis</b>
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**Statement of Changes in Net Assets (Income Statement)**

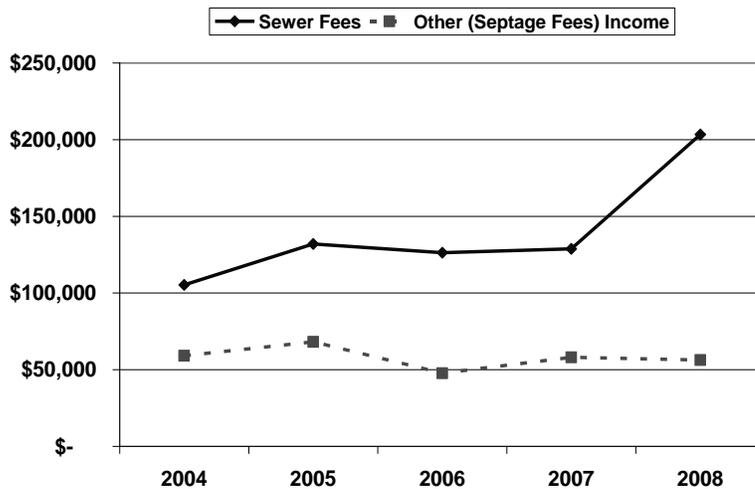
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
<b>Operating Income</b>					
Sewer Fees	105,271	131,910	126,236	128,791	203,337
Other Operating Income	59,116	68,108	47,660	58,012	56,227
	<u>164,387</u>	<u>200,018</u>	<u>173,896</u>	<u>186,803</u>	<u>259,564</u>
<b>Operating Expenses</b>					
Salaries	92,617	94,832	79,297	85,783	94,358
Casual Labor	1,468	423	141	869	170
Employee Benefits	926	2,631	508	9,586	12,022
Payroll Taxes	10,317	13,717	6,426	9,950	7,355
Vehicle Expense .	1,747	3,967	2,980	2,492	3,327
Insurance	6,827	7,329	7,043	8,834	4,923
Supplies	5,223	10,581	10,240	12,932	7,056
Contract Services	1,462	4,420	502	7,475	3,237
Professional Services	3,607	5,722	5,263	6,621	6,508
Travel	1,934	166	742	409	0
Licenses and Fees	2,694	2,565	5,865	4,637	5,940
Maintenance	5,856	919	124	1,928	1,922
Monitoring and Tests	4,469	1,460	8,191	8,546	6,006
Utilities and Telephone	6,531	6,833	8,207	8,342	8,730
Office Expense	1,012	876	535	1,473	3,357
Other	6,005	2,209	1,835	2,327	2,917
Total Operating Expenses	<u>152,695</u>	<u>158,650</u>	<u>137,899</u>	<u>172,204</u>	<u>167,828</u>
<b>Net (Loss)</b>	<u>11,692</u>	<u>41,368</u>	<u>35,997</u>	<u>14,599</u>	<u>91,736</u>
<b>NonOperating</b>					
Interest Income	350	351	572	739	671
Loan Fees			(1,255)		
Total NonOperating	<u>350</u>	<u>351</u>	<u>(683)</u>	<u>739</u>	<u>671</u>
<b>Earnings Before Interest, Depre. Amort.</b>	12,042	41,719	35,314	15,338	92,407
Interest Expense			1,463	5,893	16,998
Depreciation	24,396	25,593	23,090	25,018	25,226
	<u>24,396</u>	<u>25,593</u>	<u>24,553</u>	<u>30,911</u>	<u>42,224</u>
<b>Annual Net Earnings (Loss)</b>	<u>(12,354)</u>	<u>16,126</u>	<u>10,761</u>	<u>(15,573)</u>	<u>50,183</u>
Grants/Capital Contributions	59,678	21,570	0		1,510,432
Prior Period Adjustment	4,727				
Extraordinary Items	<u>64,405</u>	<u>21,570</u>	<u>0</u>	<u>0</u>	<u>1,510,432</u>
<b>Net Income (Loss)</b>	<u>52,051</u>	<u>37,696</u>	<u>10,761</u>	<u>(15,573)</u>	<u>1,560,615</u>

### Fees for Services

Some special districts receive property taxes for the services they provide, e.g. a fire district. Other districts are funded through the provision of services for a fee. Water and Wastewater districts are commonly of this type. Fee-for-services districts are also known as “enterprise” districts. Covelo CSD is a fee-for-service agency.

The District reports two categories of Operating Income on its Income Statement: (1) Sewer fees and (2) Other Operating Income. In the Management’s discussion in the audited financial statements two types of Operating Income are discussed: (1) User Fees (sewer fees) and; (2) Septage Haulers Fees received from septage haulers that pay the District to accept, process and dispose of material pumped from septic tanks.

The reports don’t explicitly tie the two types of Operating Income discussed by management to the two types reported in the statements. Further it doesn’t explicitly say there are no “other” types of “other operating income” besides septage hauler fees. This Report assumes that “Sewer Fees” are the fees paid by district residents who receive sewage services from the District, and “Other Operating Income” is the sum of fees paid by septage haulers.



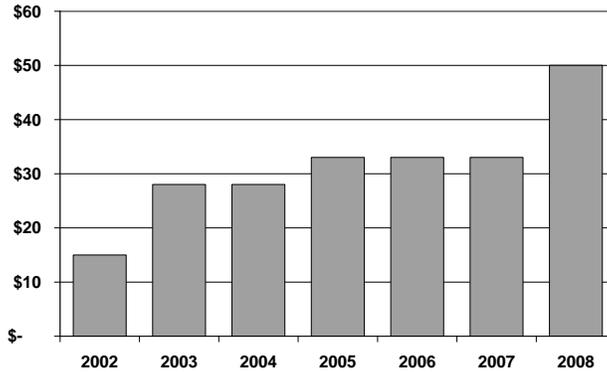
**Figure 9 - Covelo CSD Operating Income**

As illustrated by **Figure 9** and as you can see from the Statement of Changes in Net Assets on page 48, Sewer Income increased 25% in 2005, remained essentially flat for the next two years and then increased 58% in 2008. Other Income (Septage Fees) was less variable.

**Increase in Fees**

The district has substantially increased the fees charged to district residents for monthly sewage disposal services.

**Figure 10:** In 2002 the Residential Equivalent Unit (REU) monthly rate was \$15. It is now \$50 - over 3 times greater in 6 years. An REU is an amount of effluent assumed to be generated by a standard single family dwelling.



**Figure 10 - Monthly Sewer Fees - REU**

All other types of locations (auditoriums, retailers, clinics, etc.) are assigned a number of REUs. For example, elementary schools may be assigned 0.025 REUs per pupil. Or, a mobile home with 2 bedrooms may be assumed to be 0.667 REU.

**Table 5 - Change in Sewer Revenue & Rates**

	2005	2006	2007	2008
Sewer Fee Revenue	25%	-4%	2%	58%
Sewer Rates	18%	0%	0%	52%

**Table 5** shows the yearly percentage change in total sewer fee revenue and sewer rates. This comparison strongly suggests most of the increase in total sewer fee revenue results from increases in the rates.

**Septage Hauler Fees**

District management makes two points in every audited statement regarding this income:

- Income from septage haulers is high risk income.
- This income provides very significant “subsidies” to those who pay regular sewer fees.

Assuming the district incurs very low “marginal” or additional expenses in earning this income, it does appear septage hauler fees are very important contributors to the district’s ability to exceed the break even point.

**Table 6 - Other Income (Septage) Impact on Net Margin**

	Dollars			Percent			Net Margin Before Extraordinary	
	Sewer Fees	Other	Annual Income	Sewer Fees	Other	Annual Income	Dollars	Percent of Annual Income
2004	105,271	59,116	164,387	64%	36%	100%	(12,354)	-8%
2005	131,910	68,108	200,018	66%	34%	100%	16,126	8%
2006	126,236	47,660	173,896	73%	27%	100%	10,761	6%
2007	128,791	58,012	186,803	69%	31%	100%	(15,573)	-8%
2008	203,337	56,227	259,564	78%	22%	100%	50,183	19%

**Table 6** shows the two components of annual operating income for the past five years in both dollars and as percentages of operating income. The district’s non-operating income is negligible and therefore, as a practical matter, has no affect on the district’s annual net margin. It also shows the district’s annual net margin before extraordinary items. Extraordinary items would be non-recurring items such as income from a sale of building, a one-time grant or prior year adjustments.

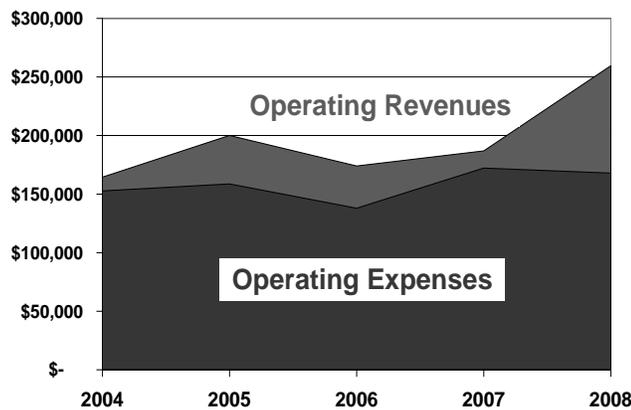
The “Other Operating Income” has provided from 36% to 22% of total operating income over these years. The percentage has declined over the period as sewer fees increased. The net margin was negative in two years and positive in three, varying from -8% to 19%.

**Note:** It appears that the septage hauler fee income is very important to the district’s ability to generate the margins necessary to service its debt and provide for appropriate operating and infrastructure reserves

Operating Expenses

**Figure 11** shows operating revenues and expenses. While operating revenues grew from about \$165,000 to nearly \$260,000, expenses remained almost flat - about \$153,000 to about \$168,000. This has allowed the operating margin to grow from about \$12,000 to about \$92,000.

Staff expenses (salaries, casual labor, benefits, payroll taxes) are the largest operating expense. They consume about 2/3 of operating revenue.



**Figure 11 - Operating Revenues & Expenses**

**Summary Balance Sheet:****Table 7 - Summary Statement of Net Assets (Balance Sheet)**

	Years Ending				
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
<b>ASSETS</b>					
Current Assets	67,788	91,511	137,675	93,663	389,631
Property, Plant and Equipment, Net	468,431	475,332	540,636	557,372	2,651,036
Other Assets - Restricted Cash	0	0	0	30,045	30,241
Total Assets	536,219	566,843	678,311	681,080	3,070,908
<b>LIABILITIES AND NET ASSETS</b>					
Current Liabilities	4,977	9,905	34,623	9,151	287,867
Long Term Liabilities	0	0	75,989	119,803	670,300
Other Liabilities	12,000	0	0	0	0
Total Liabilities	16,977	9,905	110,612	128,954	958,167
<b>NET ASSETS</b>					
Invested in Capital Assets, Net of Related Debt	468,431	475,332	464,646	437,569	1,974,037
Restricted - Maintenance and Capital Improvements	0	0	0	30,045	30,240
Unrestricted	50,811	81,606	103,053	84,512	108,464
Total Net Assets	519,242	556,938	567,699	552,126	2,112,741

Section Two of this Chapter provides a review and comparison to Covelo CSD of similar sized wastewater districts in California. Covelo appears to have one of the lowest levels of financial liquidity among its peers. However, in most industries its liquidity as measured by the current ratio and working capital turnover would be considered comfortable. The classic indications of a lack of financial liquidity include pressure to stretch payments, pressure to collect receivables, deferral of necessary expenditures, etc. (See Section Two this Chapter)

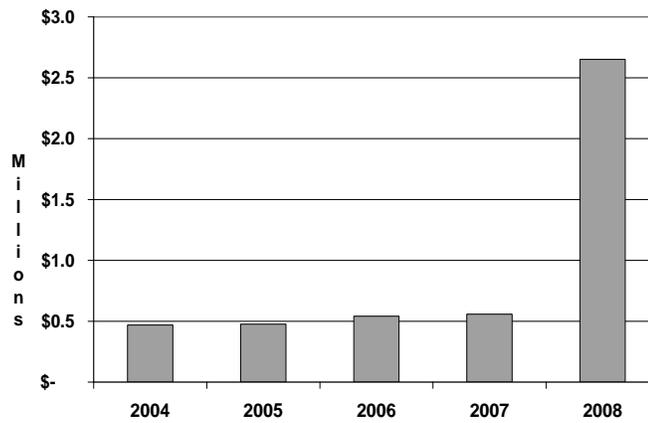
The district changed its policy regarding delinquent accounts receivable during fiscal year 2005-06. The Statement of Net Assets for the two previous years (03/04 and 04/05) reported accounts receivable as the net of total receivables less an allowance for doubtful accounts. In August 2005 the district entered into an agreement with the County of Mendocino for the County to place delinquent accounts receivable as billings on property tax statements, and to place liens against parcels in the case of severe delinquencies. The value of the district's accounts receivable reported for fiscal year 2005-06 and after is the total value; there is no allowance for doubtful accounts deducted.

**Accounts Receivable**

The balance of accounts receivable reported on the Statement of Net Assets varied from \$20,000 to \$30,000 for the first four years of this period, then jumped to nearly \$54,000 in fiscal year 2007-08. There is no explanation in the reports regarding this relatively significant jump in receivables. Although it doesn't necessarily indicate a problem with collection of receivables, it begs the question.

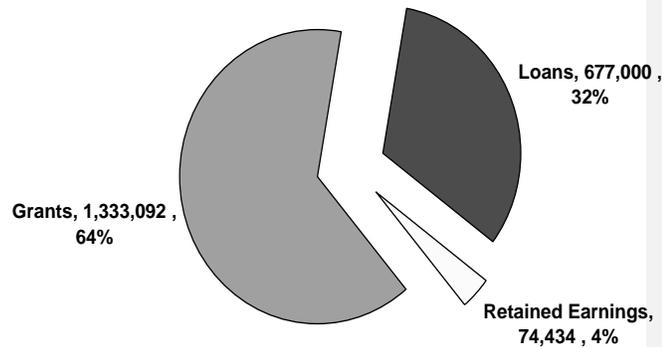
As discussed previously the district began a significant infrastructure improvement program during these years that greatly increased its fixed assets. As **Figure 12** shows the increase in fixed assets was about \$2 million.

As seen in **Figure 13** the district financed these fixed assets primarily with a mix of debt and grants. Retained Earnings played a very minor role, and the district apparently had not established restricted reserves in the past to fund future capital projects.



**Figure 12 - Fixed Assets Net of Depreciation**

Two-thirds of the capital investment projects were financed with state and federal grants. About one-third was financed with long-term debt. It appears less than 5% of the project was funded out of the district's net earnings, and that amount was obtained during the years in which the capital project was being executed.



**Figure 13 - Fixed Asset Financing**

Accounts Payable

There doesn't appear to be a problem with paying accounts payable. At the end of the last fiscal year (07/08) a very large payable of about \$266,000 was considerably larger than the general range in the four previous years (\$2,000 to \$30,000). However, most of that balance appears to have been accrued construction costs that had not yet been paid because the district was waiting to receive around \$260,000 from one of the grants it had secured. Once that amount was received and paid out the payables balance would decline to its normal levels.

## Section Two: Wastewater Special Districts in California

### Overview

The State Controllers Office (SCO) annually reports data for nearly 5,000 districts of various types. About half of these districts are subject to LAFCO jurisdiction and review. Over the past few years, SCO has reported data for about 600 districts that provided “waste management” (defined as wastewater and solid waste) services. Of these 600 districts, 420 are subject to LAFCO jurisdiction. Over 90% of those LAFCO districts have more financial activity in their wastewater services than solid waste. Only 2% provide only solid waste services, and 6% had more activity in their solid waste services than in wastewater.

This section presents a brief view of wastewater special districts as reported in California State Controllers Office (SCO) reports. It then establishes a set of Agencies for Industry Analysis. The purposes of identifying a set of California wastewater districts for analysis are:

- To identify financial trends and patterns within the industry
- To place Covelo within a larger industrial context
- To compare Covelo to comparable districts

The following criteria were used to establish a set of water districts for analysis and comparison:

- 2006 year data for comparable districts
- Under LAFCO jurisdiction
- Total Revenue between \$100,000 and \$500,000
- Only provide wastewater services
- Exclude districts with unexplained volatile Income Statements

All but the last criteria were easily executed through simple selection criteria in the database. The last criteria required individual analysis of specific districts that showed volatility to make sure the volatility could not be associated with recurring operational factors. Twenty-two districts satisfied these criteria other than Covelo.

### Number of Activities

SCO defines 30 different “activities” or services that special districts provide. Among LAFCO-jurisdiction districts 85% provide just one service, 11% provide 2, and 4% provide 3 or more. Of the 420 LAFCO-jurisdiction districts that provide wastewater services, 45% provide only that service, 26% provide 2 services, 11% provide 3, and 8% provide 4 or more.

Over half of all LAFCO-jurisdiction districts that provide wastewater services provide other services as well. Forty five percent provide both water and wastewater. Drinking water and wastewater are by far the most common “pairing” of services among these types of districts.

**Table 8 - Total Revenues of LAFCO-Subject Wastewater Districts by Revenue Range**

Revenue Range	Number Districts	Wastewater Enterprise	All Other Activities	Total Revenue
Over \$100 million	6	\$697,883,136	\$669,336,624	\$1,367,219,760
\$50 million - \$100 million	17	655,341,597	545,752,947	1,201,094,544
\$10 million - \$50 million	68	953,514,934	566,912,711	1,520,427,645
\$5 million - \$10 million	39	222,597,863	68,064,417	290,662,280
\$1 million - \$5 million	108	175,401,391	95,996,803	271,398,194
\$500K - 11 million	59	27,311,785	14,330,475	41,642,260
\$100K - \$500K (Covelo)	89	15,084,872	8,826,679	23,911,551
Less Than \$100,000	32	1,219,444	510,869	1,730,313
<b>TOTAL</b>	<b>418</b>	<b>\$2,748,355,022</b>	<b>\$1,969,731,525</b>	<b>\$4,718,086,547</b>

Covelo CSD provides only wastewater services. Its total recurring annual revenue (operations and non-operational) grew from about \$165,000 in 2004 to \$260,000 in 2008. Therefore, Covelo is one of the 89 districts in the \$100K - \$500k revenue range group.

**Table 9 - Comparable Wastewater Districts - 2006 Total Revenue**

Almonte Sanitary District	317,805	Julian County Sanitation District	256,587
Alto Sanitary District	194,206	Lone Pine Community Services District	150,303
Burlingame Hills Sewer Maintenance Dist.	336,350	Newcastle Sanitary District	224,699
Byron Sanitary District	195,466	Northeast Willows CSD	113,072
Country Club Sanitary District	413,658	Occidental County Sanitation District	261,616
Davenport County Sanitation District	388,378	Rossmoor/Los Alamitos Area Sewer District	375,059
Devonshire County Sanitation District	156,287	Salsipuedes Sanitary District	136,985
Empire Sanitary District	204,052	Saticoy Sanitary District	342,948
Grayson Community Services District	108,758	Sunol Sanitary District	128,050
Happy Camp Sanitary District	176,324	Terra Bella Sewer Maintenance District	169,874
Homestead Valley Sanitary District	434,020	Woodbridge Sanitary District	364,748

For this Report, Covelo's values for all 5 years (2004 - 2008) as reported in its audited financial statements were compared to 2006 results for these districts.

### **Natural Monopolies and Economy of Scale**

Community Wastewater Systems are natural monopolies. A “natural monopoly” by the nature of its “product” must be the single supplier to its market. The cost of laying down infrastructure precludes having more than one wastewater service supplier in a given area.

Natural monopolies have far more dependable revenue streams than for profit businesses that face market competition. They have “captive markets”; customers either pay their bills or do without. Natural monopolies don’t face market competition; they are either regulated by or are organized as governments. Because their operational finances are highly predictable and are likely to be “profitable”, the political pressure to maintain “reasonable” rates is likely to be more focused and intense. Therefore, “price resistance” takes the form of political pressure rather than “taking your business elsewhere”.

“Economy of Scale” is one of the most powerful economic forces across almost all forms of economic activity. The classic definition is that as production volume increases production cost of an individual unit declines. Many factors enter into this result. Larger organizations can afford more costly but much more efficient technology. They buy inputs at lower costs because of high volume purchasing. They have more customers over which they can spread their fixed costs.

Wastewater treatment tends to involve large fixed-costs, so wastewater systems typically exhibit economies of scale as their service population increases. Thus, the unit cost of providing wastewater treatment varies according to system size. The typical wastewater system has a substantial investment in fixed assets, including collection system, WWTP and treated water storage. Because the fixed cost of the system is spread over larger volumes, the average cost per unit volume drops as the overall volume increases.

Larger systems, therefore, face lower average costs than smaller systems and have lower costs per connection and per wastewater treated. Because of economies of scale, system size is a key factor in explaining financial performance. In addition to their greater production, larger systems also have larger rate bases and more technical and support staff; larger systems have more “eyeballs” looking at their operations. Therefore, larger systems generally perform better financially than small systems because of this they have more operational financial stability. This has implications for the system’s financial well being and for its managerial and technical capacity.

Another economy of scale dynamic often missed is that larger organizations are able to “cover all the bases” whereas smaller organizations typically can’t have skilled people performing every necessary task. In many important respects large and small economic organizations in the same line of “business” must perform the same tasks. But larger organizations can afford to “break those tasks apart” and employ trained specialists to accomplish them.

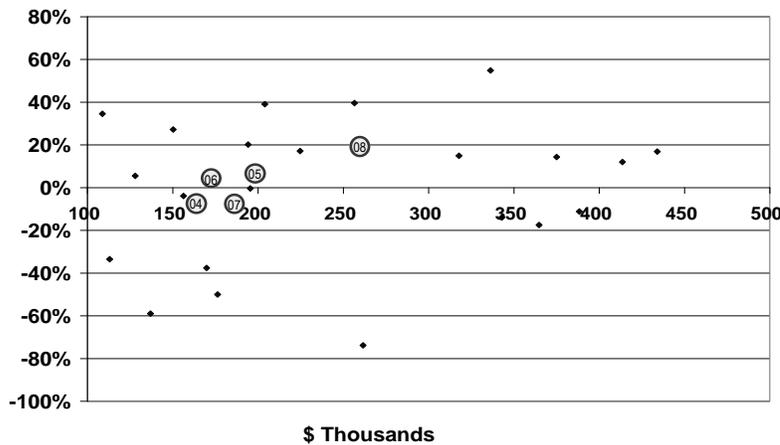
People in smaller organizations have to “wear more hats”. They may have expertise in one or more of their tasks, but are often assigned additional tasks in which they have far less expertise. Smaller organizations usually can’t afford to do everything well; they simply don’t have enough resources. Size matters here also. Larger water and wastewater systems enjoy greater economies of scale and have far more operational financial stability.

Over the long term larger economic organizations show more stability in their “bottom lines” (operating ratio, profit margin, net margin, etc.) than do smaller organizations. Small problems that would disappear into a larger organization’s revenues can whipsaw smaller organizations. As an analogy, aircraft carriers plow through huge storms whereas smaller squalls sink sailboats. All these factors - economies of scale, stability of operational finances, and the nature of political pressure on “profits” - create the pattern we see in Figure 13.

**Annual Yearly Margins**

**Figure14** shows “Earnings before Extraordinary Items and Prior Year Adjustments (Net Yearly Operating Margin). This includes all regular yearly recurring items - operating and non-operating revenues and expenses, interest expense, and depreciation and amortization. Because these items are not part of the organization’s ongoing operations for the year, it does not include “Extraordinary Items” (significant non-recurring and usually non-operational financials such as payments resulting from lawsuits, sale of capital items such as buildings, etc.) and “Prior Year Adjustments” (amounts that have to be entered into this year’s ledgers in order to correct the financial results of earlier years).

The 5 circles with numbers are Covelo’s results for 2004 through 2008.



**Figure 14 - Net Yearly Operating Margin**

If this graph had been produced for a broader revenue range we would see there is a strong economy of scale in wastewater districts. As wastewater operations grow larger two things happen. First, a higher proportion has positive margins. Second, the range of results narrows. Covelo’s first four years were closely clustered together from \$165,000 to \$200,000 total regular annual revenue. There were two years positive margins and two years of negative margins from -7% to 8%. In 2008, Covelo “jumped” significantly in income to about \$260K and in margin to 19%.

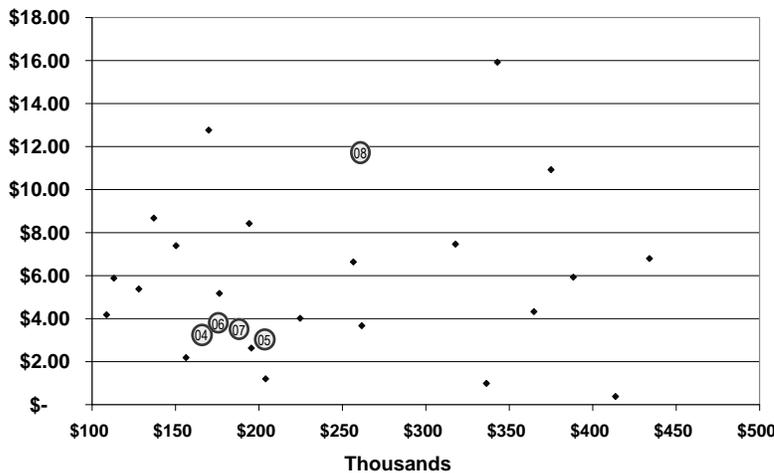
**Asset Efficiency/Intensity**

An asset is a resource owned by an entity that will provide future economic benefits. There are several ways to classify and analyze assets. There are a number of financial ratios that measure the relationship between assets and revenues. We use Assets per Dollar of Revenue

By dividing Total Assets by Total Revenue, we answer the question “how many dollars of assets are vested in the organization for every dollar of annual revenue”. It’s a measure of “asset efficiency”. There are typically one or more optimal configurations of assets for industries across the revenue spectrum. Often a “most efficient” level of revenues and configuration of assets are found at those levels. The “best” performing organizations in an industry tend to exhibit very similar key financial characteristics including the total value of assets employed.

In general, the more assets in an organization, the higher the “capital cost”. If assets are financed with debt, interest expense is incurred. If financed through investment or retained earnings, “opportunity cost” is incurred. And more tangible assets usually mean more maintenance expenses.

If fewer assets could properly support the same level of revenue, those “excess” assets might be used more productively elsewhere, including being returned to “owners”. On the other hand, “under-capitalized” organizations suffer from not having enough assets to operate properly. Equipment tends to be inefficient; systems are “cobbled” together.



**Figure 15 - Assets Per Dollar of Total Revenue**

**Figure 15** shows the range of values for the comparison set of districts and values for 5 years from Covelo. Covelo’s values once again cluster together for the first four years then “jump” in the fifth.

The value of a district’s assets can vary from the group average for a number of reasons that are not related to fundamental efficiency. Most major wastewater assets are very long-lived. Many wastewater districts haven’t had to make significant investments in infrastructure for decades. Therefore much of its assets will have been purchased decades ago for much less money than they would be today. Further, their values will be written down considerably through depreciation. This explains both Covelo’s “leap” and also the fact that its asset to revenue ratio for 2008 was significantly higher than most. Covelo has recently undertaken a relatively significant upgrade of its infrastructure and these new un-depreciated assets coming into the district greatly increased its assets relative to revenues.

**Liquidity**

Current Assets are expected to “turn into cash” within one year. Cash obviously is a current asset. Usually accounts receivable are current. Most inventory is a current asset unless some part of it isn’t expected to be sold or used to produce a saleable product within a year. Organizations fund their regular ongoing operations with current assets.

Fixed Assets have a useful life of more than one year and therefore their value endures for more than one year. These include “tangible” fixed assets such as land, buildings, and equipment and “intangible” long-lived assets such as patents, copyrights, “goodwill”, etc. The cost of obtaining fixed assets is usually slowly “written” off through “depreciation” or “amortization” over their useful lives,. Some fixed assets, such as land, are not expensed - their value is considered to be of extremely long duration. Organizations typically use fixed assets to support the production of their goods and services over long periods of time, or as a way to “store value”.

Liquidity is the ability to make payments as they come due. It is a “short-term” financial concern - the time frame is typically one year. Liquidity contrasts current assets with short-term liabilities. There are several measurements of liquidity; reviewed here are (1) Current Ratios and (2) Working Capital Turnover.

**Current Ratio**

The “Current Ratio” is Current Assets divided by Short Term Debt, and is a key measurement of liquidity. It answers the question “For every dollar of debt that must be paid within the next 12 months, how many dollars of assets are there that will ‘turn into cash’ and therefore be available to make those payments during that time?” A high Current Ratio indicates that there is a high “liquidity”; that is “cash” is available to pay bills (Short Term Debt). A low Current Ratio is an indicator that the agency may be “illiquid”; that it is struggling to pay its bills.

**Table 10:** Covelo’s values for the five years reviewed are:

**Table 10 - Covelo CSD Current Ratios**

2004	13.62
2005	9.24
2006	3.98
2007	10.24
2008	1.35
2008*	4.70

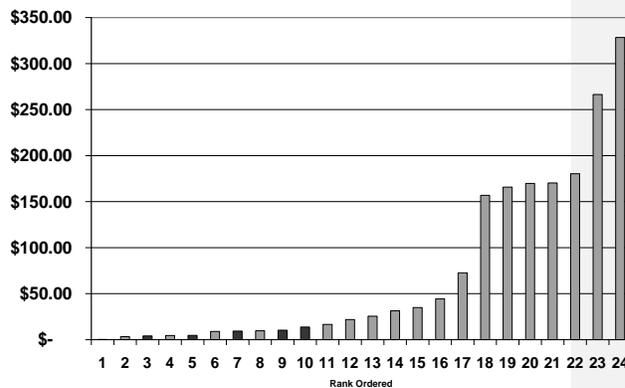
The 2008\* adjusted value is the current ratio that results from pulling the amount of the grant receivable out of both current assets and short term liabilities.

The “proper” value for a current ratio varies from industry to industry. Pure service industries have very small physical inventories of salable products, if any. They can operate with much lower current ratios than industries that produce long-lived physical assets, such as water or wastewater agencies. Most of these numbers would be considered quite adequate in nearly all American private sector industries. The 2008 value of \$1.35 for Covelo would be very worrisome except that it appears it was created by one of those anomalies that can occur right at the end of a fiscal year. In this case there was a \$260K “grant receivable” in current assets. Short term debt was below \$10K in 3 of the previous 4 years and was slightly less than \$30K in one year. In contrast, it was \$266K at the end of fiscal year 2008.

Covelo was engaged in a relatively major infrastructure investment program during 2008. The similarity of the two values (\$260K and \$266K) suggest that the district owed about \$260K in construction costs that were about to be funded by receipt of a portion of grant funds. Therefore, not only was that an extraordinary year end occurrence, but it also was not involved with the normal operations of the district.

**Figure 16** shows the current ratio for most of the districts used for analysis; it excludes 2 districts that had no current ratio because they had no short-term debt. It also excludes a district that had a current ratio of \$3,992.69!

Covelo’s ratios are the dark bars at the lower end of the spectrum.



**Figure 16 - Current Ratios**

These are an astonishing range of Current Ratios compared to private industries. For companies over most of this revenue range, ratios at the upper end of this graph would very rarely if ever appear in the for-profit private sector. Owners and management would look for more productive uses for that “excess liquidity”, which could include disbursing it to owners.

At first glance these relatively high current ratios are even more perplexing since wastewater systems don’t hold large inventories of salable products. There are two major possible explanations (other than some very temporary fluke that occurred precisely at the end of a fiscal year). One: From an economic point of view, these extremely high Current Ratio values could very well mean that significant liquid assets are not being used productively. A serious discussion about whether or not such a district’s revenues are “excessive” could be in order given the general mandates of a public “natural monopoly” to operate with no more than an “adequate” operating margin.

Two: However, such a very high current ratio could reflect large reserves for a major capital acquisition projects. Wastewater systems face huge required infrastructure investment in the next 30 years as a major portion of the nation's wastewater infrastructure reaches the end of its useful lifetime. A high current ratio could result from excellent capital improvement plans building up large reserves.

Seven of the other districts had "restricted retained earnings" on their Statements of Net Assets. These are probably reserves for capital projects. During the last two years Covelo had a small restricted retained earnings balance as well - about \$30K each year. But of the 14 districts with ratios above \$20.00 only 5 had restricted retained earnings. For those 5 there appears to be a clear connection between the cash or short term investment values and the restricted retained earnings. But the other 9 districts had not established restricted retained earnings, or restricted reserves.

**Note:** Compared to other agencies, Covelo has a very low Current Ratio indicating a lack of liquidity. The symptoms of a lack of liquidity include the need for hurried collections of receivables to get enough money to pay bills, occasional late payroll, putting off reasonable expenditures for supplies, etc.

### Working Capital Turnover

Working Capital = Current Assets - Short Term Liabilities.

Working Capital is directly related to the Current Ratio, but instead of the ratio of current assets to short term debt, it's the amount that current assets exceed short term debt. In rough terms, it is the amount of current assets that can be spent without compromising the ability to pay short term debt. An organization's Working Capital funds day to day operations - payment of operating expenses, purchases of operating supplies, etc.

Working Capital Turnover measures the "velocity" of Working Capital. That is, how fast current assets move through the "Working Capital Cycle". Instead of a "static" measure such as the current ratio or the value of working capital, it is a "dynamic" measure. The working capital cycle starts when cash buys supplies, pays expenses, buys inventory, pays the short term portion of long term debt, etc. Working capital funds the production of goods or services. Those are purchased by customers and turn into accounts receivable, that when paid turns into cash again.

There are several ways to measure Working Capital Turnover. One is to calculate how many years it takes to turn over Working Capital - that is, to complete one Working Capital cycle.  
 Working Capital Turnover per Year = Total Revenue/ Working Capital

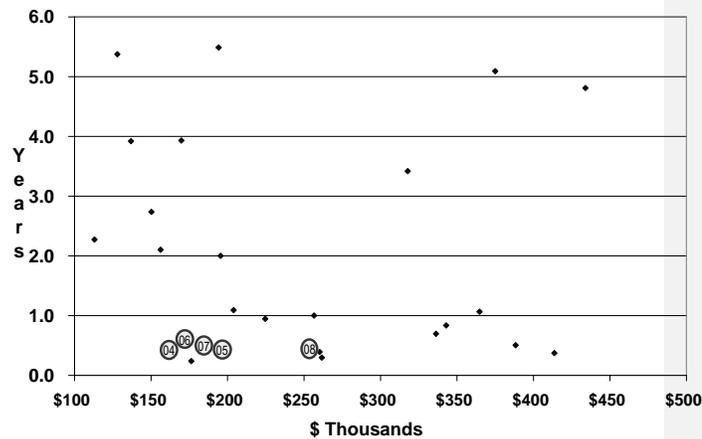
The range of Working Capital Turns per Year varies widely across industries. Service industries and those that typically move through inventories quickly turn Working Capital over as many as 12 times a year and even more. At the other range are industries that have relatively slow moving inventories. They may only turn their Working Capital over twice a year. Occasionally private sector for profit industries may exhibit Working Capital turnover of more than a year.

Once again, the interpretation of financial ratios requires judgment and caution. Is a very fast working capital turnover good or bad? What about a very slow turnover? The general financial thinking is that each firm and generally speaking industries as well, have an “optimal” turnover. If an organization’s turnover is somewhat faster than the industry average and the other benchmarks, especially net yearly operating margin, are “solid”, the general rule would be to think that organization has learned how to use Working Capital more efficiently. This would tend to reduce “capital costs” and release assets that would have been committed to Working Capital to be used for other productive purposes. This would be a “good” thing.

However, if it is significantly faster, then the organization probably doesn’t have enough working capital and its liquidity (ability to make payments when necessary) is probably weak and puts the organization at great risk of default. This is a “bad” thing. On the other side, if turnover is much longer than average, it probably is not using its assets efficiently and may well be incurring unnecessary “capital costs”. This also is a “bad” thing.

This liquidity ratio has a relatively huge range among these wastewater districts compared to most American industries.

About half the values including the five years for Covelo- (circled numbers in **Figure 17**) are below one working capital turnover per year and half above.



**Figure 17 - Working Capital Turnover Number of Years**

In terms of districts - counting Covelo as 1 - half the districts have working capital turnover periods of more than 2 years. Once again much of this can be explained by districts building up reserves for future infrastructure expenditures and holding those reserves in liquid investments - which mean they can be turned into cash within a year. About half the districts that have working capital turnover periods of more than 2 years have established significant restricted retained earnings that are probably reserves for future infrastructure - but half haven’t established such reserves.

**Note:** Compared to other comparable agencies, Covelo operates with basically the fastest working capital turnover period - on average about 2 turns a year. Most American industries would find that comfortable. But given that practically all other comparable districts have more liquidity as shown by longer working capital turnover periods, the question should be asked of Covelo’s management - “Do you ever have times when it is difficult to make all your payments on time?”

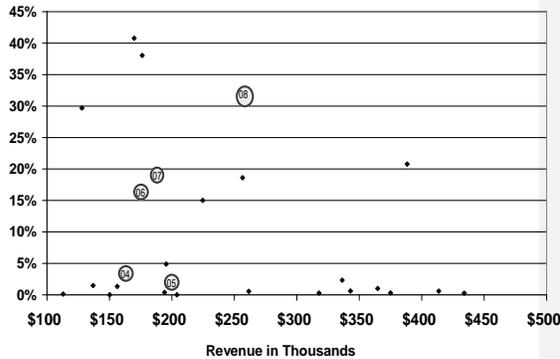
**Financing and Capital Project Funding**

**Debt to Assets**

The Debt to Assets Ratio = Total Debt/Total Assets.

This measures what percentage of an organization’s assets is financed with debt. The inverse is the Equity to Assets Ratio. The two equal 100%.

**Figure 18** shows the debt ratio for our analysis-set districts (the circled numbers are Covelo years). At first glance this graph seems very odd; most districts have practically no debt relative to assets, and others range up to 40%.



**Figure 18 - Debt to Total Assets Ratio**

However, once again the very long-lived nature of wastewater system infrastructure mostly explains this pattern. Districts that have paid off the funded debt for their major capital assets will appear to have very low debt ratios. But that also means those assets are closer to the end of their productive lives and will need to be replaced. But until these districts engage in major capital projects, their debt ratios typically will be quite low.

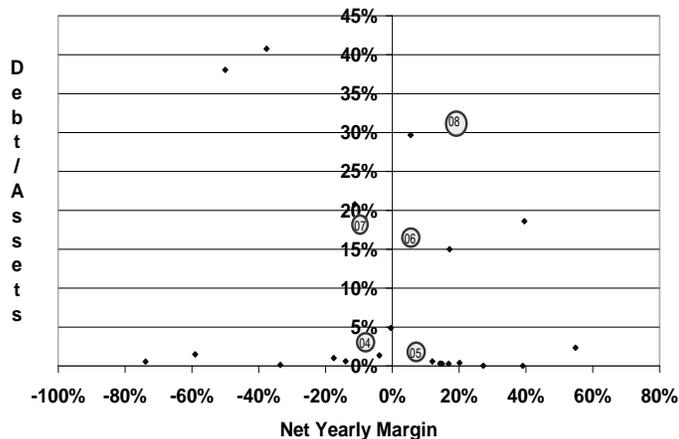
In contrast, wastewater districts that recently have executed major capital projects can be expected to have the highest debt ratios.

**Note:** Covelo was one of the very low debt-financed districts for 2003 and 2005. Then it began a major capital project and began to borrow long-term debt, which catapulted it by 2008 into the third highest debt to asset ratio in this group. But once again, this isn’t a “bad” thing necessarily; it’s a consequence of borrowing to make a significant investment in infrastructure.

**Debt to Profitability**

Is there a relationship between the ability of a district to produce positive annual net margins and its level of debt? **Figure 19** shows this relationship.

In 2004 and 2005 Covelo had not yet started taking on long term debt to fund its major capital program and therefore had a very low debt to assets ratio. Its “annual recurring margin” (change in net assets before extraordinary items



**Figure 19 - Debt Ratio to Net Margin (Profitability)**

including government construction grants) were minus 7% and positive 8%.

Beginning in 2006 and 2007 its debt to assets ratio grew as the district took on long-term debt. The annual recurring margins were almost the same, a minus 8% and positive 6%. But then the district's debt leaped from \$120,000 long term debt to \$670,000. The impact on its income statement (changes in net assets) was an increase in interest expense from \$6,000 to \$17,000. That level of interest would have been enough to have consumed the two previous positive yearly margins and nearly double the two previous yearly losses. And yet, even with this increased debt, the district's recurring annual net increased from a loss of \$16K in 2007 to a positive margin of \$50,000 - a \$66,000 increase.

The reason for this positive development is that the district increased its service charge revenue dramatically in 2008 from \$129,000 to \$203,000. According to the "Management Discussion and Analysis" in the fiscal year 2008 audited financial statements:

1. The District's Operating Income increase is due to increased revenue received from User Fees and delinquent collections by the County Assessors office.
2. The District's income from Users Fees was maintained by receipt of User Fees at the rate of \$50 per month and the collection of most delinquent accounts that are turned over to the County Assessors office.
3. The District's income from septage haulers declined as a result of an increase in fuel cost for a local septage hauler and a decline in business.

**Note:** Operational Expenses are currently supplemented by fees collected from septage haulers; this equates to approximately \$10.27/month per Residential Equivalent Unit. If fees from septage haulers were to be reduced for any reason, monthly fees would have to be raised accordingly. District Management is aware that income from septage haulers is high risk income.

### Section Three: Key National Issues Applied to Covelo CSD

The analysis in Section Two compared Covelo to 22 comparable California wastewater districts. Section one briefly delved into some of the major aspects of the district's financial statements. This section places Covelo CSD into the context of major national issues.

#### Ageing Infrastructure

Over the past decade the nation's drinking water and wastewater systems have been the subject of very intensive analysis and debate. National analysts agree that the major financial issues regarding community water systems and community wastewater systems infrastructure are largely the same.

There is broad national agreement that aging infrastructure is the biggest challenge facing the nation's water and wastewater supply. Although estimates of the industries' total infrastructure needs lack precision, there is actually a considerable amount of consensus that the water and wastewater sector faces its most formidable challenge in terms of replacing and upgrading the aged infrastructure.<sup>7</sup> This is precisely the issue that Covelo had to grapple with over the past few years.

**Table 11** shows the US EPA broad estimate of how long major wastewater infrastructure components last before needing to be replaced.

**Table 11 - Useful Life of Wastewater Infrastructure**<sup>8</sup>

<u>Years</u>	<u>Component</u>
80 - 100	Collections
50	Treatment Plant - Concrete Structures
15 - 25	Treatment Plant - Mechanical/Electrical
25	Force Mains
50	Pumping Stations - Concrete Structures
15	Pumping Stations - Mechanical/Electrical
90 - 100	Interceptors

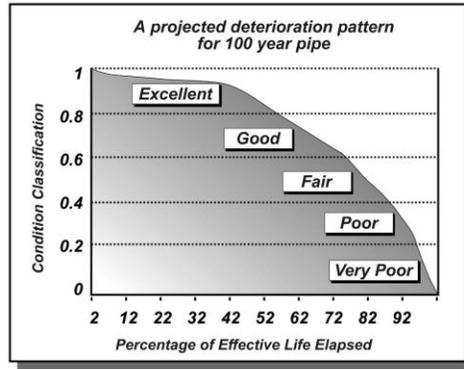
However, it isn't as simple as that. Two other issues play a major role:

- Systems that are constantly maintained and given occasional minor upgrades last far longer and cost less in the long-run than those that are allowed to deteriorate.
- Even with good maintenance, the condition of infrastructure components towards the end of their useful lives at some point makes replacement the less costly and more effective alternative.

<sup>7</sup> Statement of Janice A. Beecher, Beecher Policy Research, Inc., On Behalf of the H2) Coalition, document located on the Senate Committee on Environment and Public Works website - [http://epw.senate.gov/107th/bee\\_0327.htm](http://epw.senate.gov/107th/bee_0327.htm)

<sup>8</sup> The Clean Water and Drinking Water Infrastructure Gap Analysis, US EPA, 2002, Page 11

**Figure 20** is from a US EPA report on water and wastewater systems.<sup>9</sup> The same shape applies to shorter-lived pipe. EPA estimates early 20th century pipes typically have 100 year lives. Those installed in the 20 years after World War II have only 75 year lives.



**Figure 20- Example of Life Cycle Deterioration**

**Note:** Covelo CSD was organized in the late 1950's. If most of its infrastructure was installed by 1960, and if the useful life of its pipes is 75 years, then their overall condition would be falling from "good" to "fair". Deterioration may be expected to rapidly increase.

### "Nessie" Curve

Over the past decade a new planning tool has become very popular among national water and wastewater analysts - the "Nessie" Curve.

A "Nessie Curve" is a graph of estimated annual expenditure needs for replacement of water and wastewater utility pipe infrastructure. It reflects an echo of demographic waves that determined the rate at which the pipes in a city were originally installed. The rising shape of this graph has caused it to be named a "Nessie Curve" after the Loch Ness Monster. This imagery is a perfect fit for the strategic problem of defining the right replacement schedule for the underground assets of water and wastewater utilities

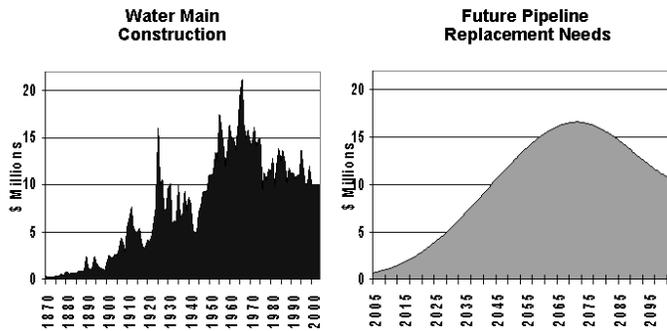
It is the dawn of the replacement era for water and wastewater utilities. Over the next 30 to 40 years, budgets will have to adapt to the fact that pipe networks will present a growing demand on financial resources. To manage the transition successfully, it is critical to define the "right" rate of reinvestment. Investing too little might cause an agency to fall behind, allowing a financing gap to open up. Playing catch-up could be very difficult. On the other hand, investing too aggressively might result in premature retirement of valuable assets and conflict with other important investments.<sup>10</sup>

<sup>9</sup> The Clean Water and Drinking Water Infrastructure Gap Analysis, US EPA, 2002, Page 12

<sup>10</sup> *The Nessie Curve*, Home Page for website of John Cromwell, Stratus Consulting Inc., Washington DC, <http://nessiecurve.com/>

## A Nessie Curve is a demographic echo.

Anytown – Population 250,000



**Figure 21 - The “Nessie” Curve - Pipe Replacement Model**

**Figure 21:** The American Water Works Association has strongly promoted the use of the Nessie Model to construct long-range water and wastewater pipe repair and replacement plans. It helps a water or wastewater system understand what its replacement costs will be and when they will occur.

### Full-Cost Pricing

Full Cost Pricing recovers all the costs of a wastewater utility, including capital and intangible costs, and provides a necessary margin to build capital and contingency reserves, often cited as 15% above all fully-recognized annual costs. Many studies have found that of all types of utilities, water and wastewater systems have most “under priced” its “product”. They are the least likely to recover all their costs and build necessary reserves through their customer fees.

The data indicate that in general, when municipalities (or any public body such as districts) provide electricity and natural gas services, revenues exceed total capital and operating expenditures. However, for water and sewer services total expenditures exceed revenues. The findings generally suggest that water and wastewater customers do not cover expenditures through rates and other user charges. The implications of this “gap” are worse if the reported expenditures understate the cost of the service as is the case with deferrals of major capital asset repairs, upgrades, and replacements. For many publicly owned systems, the real problem is not the willingness nor the ability to pay - but the “willingness to charge” customers at rates closer to the true value of the service.<sup>11</sup> There is broad agreement in the industry literature that wastewater utilities must move to full cost pricing for many reasons.

<sup>11</sup> Statement of Janice A. Beecher, Beecher Policy Research, Inc., On Behalf of the H2) Coalition, document located on the Senate Committee on Environment and Public Works website - [http://epw.senate.gov/107th/bee\\_0327.htm](http://epw.senate.gov/107th/bee_0327.htm)

## Affordability

“Full-Cost Pricing” collides with another key concern - “Affordability”.

### What is the Measure of Affordability?

The “Effective Utility Management” group, led by EPA, has adopted the affordability standard that water bills in excess of 2% to 2½ % of a household’s income are “unaffordable”. But there is confusion in the literature about whether this standard applies only to water or to the combination of water & wastewater. This review has found instances of both applications by different analysts within the EPA. Clearly the inclusion of wastewater rates pushes more households into the “unaffordable” group.

There is a difference between customers who “can afford” to pay Full-Cost Pricing but are “shocked” by rate increases compared to those that “can’t” afford them. Of course, drawing the line between those two groups is difficult and arbitrary; but there is a difference.

### The Affordability Challenge

In many water and wastewater systems there is conflict between the desire to keep services affordable while establishing rates needed for long-term infrastructure and financial integrity. The central question for policy makers and utilities is whether the increased rate of infrastructure spending that utilities must face over the next 30 years can be financed by the utilities themselves at rates customers can afford; that is, should utilities be self-sustaining through their rates? For many utilities, however, the degree of change involved in adapting to the dawning replacement era, the adverse effect of demographic change on per household costs, and the competing demand for investment in wastewater and other municipal services, will combine to present a significant affordability challenge.

There are two related dimensions to the affordability concern. First is the ability of utilities to finance the needed additional expenditures within their rates. Second is the impact of higher rates on households.

The costs of water and wastewater service appear on the same bill in most communities. Thus, the needs to replace wastewater treatment plants and to replace wastewater lines compete with drinking water needs for the same consumer dollar. Sewer pipes generally impose higher unit replacement costs than water pipes, owing to their inherent characteristics (size, depth, etc.). The combined repair and replacement needs for water and wastewater infrastructure amount to a significant financing challenge in their own right. But the cost of compliance with combined sewer overflow (CSO) and storm water regulations may dwarf everything else in water and wastewater utilities. The scale of the expenditure required in these programs may sweep everything else aside in some utilities, causing deferral of other needs and allowing a “gap” to open up<sup>12</sup>

### Rural v. Urban Water Systems and Affordability

The typical rural household is spending all of its after-tax income. Any increase in water (or sewer) costs (or any other expenditure category) is going to force a reduction of expenditures

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<sup>12</sup> Reinvesting in Drinking Water Infrastructure , Page 19

in other categories. While some other categories may be viewed as “luxuries” (for example, entertainment, charitable contributions, and tobacco), the fact is that the typical rural household will be forced to make a choice between competing needs, while the typical urban household will not be forced to make the same choice (because its expenditures are nearly \$4,000 less than its after-tax income)<sup>13</sup>.

### Sustainability

National industry analysts are extremely concerned about the nation’s wastewater systems sustainability. Not all aspects of sustainability are directly financial but most require considerable financial resources to secure.

A practical common sense definition of system sustainability was expressed by the owner of a water system: “...a viable water (and wastewater) system is one that is self-sustaining, and that has the commitment, and the financial, managerial, and technical capability to meet performance requirements reliably on a long-term basis.”<sup>14</sup> Its converse: “... a nonviable system (is defined) in terms of four issues: lack of motivation to operate properly, lack of ability to operate properly, lack of money to operate properly, and lack of ability to sell at a reasonable price due to lack of rate base, size, or geographic location.”<sup>15</sup>

### Sustainable Infrastructure

The nation faces a very steep increase in water and wastewater system investments to replace aging infrastructure. EPA created a “Sustainable Infrastructure” initiative to address this threat. EPA believes a funding gap will grow between the level of investment required over the next 30 years and the capital available to fund that investment. The goal of its sustainable infrastructure initiative is to meet the needs of the future for adequate, affordable and safe water and wastewater systems with significantly less investment than is currently projected.

The EPA’s “sustainable infrastructure” recommendations rest on four pillars<sup>16</sup>:

- Full-Cost pricing
- Better Management - a list of best practices
- Efficient Water Use - EPA estimates simple water conservation measures could reduce the need for water over 30 years by 20%, and could indirectly affect the volume that must be processed by wastewater systems.
- Watershed Approach - a coordinated management of water (including re-use of water out of sewage treatment plants) in watersheds offers significant water and cost savings

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<sup>13</sup> Economic Characteristics of Small Systems... Pages 15 & 17

<sup>14</sup> Wade Miller Associates, Inc. State Initiatives to Address Non-Viable Small Water Systems in Pennsylvania, 1991, 5-1.

<sup>15</sup> Robert B Heater, *the Problems of Small Water Companies as Viewed by the Owner of One*, Proceedings of the Fifth National Association of Regulatory Utility Commissioners Regulatory Information Conference, National regulatory Research Institute, 1986, 1412.

<sup>16</sup> From APPENDIX A—PAYING FOR AND FINANCING INFRASTRUCTURE IMPROVEMENTS, Drinking Water Infrastructure Needs Survey and Assessment, Third Report to Congress, US EPA, June 2005, Pages 39 - 40

### Great Weakness in Many Financial Reports

The provision of safe wastewater systems is a perpetual responsibility. There are two substantial infrastructure expenditures that must be made to fulfill that responsibility:

- One, major investments to construct, significantly upgrade and eventually replace the system and;
- Two, significant annual expenditures to properly maintain the system

Both must be fully provided for in annual financial statements:

- First, the true annual economic costs of properly maintaining very long-lived wastewater infrastructure must be reported as annual expenses and properly funded, and if not funded the true built up value of deferred maintenance must be reported.
- Second, realistic projections of future major capital investments must be made and appropriate reserves need to be established to eventually contribute to the funding of those investments. If these values aren't reported, the wastewater system is not communicating what is probably its most important financial reality and greatest threat.

### GASB 34 and Infrastructure Financial Reporting

A sea-change in governmental accounting occurred when the **Governmental Accounting Standards Board (GASB)** issued its **Statement 34 - Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments** in 1999. The main goals of GASB 34 are first to reform governmental financial reporting to report the true economic-financial condition and activity of state and local governments, and second to make government financial reports more meaningful and easier to understand. The most important tool to accomplish that goal is the requirements that governments implement "accrual" accounting. Along side their old "fund" accounting statements governments now had to report "government-wide" accrual statements.

Most of the material regarding GASB 34 in the rest of this section comes from a PriceWaterhouseCoopers report on the statement's infrastructure reporting requirements.<sup>17</sup> A part of Statement 34 deals specifically with **infrastructure**. GASB's approach was based on several key national trends that emerged after the post WWII infrastructure construction boom:

- It became clear that in the long-run it would cost considerably more to replace deteriorated infrastructure than to maintain it in good condition.
- Governments shifted their focus from financing original major infrastructure capital projects to include ongoing infrastructure maintenance, improvements and upgrades.
- Congress and many state legislatures recently began to promote or require the use of "asset management systems" that assure continuous infrastructure maintenance.
- Government managers realized they needed a way to convince the public and legislative bodies of the long-term value of adequate annual maintenance expenditures.
- The public financing industry (investors, public finance firms, bond rating agencies, etc.) realized that financial statements didn't report the true financial condition of governments

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<sup>17</sup> Understanding GASB 34's Infrastructure Reporting Requirements, McNamee et al, PriceWaterhouseCoopers, October 1999

because they didn't disclose future required major expenditures driven by significantly deteriorated infrastructure.

GASB 34 requires all governments (including special districts that manage infrastructure as defined by GASB) to include the actual cost of infrastructure assets obtained after GASB 34 went into effect in their balance sheets. Larger revenue governments (above \$10 million a year) are required to determine the value of such assets acquired after 1980 and report them on their balance sheets. Where GASB 34 gets very interesting is in the two alternative methods of accounting for infrastructure:<sup>18</sup>

- One, the traditional "Depreciation" method or;
- Two, a new "Modified Approach".

The traditional depreciation method is well understood by financial professionals and easy to implement. GASB 34's innovations in infrastructure reporting lie in its "Modified Approach". Under this approach the government can elect to not report depreciation, but rather to report the full repair and maintenance expense each year. The innovations come in two additional requirements:

- **Asset Management System:** the government must define an acceptable level of infrastructure condition over the long-term, must maintain a complete inventory of infrastructure, must conduct a comprehensive condition assessment at least every three years, and must report valid estimates of the required future expenditures to maintain its target infrastructure condition.
- **Report Maintenance Efforts Relative to the Asset Management Targets:** the government must report whether or not the results of the three most recent assessments met its target condition level, and must compare the amounts determined by the Asset Management System to be needed to maintain the infrastructure properly to the actual expenditures for the past five years.

The Modified Approach usually costs considerably more to implement than the depreciation method if the agency hasn't already implemented a "holistic" asset management and planning system for long-term infrastructure maintenance. In general, most wastewater analysts believe the benefits of the Modified Approach far outweigh its costs. The Modified Approach produces both an asset management system and a public financial reporting method that is far more likely to prevent premature deterioration of infrastructure that imposes far more infrastructure costs on the public in the long run.

But one detail in GASB 34's Modified Approach is a real problem for wastewater and water systems. Unfortunately it appears GASB designed its Modified Approach based on the financial and physical nature of transportation infrastructure, especially streets and highways (the biggest value infrastructure for state and local governments). This is why the Modified Approach requires comprehensive infrastructure evaluations at least every 3 years. That makes sense for streets and highways because they are easily inspected and often rapidly deteriorate. Water and wastewater pipes aren't easily inspected, and they require far less frequent repair. This strict

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<sup>18</sup> For a technical accounting description of these methods see the various references to GASB 34 in the References attachment.

three year inspection requirement imposes an unnecessary burden on water and wastewater systems.<sup>19</sup>

Therefore, a number of analysts advocate a “hybrid” approach”:

- You can use the depreciation approach for the “numbers” part of the financial statements and still present your modified approach information in the RSI (Required Supplemental Information of the audited financial statements). In other words, you can retain the stability and predictability of depreciation and avoid the modified approach’s drawbacks while still reaping all the benefits that utility managers expect from the modified approach by reporting that information in the RSI.
- It gets even better. Auditors familiar with this issue agree that if you present your modified approach information only in the RSI, then you can design your own modified approach. This means, for example, that you can use whatever inspection program makes sense for your system and you can aggregate your assessed conditions in a way that makes sense to you. You can even report your long-range R&R needs and the details of your finding programs.

In short, reporting depreciation in the “numbers” while showcasing your infrastructure programs and asset management prowess in the RSI may well be the best way to take advantage of the considerable benefits of GASB 34’s modified approach while avoiding its pitfalls<sup>20</sup>.

### **Capital Plans**

A broadly held view among national water analysts is that Community Water and Wastewater Systems must adopt much longer planning horizons than most industries - 20 to 30 years. This is driven by the rapidly developing infrastructure replacement need that will play out over several decades. The **H2O Coalition** (H2O) provides a good checklist of the elements of a competent Capital Investment Program<sup>21</sup>:

- Adopt the General Accounting Standards Board (GASB) 34 optional asset management system that would track the conditions of capital assets and develop estimates of replacement and rehabilitation costs.
- Develop and implement a 20-year capital asset repair and replacement plan that is based on consideration of life cycle costs of the assets.
- Establish a capital replacement fund to finance the capital needs identified in the above plan.
- Develop and implement a rate structure based on all estimated current and future costs including O&M, capital investments for treatment and infrastructure replacement or rehabilitation, and depreciation expense (see page 65).

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<sup>19</sup> It’s outside the scope of this Review to investigate how water and wastewater systems may have been able to adapt successfully to this “3 year” rule.

<sup>20</sup> *GASB 34 - An Infrastructure Heresy*, Ken Harlow, Brown and Caldwell, pages 4-5.

<sup>21</sup> H2O Coalition, Page 12

There is universal understanding and agreement among national drinking water and wastewater system analysts that the biggest problem facing the nation's water and wastewater systems is the rapidly approaching wave of forced replacement of aging infrastructure. There was a huge surge in water and wastewater infrastructure system development during the 1950's that is approaching the end of its useful life. Covelo CSD's circumstances are reflective of problems to found nationally.

**Note:** Although there is a line-item in Covelo CSD's Statement of Changes in Net Assets for "maintenance" expense, it is almost certainly less than the true maintenance expense because elements of other items were probably directed to maintenance as well (staff, casual labor, perhaps contract services, supplies, etc.) Even so, the level of maintenance expenditures appears to be very minimal given the level of investment in depreciable fixed assets.

**Data Differences - Audited Statement of Changes in Net Assets .v SCO Special Districts Annual Reports**

	From SCO			From Audits			Dollar Difference			Percentage Difference		
	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006
<b>Operations</b>												
<b>Income</b>												
Total Operating Income	161,137	201,573	198,683	164,387	200,018	173,896	(3,250)	1,555	24,787	-2%	1%	12%
Total Operating Expense	152,696	189,881	152,912	152,695	158,650	137,899	1	31,231	15,013	0%	16%	10%
<b>OperatingMargin</b>	8,441	11,692	45,771	11,692	41,368	35,997	(3,251)	(29,676)	9,774	-39%	-254%	21%
<b>Income</b>												
Total Non-OperatingIncome	3,601	4,747	4,432	350	351	572	3,251	4,396	3,860	90%	93%	87%
Total Non-OperExpense	-	-	1,600	-	-	1,255			345			22%
<b>Non-OperatingMargin</b>	3,601	4,747	2,832	350	351	(683)	3,251	4,396	3,515	90%	93%	124%
<b>EBIDA</b>	12,042	16,439	48,603	12,042	41,719	35,314	0	(25,280)	13,289	0%	-154%	27%
Interest						1,463			(1,463)			-100%
DepreciationandAmortization	24,396	24,396	24,287	24,396	25,593	23,090	0	(1,197)	1,197	0%	-5%	5%
	24,396	24,396	24,287	24,396	25,593	24,553	0	(1,197)	(266)	0%	-5%	-1%
<b>YearlyRecurringItemsMargin</b>	(12,354)	(7,957)	24,316	(12,354)	16,126	10,761	0	(24,083)	13,555	0%	303%	56%

ConstructionAid- Federal/State	59,678	21,570	22,201	59,678	21,570	0	0	22,201	0%	0%	100%	
PriorYearAdjustment	4,727		24,081	4,727		0		24,081	0%		100%	
<b>FinalNetMargin</b>	<u>52,051</u>	<u>13,613</u>	<u>70,598</u>	<u>52,051</u>	<u>37,696</u>	<u>10,761</u>	<u>0</u>	<u>(24,083)</u>	<u>59,837</u>	<u>0%</u>	<u>-177%</u>	<u>85%</u>

## COVELO SOI/MSR REPORT

### Chapter Six: MSR Determinations

Government Code Section 56430 mandates the Commission to make determinations about the District in the following six categories.

Determinations can be thought of as “decisions,” “judgments” or “statements” by the Commission about any aspect of the categories for which the Commission is required to make determinations. It is apparent that the determinations should be consistent with the data, information and analysis provided in the Report. Therefore the determinations will often be a summary of information or statements taken from the body of this Report which may make for some repetition. (For additional information about Section 56430 requirements and determinations, see Chapter One.)

#### **Determination One: Growth and Population Projections for the Affected Area**

##### Growth Estimates and Projection

The Covelo area grew considerably slower than the County in the 1970-1990 decades, but then had a growth rate twice that of the County at large in the 1990-2000 decade. Official State estimates indicate a growth rate of 6.25% for 2000-2009 in the unincorporated part of Mendocino County. If this held true for the northeast part of the County population would have grown to about 2522 - of which 1990 or so would be in Round Valley - and increase of around 140 people.

The 15% growth rate over ten years for the Census Tract from 1990 to 2000 equates to a 1.4% annual growth rate. SHN Engineers in their report used an annual growth rate in the District's service area of 1.7%. This would produce an 18% growth rate over 10 years. Instead of an increase of 140 residents suggested above this growth rate would produce 170 new residents.

Obviously, these projections are reasonably similar. However, by their nature any percentage projections based on such a small population may have a wide range of possible errors; an increase in residents that would not be statistically significant in a large city could have a very significant impact on Covelo's growth rate.

**This Report's projection, based on year 2000 CDP data, is that there are approximately 430 - 450 people living within the Covelo Community Services District Boundaries. In response to a questionnaire, Covelo CSD initially estimated that there are 430 residents within its boundaries, so our estimate seemed to reasonably coincide with theirs. A later communication from the General Manager indicated that he performed a count of the District at the request of the USDA and he counted a population of 410 people as of July 9, 2009.**

##### Non-Residents

As indicated, the analysis for this MSR indicates a residential population of approximately 410 to 430 people. The District encompasses the main community and institutional service locations in Round Valley, including a commercial district, primary and secondary public schools, offices,

etc. As such the need for sewer and wastewater services is not solely based on resident population.

In the previously cited June 2006 report, SHN Consulting Engineers & Geologists provided analysis that the current inflow to the wastewater treatment plant indicates a population equivalent of 850. This is not only an estimate of the number of residents whose homes are served by the District, but also the number of people who “contribute” to the sewer system from non-residential facilities served by the District, such as commercial, industrial and institutional facilities.

**Non-residential facilities served by the District roughly double the input to the system provided by residents.**

Future Demand

In the decade ending in 2000 Covelo’s population appears to have increased by somewhere around 15%. Further, a relatively large number of residents of the Valley live just outside the District today. The District has received occasional requests by property owners of parcels adjacent to the District requesting annexation. It is likely that the District will continue to receive requests for annexation and therefore be faced with gradually growing demand. At the time of this report the District has a request for annexation of some parcels that are outside the District but are presently being served by the District. Approval of the annexation request for these parcels will not change the demand and population for the District.

There is also a request for annexation of a new four unit SFR subdivision which if approved will increase demand by four units and potential population by about 10-12 people. Additionally, some parcels within the Business Park that are included in the District’s annexation request are undeveloped. These parcels when developed will increase demand to the wastewater system. However, because of the substantial recent investment by the District in upgrading the collection system and the WWTP, the District will be able to readily provide service for these parcels.

As well, there are a number of parcels just outside the District of similar size as those within, and several which could be subdivided for development. Census Block data indicates around 200 people live within 1000 feet of the District - nearly half the population inside the District. However, there is no expressed interest by the owners of these parcels in annexing to the District.

As indicated above, at present the District is requesting the annexation of approximately 35 acres of mostly developed land that is presently being served by the District. Upon approval of the annexation request, the District is requesting that its Sphere of Influence (SOI) be determined to be coterminous with its jurisdictional boundaries. This request is based on the District’s awareness of its service capacity and the need for additional upgrades to the system. If LAFCO agrees with this request, any future annexation requests will require a request for a Sphere of Influence amendment along with the annexation request.

**Given Covelo’s relatively isolated location, it’s unlikely to experience significant population increases in the next few decades. Further, significant industrial development is also unlikely within the District’s boundaries. However, based on some population increases and some possible requests for annexation, it seems reasonable to conclude that growth in**

**underlying demand for sewage services could, at most, grow at a rate of .5 to 1.5% percent a year, which would be in line with recent past County wide growth.**

**Determination Two: Present and Planned Capacity of Public Facilities and Adequacy of Public Services Including Infrastructure Needs or Deficiencies**

There is broad national agreement that aging infrastructure is the biggest challenge facing the nation's water and wastewater supply. There is a considerable amount of consensus that the water and wastewater sector faces its most formidable challenge in terms of replacing and upgrading the aged infrastructure. This is precisely the issue that Covelo had to grapple with over the past few years.

Covelo CSD was organized in the late 1950's. The initial collection system and treatment plant were completed in 1961; the overall system is nearly fifty years old. Major upgrades to the treatment plant occurred in 1978-79. If maintained, the useful life of the pipes in a properly installed collection system is approximately 75 years. Systems that are well maintained and given occasional upgrades last far longer and cost less in the long run than those that are allowed to deteriorate.

**It appears that the present Board of Directors and Management inherited a system that was not well maintained over the decades. The overall condition of the Covelo system would be rated, at best, as falling from "good" to "fair". Deterioration may be expected to rapidly increase.**

**In recent years Covelo CSD staff has expended considerable effort to inspect, investigate and assess the condition of the collection system. Efforts included physical inspection of manhole barrels, benches and covers, smoke testing of laterals and mains and CCTV inspections of the collection system piping. Where possible, repairs were made as appropriate. At this time the District does not utilize GIS for its data gathering and record keeping.**

In its 2006 report, SHN Engineers listed a number of plant deficiencies:

- Grit, rocks, rags and other damaging materials were not effectively removed from the effluent flow. Equipment is damaged and ponds fill up with these materials requiring significant dredging.
- Headworks and pretreatment processes were significantly problematic. The headworks structure was much too small to allow proper maintenance of equipment. The comminutor was outdated, doesn't work, and needed replacement. New equipment to remove more of the damaging materials entering the system was needed.
- The septage receiving system at that time relied on self-monitoring of septage haulers regarding quantity, pH, etc. SHN recommended an automated septage receiving system be installed.
- The two oxidation ponds suffer from varying degrees of seepage through their walls caused by rodents, roots, etc. At the time of the report groundwater tests were still being conducted to determine if the seepage through the pond bottoms was significantly affecting groundwater quality.
- Both holding ponds typically dry out during hot summer months, when practically all the treated effluent is evaporated from the oxidation ponds. This has caused the bentonite

linings to crack and leak. When the ponds receive treated effluent it leaks uncontrollably into the groundwater. Attempts to keep the bottoms of the ponds moist during the hot months have not been effective because of an inadequate supply of well water and the inability to apply the water evenly across the surface.

- In recent years evaporation and seepage from the oxidation and holding ponds has all but eliminated the need to discharge treated effluent into Grist Creek. As a result the final filtering and disinfection systems have not been used in many years. This has led to significant problems with the pumping, filtering and disinfection systems.

**Regarding the last two bullet points: Via response to the Administrative Draft, the General Manager has indicated that: (1) It is not necessary to distribute water evenly in the holding ponds and; (2) There is nothing wrong with the pumping system stating, "I can use the effluent pumps, sandbed and disinfection system. They still work."**

The SHN Report indicated that a number of significant public health threats are caused by the District's sewer system:

- Elementary School - raw sewage has overflowed out of the system in front of the school for 30 years.
- Overflow in Other Locations - At least two other locations had occasional overflows out of the system into streets.
- Back up into Homes - homes in two areas of the District occasionally had sewage backing up flowing into their yards.

These problems mostly happen during storms. SHN states that both capital improvements to the system and upgraded maintenance practices are needed to correct these problems. It also indicated that the majority of effluent disposal occurs through percolation into the groundwater beneath the holding ponds, which is in violation of the District's existing NPDES permit. The uncontrolled percolation that is occurring at present does not adequately protect the quality of groundwater underlying the plant area. The system problems noted above create significant constraints on the ability of staff to properly maintain the system. The "solutions" to the indicated problems are mostly investment in upgraded facilities; the difficulty is in obtaining sufficient funds for the "solutions".

**As discussed in the Wastewater Collection System section of this Report, CCSD has been busy in recent years correcting numerous problems with their collection system. In 2007-08, 5,375 feet of new pipes were installed (654 feet of 12 inch line, 2,064 feet of 10 inch line and 2,657 feet of 8 inch line) as replacement to existing lines. This amount represents approximately 25% of the overall collection system total of 20,000 feet of pipe.**

**In addition, the District is presently engaged in construction or reconstruction of elements of its WWTP. The Project consists of lining three ponds, installation of a grit channel and spiral trash screen, an ozone disinfection system, a septage receiving station, wetlands and a percolation pond. The Project is anticipated to be complete by December 4, 2010."**

**The worst problems of the collection system and the WWTP identified in the SHN Report have been fixed or are being fixed. The present District Board and Management are to be commended for its efforts to identify and address problems to the wastewater system.**

### **Determination Three: Financial Ability of Agency to Provide Services**

**There were some significant differences between Covelo's audited statements and the values the district reported to the State Controller's Office for the 3 years overlap - 2004 - 2006. This review uses audited statements rather than the SCO data. However, the values shouldn't vary as much as they do.**

Covelo CSD provides sewer services to a rural area with a very low "customer" base numbers and "customer" base affordability for monthly fees. Covelo's annual income from monthly fees and septage haulers appears to be barely sufficient to pay for its operational costs and loan payment.

Operational Expenses are currently supplemented by fees collected from septage haulers; this equates to approximately \$10.27/month per Residential Equivalent Unit. If fees from septage haulers were to be reduced for any reason, monthly fees would have to be raised accordingly. **It appears that the septage hauler fee income is very important to the district's ability to generate the margins necessary to service its debt and provide for appropriate operating income. If septage hauler fees are substantially diminished for any reason, this places the District at significant risk. The District is aware that this income is "high risk" income. The addition of a septage receiving station at the WWTP may help assure that this income continues, but much of the haulage is coming from outside Round Valley. If this circumstance shifts, the District will be strongly affected.**

Liquidity is the ability to make payments as they come due. There are two measures of liquidity reviewed in this Report: (1) Current Ratios and (2) Working Capital Turnover.

The "Current Ratio" is Current Assets divided by Short Term Debt, and is a key measurement of liquidity. It answers the question "For every dollar of debt that must be paid within the next 12 months, how many dollars of assets are there that will 'turn into cash' and therefore be available to make those payments during that time?" A high Current Ratio indicates that there is a high "liquidity"; that is "cash" is available to pay bills (Short Term Debt). A low Current Ratio is an indicator that the agency may be "illiquid"; that it is struggling to pay its bills.

**Compared to other agencies, Covelo has a very low Current Ratio indicating a lack of liquidity. The symptoms of a lack of liquidity include the need for hurried collections of receivables to get enough money to pay bills, occasional late payroll, putting off reasonable expenditures for supplies, etc.**

Working Capital is directly related to the Current Ratio, but instead of the ratio of current assets to short term debt, it's the amount that current assets exceed short term debt. In rough terms, it is the amount of current assets that can be spent without compromising the ability to pay short term debt. An organization's Working Capital funds day to day operations - payment of operating expenses, purchases of operating supplies, etc.

Working Capital Turnover measures the "velocity" of Working Capital. That is, how fast current assets move through the "Working Capital Cycle". Instead of a "static" measure such as the current ratio or the value of working capital, it is a "dynamic" measure. The working capital cycle starts when cash buys supplies, pays expenses, buys inventory, pays the short term portion

of long term debt, etc. Working capital funds the production of goods or services. Those are purchased by customers and turn into accounts receivable, that when paid turns into cash again.

There are several ways to measure Working Capital Turnover. One is to calculate how many years it takes to turn over Working Capital - that is, to complete one Working Capital cycle. **Compared to other comparable agencies, Covelo operates with basically the fastest working capital turnover period - on average about 2 turns a year. Most American industries would find that comfortable. But given that practically all other comparable districts have more liquidity as shown by longer working capital turnover periods, the question should be asked of Covelo's management - "Do you ever have times when it is difficult to make all your payments on time?"**

Covelo recently expended \$2.3 million upgrading 25% of its collection system. This \$2.3 million dollar pipeline replacement project was funded by a variety of government grants. Mendocino County provided an initial community development block grant to begin repairing the collection system. USDA provided two rounds of grant funding for \$676,000 and \$692,000. CCSD also secured a \$677,000 loan from USDA. For this commitment of funding, USDA required CCSD to make several changes including an increase in monthly rates to provide for the loan payments.

In addition, the Covelo Community Services District Wastewater Treatment Plant Improvement approved by the Regional Water Quality Control Board, has been funded by the American Recovery and Reinvestment Act of 2009, Proposition 50 funds and by the United States Department of Agriculture Rural Assistance Program.

In essence, Covelo depended on the "kindness of strangers" for grant funding to address problems that had been building for decades because of improper maintenance. Previous Boards did not raise their rates sufficiently to allow for depreciation of their infrastructure and to build sufficient reserves to address the inevitable deterioration that occurs in a wastewater system. Had past boards sufficiently charged for the true costs of the provided services and sufficiently funded both maintenance and reserves, the future would be less problematic for Covelo CSD.

A nonviable wastewater system may be described in terms of four issues: (1) Lack of motivation to operate properly; (2) lack of ability to operate properly; (3) lack of money to operate properly and (4), due to lack of rate base, size or geographical location an inability to price the provided services according to their true costs.

**It is LAFCO's determination that the present District Board and Management have the motivation and technical ability to properly operate their system. However, they lack the necessary funds to address the problems as indicated in Determination Two. They also lack the ability to increase rates sufficiently to pay for the true cost of operations plus build sufficient reserves to fund both their present infrastructure needs and potential future needs. Additionally, they lack the size to achieve efficiencies of scale that may be found in larger organizations.**

**The remaining 75% of the collection system presently requires upgrading or will require upgrading in the very near future. Covelo CSD presently lacks the funds to address these needs. Given present financial circumstances of California and the overall economy it is somewhat doubtful that Covelo will receive additional grant funding to address their many**

**problems. It may be possible that they will find low interest loans; the repayment of which will require another substantial increase in monthly fees. During the workshop review of this Report, the Commission urged the District's Board of Directors to begin building Capital Reserves for future needs.**

**Determination Four: Status of, and Opportunity for Shared Facilities**

CCSD shares office space with the Round Valley County Water District and the Round Valley branch of the Mendocino County Superior Court.

**The District has made a strong and continuing effort to share facilities and work cooperatively with other agencies where possible.**

**Determination Five: Accountability for Community Service Needs, Including Government Structure and Operational Efficiencies**

Accountability

The Covelo Community Services District regular public meetings are held on the first Thursday of each month, beginning at 6:00 p.m., in the business office of the District at 76270 Grange Street, Covelo, California. CCSD meetings are open to the public, and the District encourages public participation. The District via the MSR questionnaire reports that meeting locations are ADA accessible.

The Board meetings must meet the requirements of the Brown Act. CCSD agendas are posted at the meeting location which is also the principal office of the District, and at three conspicuous places within the District including the Covelo Volunteer Fire Department, Redwood Oil and Gas Station, and the Post Office.

The Board may act only by ordinance, resolution or motion and a majority of the Board constitutes a quorum. A recorded majority vote of the total membership of the board is required of each action and a record is required to be kept of their meetings. The District keeps minutes of every meeting of the full Board. Minutes are available at its principal office.

The Board has established one standing committee - Budget. Agendas are published for this committee; minutes are kept and are available at the District's principal office.

New Board members receive an orientation session with the General Manager which includes a review of the treatment plant and other infrastructure.

The District's Policy & Procedures manual meets the requirements of the Principal Act as required by G.C. 61040, 61045 & 61063.

**The District has indicated that CCSD board members do not receive compensation for meetings and do not receive compensation for expenses incurred while on board business.**

Under the Political Reform Act all public agencies are required to adopt a conflict of interest code. A code designates the positions required to file annual Statements of Economic Interest forms and assigns disclosure categories specifying the types of interest to be reported. The

District has adopted a conflict of interest code and filed it with the County Clerk on September 22, 1997. Under the CCSD code, all board members are required to file annual FPPC Statement of Economic Interest disclosure statements. This seems consistent with the requirements of G.C. 87200. All filings for board members have been made as required. Filings are made to County Clerk's office in Ukiah and are available there.

According to the District's code, the General Manager and legal counsel are not required to file. FPPC Regulation 18730 indicates that designated employees that "make or participate in the making of decisions which may foreseeably have a material effect on economic interests" should be considered for filing. **Presumably, the General Manager and Counsel would have some ability to influence or participate in the making of the Board's decisions regarding economic or financial issues. In that it is foreseeable that their recommendation could have a material effect on economic or financial decisions of the Board, the Board may want to reconsider its requirements for the filing of FPPC statements for the General Manager and Counsel.**

Government Code §53234, et seq. requires that elected and key appointed officials must take biennial ethics training courses if they receive any form of compensation including reimbursement for expenses. This law requires training about conflict of interest, prohibition of use of public resources, prohibition against gifts of public funds, prohibition against acceptance of free transportation, laws about transparency of operations such as the Brown Act, Public Records Act and others.

**While the Board does not receive any form of compensation, it has had ethics training twice: April 8, 2006 conducted by Best, Best and Krieger at Brooktrails and again on June 6, 2009 conducted by Jeanine B. Nadel, Mendocino County Counsel at Covelo.**

#### Government Structure Options

LAFCOs are authorized to initiate proposals for consolidation of special districts, dissolution of special districts, mergers of special districts with a city, establishment of subsidiary districts to cities, or reorganizations that includes any of the preceding changes of organization. [56375(a), 56378, and 56425] While the SOI/MSR process does require that the Commission make determinations for the need for consolidation, the SOI/MSR process does not require LAFCO to initiate changes of organization based on SOI/MSR findings; it only requires that LAFCO make determinations per the provisions of G.C. Sections 56425 and 56430. However, LAFCO, local agencies, and the public may use these determinations as a basis to pursue changes to local jurisdictions or Spheres of Influence.

**LAFCO has no recommendations for consolidation or reorganization of the Covelo CSD.**

#### Operational Efficiencies

The Board should ascertain that it is meeting the requirements of GASB 34, especially in relation to adequately accounting for depreciation and funding maintenance. Although there is a line-item in Covelo CSD's Statement of Changes in Net Assets for "maintenance" expense, it is almost certainly less than the true maintenance expense because elements of other items were probably directed to maintenance as well (staff, casual labor, perhaps contract services, supplies, etc.). **The level of maintenance expenditures appears to be very minimal given the level of investment in depreciable fixed assets.**

**Determination Six: Any Other Matter Related to Effective or Efficient Service Delivery, as Required by Commission Policy**

There is universal understanding and agreement among national drinking water and wastewater system analysts that the biggest problem facing the nation's water and wastewater systems is the rapidly approaching wave of forced replacement of aging infrastructure. There was a huge surge in water and wastewater infrastructure system development during the 1950's and 1960's that is approaching the end of its useful life. Covelo CSD's circumstances are reflective of problems to be found nationally.

**Covelo CSD's ability to address problems associated with deferred maintenance, aging infrastructure and changing regulatory requirements is limited by its geographical size and the size of its customer base. Covelo's potential income from its limited customer base simply cannot address all of its known circumstances. The present Board of Directors and the Management of the District are making an exemplary effort under difficult circumstances to address these issues and are to be commended for that effort.**

## COVELO CSD SOI/MSR REPORT

### Chapter Seven: SOI and MSA Determination

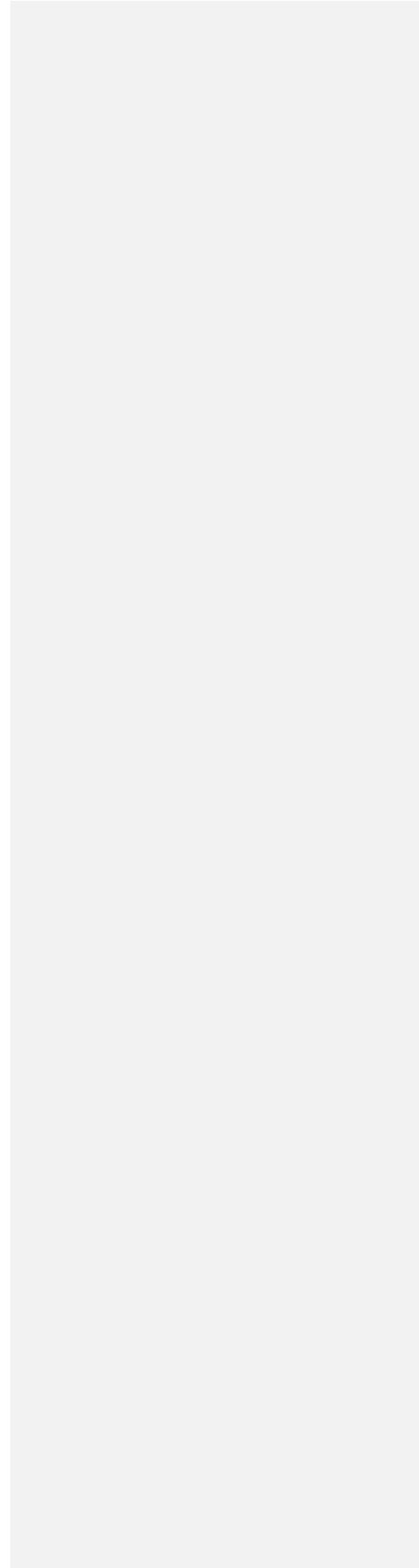
As indicated in the Foreword, this document represents a combined effort of three studies that have been mandated by the Legislature for each agency: Maximum Service Area (G.C. 56378); Sphere of Influence (G.C. 56425) and; Municipal Service Review (G.C. 56430). This is the Sphere of Influence section of that combined study. (Please refer to the definition of a Sphere of Influence and LAFCO's policies on spheres as found in Chapter One.)

In response to this SOI/MSR process, the District has indicated a desire to annex approximately 35 acres of land a large portion of which it is presently providing service via out-of-area service agreements. In addition, LAFCO presently has an application for the annexation of a four lot subdivision to the District (Travis annexation). Once, these annexations are approved, the District is requesting that its Sphere of Influence be coterminous with its new jurisdictional boundaries. It is clear that based on this Review's understanding of the recent improvements undertaken or being undertaken by the District, that the District has sufficient capacity for the requested annexations.

Based on this Review, LAFCO concurs that it is appropriate to determine the Sphere as requested by the District. An 11 X 17 map of the proposed SOI is provided on the following page. The proposed SOI is outlined in red; the existing boundaries before the annexation request are indicated using a gray background and the requested annexation territories are indicated in white.

**Note:** Once this Report is adopted this map will become the official record for the SOI. Any parcels not included will only be able to apply for annexation to the District in conjunction with an SOI amendment request. Depending on the size of the territory in the proposed annexation, this circumstance may trigger an update SOI/MSR study the cost of which will be paid by the applicant.

Inset 11 X 17 SOI map here



### **Sphere of Influence Required Determinations**

Government Code Section 56430 mandates a Municipal Service Review and requires six determinations. Those determinations were provided in **Chapter Six**. G. C. Section 56425 mandates the determination of the SOI for each local agency. For a district, this section also requires six additional determinations.

In “developing and determining” the sphere of influence of any agency (city or district) LAFCO is required to prepare a written report and statement of 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 service 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.

Upon determination of a Sphere of Influence, the commission is required to adopt the SOI at a noticed public hearing and is required to review and update, as necessary, the adopted sphere not less than once every five years. When adopting, amending, or updating a sphere of influence for a special district, LAFCO is required do all of the following:

- 5) Require existing districts to file written statements with the commission specifying the functions or classes of services provided by those districts.
- 6) Establish the nature, location, and extent of any functions or classes of services provided by existing districts.” [G.C. 56425]

### **Determination 1: Present and Planned Land Uses**

The proposed SOI is the same as the proposed jurisdictional boundaries of the District once the requested annexations are approved. The territory of the District and the proposed coterminous SOI are in the County; therefore the zoning for these parcels is controlled by the County. There are no present or planned land uses within the proposed coterminous SOI that differs with existing County zoning.

### **Determination 2: Present and Probable Need for Facilities and Services**

Based on existing circumstances and needs of the collection system and the WWTP, it appears that the District does not have the capacity to provide wastewater services beyond its proposed service area if the annexations are approved. There may be a future need for services outside the proposed jurisdictional boundaries of the District; however, the District is presently unable to provide those services. It is not clear when that ability may change, thus there is no guarantee that the District will be able or willing to provide additional services to the territory immediately adjacent to its boundaries/SOI within in the next five years.

**Determination Three: Present Capacity of Facilities and Adequacy of Public Services**

The District in this SOI/MSR Report has provided extensive details of its present capacity and infrastructure circumstances. Its present capacity is limited with sufficient capacity for potential needs within its proposed boundaries/SOI. With the proper funding, wastewater treatment capacity can be increased such that future ability to provide services to the territory immediately adjacent to the District's boundaries could occur. However, it is unknown when additional funding may become available.

**Determination Four: Existence of Any Social or Economic Communities of Interest**

The Covelo Indian Community of the Round Valley Indian Reservation is a recognized Indian Community organized under a constitution and by-laws ratified by the members of the Covelo Indian Community on November 7, 1936, pursuant to section 16 of the Act of June 18, 1934 (48 Stat. 984), as amended by the Act of June 15, 1935 (49 Stat. 378). It is located to the north of the service area of the District.

**Determination Five: Functions or classes of services provided by CCSD**

See Current Services in Chapter Three.

**Determination Six: Nature, location, and extent of services provided by CCSD**

See Chapters Three, Four and Five

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**Note: Based on the information that is provided in the SOI/MSR report to support these statements, it is clear that the District's decision to request a coterminous SOI consistent with the requested annexations should they be approved is the appropriate decision. Therefore, LAFCO can be reasonably certain that approving the SOI as requested would be the appropriate decision for the Commission.**

## Section Two: Maximum Service Area and Service Capacity

In addition to completing an MSR study and a Sphere of Influence study for an agency LAFCO is also required to complete a study to determine the Maximum Service Area and Service Capacity of that agency. Government Code Section 56378 provides the following:

*“In addition to its other powers, the commission shall initiate and make studies of existing governmental agencies. Those studies shall include, but shall not be limited to, inventorying those agencies and determining their maximum service area and service capacities. In conducting those studies, the commission may ask for land use information, studies, and plans of cities, counties, districts, including school districts, community college districts, and regional agencies and state agencies and departments. Cities, counties, districts, including school districts, community college districts, regional agencies, and state agencies and departments, shall comply with the request of the commission for that information and the commission shall make its studies available to public agencies and any interested person. In making these studies the commission may cooperate with the county planning commission.” (underline added)*

As seen by the underlined words above, this code section provides mandatory direction to LAFCO. In LAFCO law, there are no definitions provided for Maximum Service Area (MSA) or Maximum Service Capacity (MSC) nor are there any guidelines provided as to how LAFCO would accomplish the requirements of this section.

Rather than conduct a separate study, Mendocino LAFCO’s policy is to include the requirements of this section in the same study/report as that for the Sphere of Influence and the Municipal Service Review. This approach prevents excessive study efforts and minimizes costs to the agencies and LAFCO. This approach is more efficient and effective because it provides to the public, a report available in one location that details comprehensive information about the agency.

Because there are no guidelines as to Maximum Service Area, LAFCO has determined that the MSA should include, at a minimum, the present territory of the agency, the proposed SOI and any areas provided service through either Municipal Improvement Districts, approved Out-of-Area Service Agreements (Section 56133) or historical areas of service provided by the agency prior to the requirements of Section 56133.

**Based on information provided in this report about the present and future capacity and ability to provide wastewater services, LAFCO has determined that the Maximum Service Area and Maximum Service Capacity of Covelo CSD is to include: (1) the existing District jurisdictional boundaries and; (2) the proposed coterminous SOI once annexations are approved.**

## COVELO SOI/MSR REPORT

### Chapter Eight: Environmental Review

#### CEQA Applicability

The California Environmental Quality Act (CEQA) applies to all discretionary activities proposed to be carried out or approved by California public agencies, unless an exemption applies. CEQA defines a project *“as the whole of an action which has the potential for resulting in either a direct physical change in the environment or a reasonably foreseeable indirect change in the environment.”* As used in CEQA, the term “project” is very broad. A project under CEQA is considered to be an activity directly undertaken through public agency contracts, grants, subsidies, loans, or other assistance from a public agency or an activity involving the public agency issuance of a lease, permit, license, certificate or other discretionary entitlement for use, unless exempted. In *Bozung v. Local Agency Formation Commission (1975)*, CEQA was judged to apply to changes of organization or reorganization.

An SOI determination is a discretionary decision of the Commission that will affect future growth and development. A Municipal Service Review is a study that will be used as an information source for assistance in determining SOIs and other decisions of the Commission. State CEQA Guidelines provide for an exemption for studies. Article 18 of the State CEQA Guidelines provides the following Class Six exemption in Section 15306: *“Class 6 consists of basic data collection, research, experimental management and resource evaluation activities which do not result in serious or major disturbance to an environmental resource. These may be strictly for information gathering purposes or as a part of a study leading to an action which a public agency has not yet approved, adopted or funded.”*

Because a Municipal Service Review is a study and studies are exempted, it therefore does not require an environmental review under CEQA. It does lead to an action in that, by law, Sphere of Influence determinations or amendments cannot be approved until the Service Review is complete. Under G.C. 56425, Sphere of Influence determinations require a corollary study, which may be combined with the MSR study, with separate determinations and a discretionary decision of the Commission for which the information in the Service Review can and will be used for making those determinations and decision.

Because a Sphere of Influence determination requires a discretionary decision of the Commission as to the size and circumstance of the Sphere, Sphere of Influence determinations are a project under CEQA and clearly do require an environmental review. Therefore the environmental review occurs at the time that the Commission undertakes the Sphere of Influence determination for any agency.

#### Covelo CSD Sphere of Influence Environmental Review and Exemption to CEQA

LAFCO’s determination of an SOI is a project under CEQA. LAFCO is the Lead Agency for this environmental review. Once a Lead Agency has determined that an activity is a project subject to CEQA, the Lead Agency is required determine whether the project is exempt from CEQA.

The conduction of the SOI/MSR study demonstrated that the District does not have the present ability to service an area larger than its proposed service area including annexations. Thus, a request for a coterminous SOI is being provided to LAFCO by the District.

The nature of a decision to determine a SOI is a legislative/planning decision of the Commission supported by a mandated study. Determining an SOI is the designation of future growth areas (depicted by the lines on a map) that will provide guidance to the District, landowners and LAFCO for any future decisions regarding annexation to the District. Providing that the territory of an SOI be coterminous with the District's legal boundaries effectively reduces the totality of possible annexation requests and thus potential future development. A coterminous SOI does not provide for any opportunity for increased development or other activities that would support or induce development; it does the opposite. Additionally, any future annexation requests will require a SOI amendment request and thus an environmental review commensurate with the proposed development associated with the annexation request.

However, for the proposed annexations, LAFCO conducted an Initial Study/Negative Declaration. Included in this environmental review was the understanding that the SOI would be determined to be coterminous with the new jurisdictional boundaries if the annexations are approved or would include this territory if not approved. Thus LAFCO will be filing a Notice of Determination of a Negative Declaration for the annexations and included SOI.