

TIME FOR CHANGE:

A Report on the Relationship Between the Ukiah Valley Sanitation District and the City of Ukiah Sewer System

May 21, 2009

Summary

The City of Ukiah (the City) and the Ukiah Valley Sanitation District (the District) are jointly responsible for providing sewer services to the Ukiah Valley area. Complaints and allegations of financial wrong-doing on the part of the City of Ukiah as a joint service provider with the Ukiah Valley Sanitation District led the 2008-09 Grand Jury to investigate the history and relationship between the City and the District.

Jurors found no evidence to support allegations of improper financial manipulation. The investigation did reveal a lack of transparency on the part of the City and mistrust by the District. The investigation also identified examples of inadequate accounting procedures for cost allocation, poor or non-existent communication between the two parties, and inadequate long-term planning.

The necessity to build an updated and expanded wastewater collection and treatment plant has resulted in financial commitments that bind the City and the District with shared payments averaging \$4.9 million annually until 2036.

This indebtedness has exacerbated tensions between the City and the District. It has brought into question accounting procedures that fail to track accurate data on water and sewer system maintenance costs within the City, including allocation of depreciation of equipment. The current accounting system does not detail operating and maintenance costs specifically attributable to the District.

The City Council and District Board have not always engaged in regular, effective communication. In the absence of long-range planning, they were largely reactive in actions taken regarding major maintenance and capital improvements, new sewer services, project planning and annexations.

In December 2008, the District changed from a *dependent* to an *independent district* as defined by Special District law. The composition of the board changed from having three appointed members to having five members elected from among residents of the District. As a *single purpose, enterprise district*, the District is dependent on service fees and tax revenues to meet capital and operating needs and is required to complete annual audits.

The new board is somewhat limited in their actions and decision making processes due to provisions of the existing Participation Agreement and Financing Agreement for the Treatment Plant Upgrade and Expansion Project.

Background

The City of Ukiah has owned and operated its wastewater collection and treatment system since the late 1880s.

In the mid 1950s, due to more stringent state and federal public health mandates and a home construction boom in and around the City of Ukiah, the City chose to abandon its old and failing sewer plant on East Gobbi Street near the river, now known as Riverside Park.

The City acquired property south of the City, northeast from the intersection of Boonville Road and South State Street, and planned for the construction of a new plant. The new plant was completed and placed in service in 1959.

The location of the new facility provided an opportunity for use by areas outside the City service area. At that time those areas were served by private disposal systems, except for the Ukiah Village subdivision. That development had built its own small disposal plant located on the northwest corner of Laws Avenue and South State Street. The small privately owned and operated treatment facility was failing and was a constant source of complaints to the County.

In answer to recurring complaints from residents just outside the City limits, the County Board of Supervisors (BOS) created the Ukiah Valley Sanitation District and established its boundaries. Except for annexations, some of which were non-contiguous, the boundaries have remained essentially the same.

Rather than constructing a separate wastewater treatment facility, the newly formed District joined with the City to provide sewer services for the Ukiah Valley area.

Methods

The Grand Jury interviewed past members of the District board and present employees of the City as well as interested community members, attended meetings of the City Council and the District, reviewed resolutions, indices of relevant ordinances, agendas and minutes of the District, Ukiah City Council and the Joint Ad Hoc committee of the City and District, and other documents.

Findings

1. On July 6, 1954, the Board of Supervisors created the Ukiah Valley Sanitation District. The District was to be governed by two Mendocino County Supervisors and one Ukiah City Council Member, all appointed by their respective governing bodies.
2. Negotiations between the City and the District resulted in an agreement to allow the City treatment plant to be used by the District. The agreement called for the City to construct the treatment facility and the District to pay for

- costs to install the necessary north-south pipelines (trunk sewer) to transport the waste to the plant. The work on both projects was completed in 1959.
3. A District bond issue was passed to pay for sewer lines into some of the formerly unserved areas. Some areas within the District, such as Fireside Village, chose to opt out of being included in the sewer service area.
 4. The District chose not to set up its own operations for such tasks as maintenance, billing and collections but rather negotiated with the City to provide the following services:
 - Treating wastewater generated within the District at the City-owned wastewater treatment facility
 - Operation and maintenance of its sewer collection system in accordance with District ordinances, policies, procedures and industry standards
 - Meeting all required Federal and State regulations
 - Performing minor engineering and construction projects within the District
 - Billing and collection of monthly user fees
 - Receiving fees and charges and for making inspections of new connections
 - Maintaining financial records and performing transactions relative to certain District revenue and expenditure accounts
 5. On July 19, 1995, the City of Ukiah and the District entered into a new Participation Agreement for the operation of joint sewer facilities. The agreement was modified three times: March 24, 1999, December 15, 2004, and March 2, 2006. The following are key elements of the Agreement, as modified:
 - a. The City shall operate, maintain and repair the District's collection system, in accordance with the District rules, regulations and ordinances.
 - b. The City and District are prohibited from contracting for sewage treatment outside the District boundaries without the consent of both parties.
 - c. New connections may only be made at points that are mutually agreeable to the City and District.
 - d. Costs of treatment shall be apportioned annually based on the ratio, as of each March 31, of the number of equivalent sewer service units (ESSUs) of each jurisdiction. An ESSU is a unit calculated as discharge from a typical single family residential unit.
 - e. The City shall be the paying and receiving agent for all District and City maintenance and operation funds.
 - f. The City shall comply with specified insurance requirements.
 - g. The City shall maintain complete records and accounts related to costs and expenditures and all sewer revenues collected.
 - h. The City shall retain title, management responsibility and control of the sewer treatment plant including additions or changes. City personnel shall maintain, operate and control the treatment plant and also service and maintain all trunk and collection lines.
 - i. The District shall establish ordinances, resolutions, rules and regulations for administration of the District's system.

- j. The District shall set connection, service, permit and inspection fees and capacity charges. Fees shall be sufficient to reimburse the City in amounts calculated by the City.
 - k. The original Agreement specifies a 30-year term, to July 2025, with an option for either partner to cancel upon 5 years advance written notice. However, the financing agreement includes an extension to 2036, the final maturity of the Association of Bay Area Governments (ABAG) bonds. It precludes cancellation or termination of the Agreement unless the District enters into a substantially identical agreement with ABAG or prepays all future allocated debt service to the City.
 - l. The total annual debt service due from the City and District on the revenue bonds for expansion and upgrading of the plant averages \$4.9 million through 2036.
 - m. The District Board of Directors and the City Council are required to meet at least once a year.
6. The Agreement clearly calls for the City and the District sewer systems to be operated and maintained as a single enterprise system with operating costs apportioned to the City and the District based on the ratio of City/District ESSUs.
 7. The City must constantly be in a planning mode in order to meet current and anticipated state and federal regulations and to secure the required five-year renewals of their National Pollutant Discharge Elimination System (NPDES) permit.
 8. In the late 1990s the City and District agreed that the plant needed more capacity to accommodate projected development over the next 15 to 20 years. The City and District planned for a reasonable expansion of ESSUs, taking into account the limited ability of the current ratepayers to repay the associated debt.
 9. A preliminary study of the plant was completed by Kennedy /Jenks Engineering Consultants in 2000. The study considered current plant treatment capacity and provided the City and the District with an independent evaluation of future capacity needs and estimated costs.
 10. On May 23, 2001 results of the Kennedy/Jenks study were presented to the District Board. A similar briefing was made to the City Council the previous month. Minutes indicate that both entities recognized the need to proceed with final planning for a plant upgrade and expansion project.
 11. At the July 24, 2002 meeting action was taken to adopt a 50/50 cost sharing between the City and District for engineering expenses associated with the City of Ukiah Wastewater Treatment Plant project.
 12. After a formal request for proposal (RFP) process seeking preliminary design and cost estimates, Brown and Caldwell, Consulting Engineers was selected by the City with District concurrence.
 13. Brown and Caldwell's estimated costs for the upgrade and expansion substantially exceeded previous estimates presented in the 2000 Kennedy/Jenks report.
 14. In response to concerns about the cost of the plant project, the City and District authorized a "value engineering" study to examine various aspects of

- Brown and Caldwell's preliminary design and to make recommendations for appropriate cost-cutting measures that would not affect overall upgrading and expansion goals.
15. This study delayed the project for six months. During the delay, construction costs increased considerably.
 16. The financial consulting firm, Bartle Wells was hired to provide an initial analysis and recommendation for financing the cost obligations based on the preliminary engineering estimates by Brown and Caldwell. A follow-up analysis was made after the low bid was received.
 17. Bartle Wells recommended that costs for the expanded capacity of the plant be met by adjusting fees and charges on new hookups in the City and District.
 18. Bartle Wells also recommended that the current and future users in the City and District pay for the plant upgrade portion of the project through a series of five rate increases on the monthly sewer service charges.
 19. On November 2, 2005, the District and the City separately adopted identical sewer service fee schedules for the five fiscal years allowing annual adjustments through June 30, 2010. Approval proceedings were conducted in compliance with Proposition 218 (Articles XIII C and XIII D of the State constitution) calling for public notice and majority protest hearings for service based user fees. This obviated the need for electoral approval of tax increases. The final rate increase is scheduled to be implemented on July 1, 2009 and to remain in effect through June 30, 2010.
 20. The City and District entered into an agreement on March 2, 2006 to secure financing for the plant project and establish the procedure for the District to pay its share of the installment payments.
 21. The City has the primary obligation for repayment of the \$75,060,000 in revenue bonds issued by the Association of Bay Area Governments (ABAG) for the project. Upgrades and rehabilitation costs are to be paid on the same basis as operating costs. This basis is the number of ESSUs billed to each entity and annually adjusted according to the ratio of existing ESSUs. Expansion of the capacity is to be paid by the potential additional ESSUs allocated to each entity and the loan interest charges are to be paid by the new hook-ups.
 22. More of the additional hookups were allocated to the District because more growth was projected outside the City limits. This obligated the District to a greater share of the long-term financial obligation.
 23. Both the City and the District initially approved the Wastewater Treatment Plant upgrading and expansion project and authorization was given to City staff to proceed with a call for construction bids. The Kiewit Pacific Company bid was accepted and the contract was awarded on October 17, 2005.
 24. Completion of the multi-year plant project is anticipated by June 2009, ahead of schedule and under budget.
 25. Former members of the District Board have reported a "lack of communication or transparency" and not consistently receiving timely information from City staff and City administration. This situation is alleged to

- have occurred mostly leading up to the current plant project and following the implementation of the 1995 Participation Agreement.
26. In recent years the District has sought increasingly detailed information from the City.
 27. City staff members have acknowledged past shortfalls in providing information to the District and are considering a new accounting system that might improve responsiveness. Some argue that the City is not sufficiently staffed to provide all the information that the District may desire and that more detailed accounting would not be cost-effective in terms of ratepayer benefits.
 28. Recorded minutes show that District meetings were held sporadically during the planning and formative phases of the plant project. For example, only three District Board meetings were held in 2000, two of which were related to consideration and adoption of the annual budget.
 29. Despite a lack of involvement in the planning process, recorded minutes indicate that from mid-2002, the Board *did* become more vigilant and ultimately concurred with all plant project decisions and participated in public hearings for establishing the new user rates and new connection fees.
 30. The City maintains accounting records on the basis of a single unified sewer enterprise fund. Financial statements are audited annually by independent certified public accountants as part of the normal audit requirement. The City's audit reports have been timely and contain "clean audit" opinion letters.
 31. The Participation Agreement requires the City "...to maintain complete records and accounts..." but it does not appear to require the City to differentiate City and District financial information. Until recently, there have not been separate audit reports for the District. This practice has been publicly criticized.
 32. In 2007 an audit firm, other than the City's, was engaged to examine the District books for the period 2001 through 2005. The auditors reported that because the City did not allocate costs between the District and City, available data were inadequate to support an independent audit report for the District. However, the firm subsequently completed an audit for 2006-07 that was accepted by the District Board and forwarded to the State.
 33. Budgets proposed by the City and approved by the District have regularly included more approved major maintenance projects than were achievable with the available level of funding and staff.
 34. Mutual disrespect and a lack of cooperation have developed between some representatives of the City and the District.
 35. In May 2008, the District established a part-time District Manager Position.
 36. In November 2008, the District changed from a *dependent* to an *independent district*.¹ The composition of the board changed from having three appointed members to having five elected members who reside in the District. The five-member board took office in December 2008.

¹ Dependent districts are governed in full by individuals appointed by other existing legislative bodies like a city council or board of supervisors. Independent districts are governed by a board of directors elected directly by the district's voters or appointed to a fixed term of office by another legislative body such as a board of supervisors.

37. As an *independent single purpose, enterprise district*, the District is dependent on service fees and tax revenues to meet capital and operating needs. As an independent district, it is required to perform an outside audit annually unless the board and board of supervisors approve biannual audits.
38. The first amendment to the Agreement requires joint approval of the annual combined sewer budget (Account 612).
39. The current plant expansion project provides for 2,400 additional ESSUs and allocates 1560 (65%) to the District and 840 (35%) to the City.
40. Because some of the District service area lies within the City limits, it is conceivable that some of the District's ESSUs could be used on City authorized projects in this *overlap area*.
41. Approximately one-half of the District's sewer accounts for domestic and commercial sewer billings lie within the City limits, in the *overlap area*.
42. The City maintains separate revenue accounts for domestic and commercial sewer billings for the City and the District.
43. As an independent *special district*, the District may:
 - procure services
 - enter into contracts and agreements
 - incur debt
 - employ personnel
 - adopt resolutions and ordinances
 - initiate and approve annexations
 - approve and construct sewer extensions and new connections
 - establish user rates, fees and charges in accordance with existing agreements with the City. The District is obligated to budget and fund such activities from sources outside of Operating and Maintenance account 612.
44. Account 612 fund balances found to be in excess of annual operating and maintenance needs are accumulated in the sewer enterprise fund and are available for budgeting in future years.
45. The City currently estimates system maintenance and repair costs rather than tracking actual data to allocate these expenses.
46. In some instances, work crews and vehicles or other major equipment or machinery that are paid for and maintained partially or wholly with merged funds are used by other City Departments.
47. The District and City have not engaged in adequate joint long-range planning. They have been largely reactive in actions taken regarding major maintenance and capital improvements, new sewer services, project planning and annexations.
48. Many of the findings cited in this report should be addressed in the City's Sanitary Sewer Management Plan (SSMP) and the Municipal Service Review currently underway by the Local Area Formation Commission (LAFCO).²

² Additional information may be found on the LAFCO website at www.mendolafco.org

49. On August 14, 2008, a joint Ad Hoc committee of the City and the District published a report including nineteen recommendations for amendments to the Participation Agreement.³

The Grand Jury recommends that:

1. the City Council and District Board hold joint briefings at the earliest stages of planning and discussion for National Pollutant Discharge Elimination System (NPDES) permit renewal and/or consideration of plant upgrading or expansion, and that they continue joint briefings throughout any subsequent project. (Findings 7, 10, 14, 28-29, 47)
2. the City Council and District Board schedule periodic orientation workshops for City Council and District Board Members to ensure that all members understand their shared responsibility for providing sewer service in the Ukiah Valley. (Findings 34-36)
3. the City Council and District Board secure input from Mendocino County, LAFCO and other planning bodies and review all available area-wide planning documents prior to making decisions about future expansion and ESSU determinations. (Findings 22, 48)
4. the City Council and District Board base final determination of future plant expansion on a detailed financial study that addresses the potential economic impacts on current and future users, strategies for dealing with changing economic conditions, and the ability of City and District ratepayers to meet current and future indebtedness. (Findings 5-6, 40, 47)
5. the City and District maintain a central list of prioritized projects but that they only include in annual budgets items for which funds and staffing have been identified. (Finding 33)
6. the City Staff provide the City Council and District Board with monthly reports including but not limited to:
 - revenue and expenditures (Account 612) with comparisons with the budget
 - summaries of new connections
 - field maintenance and inspection activities
 - overflows and/or treatment plant process malfunctions, if any, actions taken and any fines incurred.
(Findings 25-27, 30)

³ The report of the Ad Hoc committee is available on the Grand Jury website as a backup document to this report www.co.mendocino.ca.us/grandjury

7. the City Staff, City Council and the District Board and Manager regularly exchange information, as needed, including:
 - updates on major projects
 - inquiries regarding new connections
 - status of pending projects and/or planning activities in each entity
 - relevant information such as complaints, inspections by regulatory agencies, etc. during the past month.
(Findings 25-28)
8. any actions or services requested of the City (by the District) beyond the existing Agreement be documented in supplemental agreements that are negotiated, budgeted and funded by the District independently of the restricted Operating and Maintenance (O&M) funds in Account 612.
(Findings 4-5, 49)
9. any expense for a purpose specifically benefiting one entity, and not of value to the other, be separately budgeted and funded. (Findings 34, 44, 46)
10. the City develop accounting procedures to accurately allocate costs, including the full cost of equipment used for maintenance of City water, City sewer, District sewer, and for use by other City Departments in a manner that will permit monthly expense reports for each entity. (Findings 5, 37)
11. the City Council and District Board conduct a joint mid-year sewer budget hearing no later than January 31 each year to compare actual revenue and expenditures with budget estimates, review the status of budgeted activities and consider maintenance and capital improvement goals. (Findings 4-5, 45-47)
12. the City and District notify and keep each other fully informed of all activities that might directly or indirectly impact the other such as planning for boundary changes, annexation of new areas, proposed subdivisions, collection system extensions, new connections, major maintenance projects, "will serve" commitments, permits for pre-treatment facilities, or any legal or financial issues. (Findings 38, 43)
13. the City and District adopt similar, if not identical policies, procedures, standards for construction, user rates, and miscellaneous fees and charges wherever possible. (Findings 5-6, 19)
14. the City, while exercising its obligations of the Participation Agreement and amendments thereto retain sole authority, discretion and responsibility for selection and employment of administrative, operating and maintenance personnel for the unified City/District system along with the right to establish appropriate pay schedules. (Finding 5)

15. the District, apart from its contractual relationship with the City under existing Agreements, retain its identity, and continue exercising power and discretion as an *independent special district*. (Findings 37, 43)
16. the City employ only appropriately certified operating and maintenance personnel including those in direct supervisory or administrative positions in the sewer division of the City's Public Works Department. (Findings 5, 7)
17. the City and District hold joint planning and budget review sessions on a quarterly basis as a minimum and more often as needed. (Findings 28, 29, 34, 38-40)
18. the District continue to hold regular monthly meeting dates and special meetings as needed. (Finding 28)
19. the City and District re-visit the Participation Agreement and subsequent amendments, review their respective needs for efficient, cost-effective and transparent operations and make revisions, as required, to ensure transparency and a unified approach for providing sewer service. (Findings 4-5, 49)

Discussion

The Grand Jury found no evidence of wrong-doing but did find that the City's records of sewer and water related expenses do not break out operating costs specifically attributable to the Ukiah Valley Sanitation District. While doing so would be costly, it could be a valuable step toward transparency and a more trusting working relationship.

A lack of frequent, effective communication and adequate long-range planning has resulted in the District and City being largely reactive in actions taken regarding new sewer services, project planning and annexations.

Improving communication and planning will become increasingly important in view of the need to reclaim and reuse water more effectively and minimize further financial burdens on ratepayers.

The findings illustrate the complex structure through which the City and District provide sewer service to the Ukiah Valley. Each entity has a long-term financial obligation to work together. The City and District are encouraged to review their respective needs for efficient, cost-effective and transparent operations and adopt a unified approach for providing sewer service.

Required Responses

City Manager, City of Ukiah (All Findings; All Recommendations)

Ukiah City Council (All Findings; All Recommendations)

Ukiah Valley Sanitation District Board of Directors (All Findings; All Recommendations)

Ukiah Valley Sanitation District Manager (All Findings; All Recommendations)

Director, Local Area Formation Commission (LAFCO) (Findings 37, 43, 48 and Recommendation 3)