



EDUCATIONAL SERIES

Release 3, April 29, 2021

DEBT

FVC’s Educational Series serves as educational communications to Vallecitos Water District Board Members and advocates to provide information sufficient to acquire an understanding and comfort level for initiating and supporting Board actions for positive change for the benefit of ratepayers.

Board Members, please see “Caution – Open Meeting Act Compliance” at the end of this release. These communications cannot be a means to reach a consensus of the Board majority or communicate a position on an issue. That must be done at meetings posted and open to the public. These communications are strictly to educate, inform, and mitigate the current lack of transparency at the Vallecitos Water District.

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## Background

Vallecitos Water District (VWD) is a publicly-owned, sole purpose, special district (political subdivision of the State of California). Its sole purpose is providing water and sewer service to its customers. Being a publicly-owned entity, the public (ratepayers) own the assets of VWD and are burdened with the liabilities VWD incurs on their behalf. VWD's Board of Directors and administration have a legislated fiduciary responsibility to manage and maintain those assets and liabilities for the benefit of ratepayers and to provide the service for which customers have paid.

Utility companies, whether public or investor owned, are capital-intensive entities, requiring costly acquisition and replacement of capital assets, like treatment plants and process equipment, tanks, reservoirs, lift stations, pump stations, and pipe lines. Financing these capital assets with debt is common in the utility industry.

Debt, as opposed to cash financing, provides intergenerational equity. These capital assets can cost scores of millions of dollars, but provide benefit to ratepayers for 30, 40, maybe 100 years. Cash financing would place undue burden (usually in the form of higher water and sewer rates) on current ratepayers. Debt financing stretches that burden equitably among current and future generations that benefit from the capital assets being financed.

Capital assets that are acquired to accommodate new demand from new customers (growth) cannot legally be paid for by existing customers. New owners, or the developers of residential and commercial building projects, must pay for their impacts. ***Amounts VWD receives from water and sewer bills (ratepayer money) can be used only to pay for costs necessary to provide water and sewer service.*** [California Constitution Article XIII D Section 6\(b\)](#)

VWD has been using ratepayer money to cash finance developer obligations due to a spiraling deficit in VWD's developer, or capacity, funds. The deficit (negative balance) means there is no developer money – the cost of their impacts have exceeded the fees they have been assessed. The developer fund is funded by capital facility fees assessed to developers to cover the costs VWD incurs to accommodate growth. The fund is reduced by the cost to acquire growth-related capital assets as well as the debt service (principle and interest) on debt incurred to finance growth-related asset acquisitions. ***Since 2013, the VWD Board of Directors has made several accommodations to developers*** (allowing a particular builder to develop without paying impact fees, deferring time of payment of capital facility fees, suspending and refunding impact fees, delaying a much-needed capital facility fee increase for more than four years, adopting insufficient developer fees with known calculation errors – see [FVC Educational Release 1](#) for more details). ***Because of these accommodations, the developer fund has gone negative, leaving only ratepayer money available to pay for developer obligations*** (growth-related capital assets and debt service).

On April 15, 2019, ***staff relayed a request from developers to VWD's Finance Committee, "Can we continue to borrow from ratepayers?"*** Staff explained, "Instead of paying our ratepayers back at 2% [interest], developers would be paying 5%" if bonds were issued. Developers apparently knew that they were borrowing from ratepayers, but the debt was never authorized. No Board action was placed on an agenda. ***Ratepayers never knew they were party to a loan with no collateral, no due date, and no agreed-upon terms.*** With VWD projecting an escalation of the deficit (which is equal to the amount "borrowed" from ratepayers), ***ratepayers may never be paid back the principle or interest on this unauthorized and unconstitutional "loan."*** VWD Board Member, Director Mike Sannella, acknowledged, "We [developers] are making money on ratepayers' money." [Finance Committee meeting audio, 1 hour and 59 minutes in](#)

By cash financing urban development with ratepayer money, **VWD has shifted a significant portion of the burden of urban development from current and future builders, to current ratepayers.** Although VWD claims that ratepayers will be paid back in ten years (no such projection has been made public), their current budget includes a 5-year projection that shows, **even if VWD incurs the maximum legal debt within their developer funds, the developer fund balance will spiral further from its current deficit of \$15.7 million to a deficit of \$20.4 million in five years.**

This release endeavors to provide a basic understanding of financing alternatives, cash financing versus debt considerations, tax-exempt debt, the issuance team, the issuance process, VWD's debt portfolio, and recommendations critical to VWD recovering the deficit, paying back ratepayers, and complying with the California Constitution.

### Financing Sources and Alternatives

**Pay-Go** (short for *pay-as-you-go*) is the term associated with cash financing projects, rather than incurring debt. Larger public entities may maintain a Pay-Go fund, or reserve, in anticipation of cash funding projects in their 5-Year Capital Improvement Program (CIP). VWD uses ratepayer-funded capital replacement reserves like a pay-go fund for growth (developer-obligated) projects.

**Private Placement** occurs when the District negotiates terms for a loan with a bank or a consortium of banks and financial institutions. VWD currently has two private placements. The one with Union Bank of California has a current balance of \$3.2 million, with the final payment due in 2029. The \$8 million originally issued in 2008 financed expansion costs at a regional sewer treatment plant that accommodated additional demand on the system from new customers (a developer obligation). The other private placement was originally through Bank of America (creditor interest may have transferred since) and has a current balance of \$1.5 million with the final payment due 2023. The original \$7.1 million issued in 2012 financed sewer line expansions accommodating increased demands from new customers (a developer obligation).

Private placements have fewer SEC regulations, less underwriting fees, and less steps to issue (faster) than publicly issued bonds. Interest rates associated with private placement may be more than bonds, and the amount issued may be limited depending on the credit market. Bigger debt issues tend to be in the form of bonds.

**Bond Issuances** offer the public an opportunity to loan money to the District. Bonds are very structured and heavily regulated with extensive disclosure requirements. VWD has one bond issuance outstanding with a current balance of \$41.4 million. The original proceeds in 2015 of \$45.3 million were to refinance previous bond issuances for a better interest rate, with the final payment due in 2036. The previous bonds financed the Twin Oaks Reservoirs and the sewer treatment plant expansion – all to accommodate growth (a developer obligation).

Discussion on the variety of types of bonds (commercial paper, general obligation bonds, revenue bonds, certificates of participation) is omitted from this release. Parties involved in a bond issuance and the process are described in summary later in this release.

**Public Private Partnerships (P3s)** occur when a public entity (government) and a private entity (business) cooperate to finance, own, and operate a project. The Carlsbad Desalination Plant is an example of a P3 where Poseidon Ltd, a private entity, raised equity capital, and the San Diego County Water Authority (CWA) issued bonds to finance construction of the seawater desalination plant. Poseidon is the builder, owner and operator of the plant, while CWA is the customer receiving desalinated water pursuant to a take-or-pay contract. VWD and Carlsbad Municipal Water District share in the take-or-pay contract pursuant to agreements with CWA.

## Pay-Go versus Debt Considerations

**Rates and Charges** – Pay-Go, or cash financing, requires an entity to build up significant cash reserves before commencing a capital improvement project. VWD has only two controllable reserve sources: One from water and sewer bills, the other from Capital Facility Fees (Cap Fees) assessed to developers.

VWD continues to use ratepayer-funded reserves for Pay-Go. ***This build up in reserves requires increases to water rates, the most recent included a \$6.9 million “transfer to capital reserves,” which constitutes 14.5% of VWD’s current water bill.*** Even though VWD’s Cap Fee calculation assumes that all growth-related capital asset acquisitions are debt financed, VWD continues to put upward pressure on water and sewer rates by cash financing growth-related capital asset acquisitions with ratepayer money. Assuming debt financing in the Cap Fee calculation enables VWD to spread the costs of developer impacts to current *and* future development. The Cap Fee is not sufficient to cover Pay-Go financing, so VWD keeps relying on ratepayers to pick up the tab, and with no planned Cap Fee increase, other than inflationary adjustments, on the horizon (at least five years), the cycle will continue. In addition to issuing debt, VWD needs to address Cap Fee deficiencies to restore ratepayer equity.

**Affordability** of water and sewer rates becomes a consideration with continued use of ratepayer money for Pay-Go. In an August 11, 2020, [press release](#), ***Fitch credit rating agency considered a monthly VWD water and sewer bill in 2018 for 7,500 gallons of use (\$110) to be unaffordable for about 20% of VWD’s population.*** Fitch did not consider VWD’s summer use rate, the second highest in the County (City of San Diego is the highest), or pumping charges, in their analysis. ***Using debt to finance developer obligations versus using ratepayer money would have made VWD water and sewer rates more affordable.***

**Reserve Levels** are a consideration when using Pay-Go. Will reserves drop below policy-established targets? For VWD this has not been an issue. ***VWD’s water and sewer rates have been sufficient enough to maintain the highest ratepayer reserves of all San Diego County retail water agencies.*** VWD’s reserve policy does not address restricted reserves like the developer reserves. ***VWD is the only water agency in San Diego County (and possibly all of California) with a deficit in developer reserves. see [FVC Educational Release 2](#) for more details on reserves***

**Debt Levels** – Too much debt will not look favorable for credit ratings and lower an agency’s capacity to issue new debt. Issuers need to consider if they will have enough revenue to cover their existing debt service, plus the debt service from a new issuance. If not, the agency will need to use Pay-Go. This is not an issue for VWD considering their excessive ratepayer reserve accumulation and that their net revenues have been at least 3 times more than debt service since 2015.

## Tax-Exempt (Municipal) Bonds

Local governments can issue bonds with interest earnings for the investor that are exempt from federal and state income tax. Investors are willing to receive less in interest from government bonds than from taxable corporate bonds, since the government bonds are not taxable. Governments save money on interest expense with the lower tax-exempt rates. Private placements can also qualify for tax-exempt status.

**Eligibility** – Governments may use proceeds from tax-exempt debt only for projects that benefit the public they serve. Prior to VWD’s current budget, the financial projection VWD calls “Long-Range Planning” included only eligible tax-exempt debt – debt proceeds that were limited to the cost on the capital improvement projects in each year of the projection. In their current Long-Range Planning, VWD assumes tax-exempt debt proceeds of \$50 million in the developer funds, but only \$35 million in eligible capital improvement projects in the years debt is assumed, and a developer fund deficit that decreases to \$6.8 million in five years. If VWD issues the maximum eligible debt in the developer funds, the \$35

million, the deficit will spiral to \$20.4 million in five years, according to their projection. If they issue no debt, the deficit will exceed \$50 million in five years.

Discussion on continuing eligibility requirements (arbitrage compliance, covenant requirements, mandatory disclosures, etc.) and private activity bonds are omitted from this release.

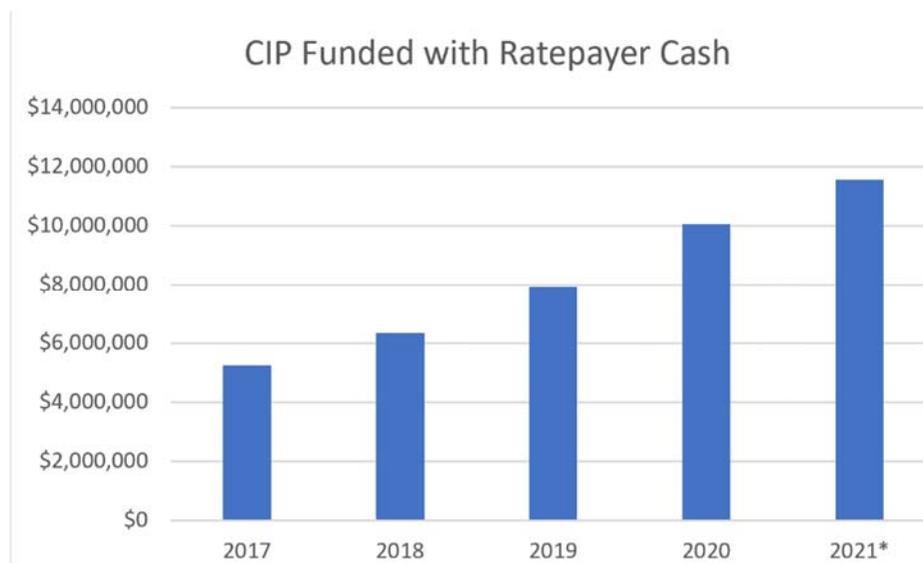
### Resolutions of Intent and the Need for VWD to Issue Bonds

**Resolutions of Intent** to incur debt (AKA Reimbursement Resolution or Inducement Resolution) are adopted before the planning process for debt issuance even begins. Prudent financial practice is to present the Resolution(s) of Intent for adoption to the Board with every annual budget.

Resolutions of Intent identify projects that may be debt financed and allow the issuer to receive reimbursement from debt proceeds for Capital Improvement Project (CIP) costs incurred before the debt issuance and after adoption of the resolution. There is no commitment to commence projects or incur debt just because the Resolution is adopted. If Resolutions of Intent are not adopted, the issuer can only request reimbursement from debt proceeds for costs incurred *after* the debt issuance. Proceeds from the issuance of debt are restricted, held with a Trustee, and only released to the Issuer when the Issuer presents a request for reimbursement of construction costs supported by invoices and other documentation.

Debt without Resolutions of Intent will only curtail future increases to VWD’s developer fund deficit, as will adopting sufficient cap fees, and may never recover the balance. The only way to reduce the deficit immediately is with the instant cash infusion that can occur only if resolutions of intent are in place when the issuer (VWD) presents the first requisition for reimbursement to the Trustee. The deficit is restored for the amount of reimbursement for prior construction costs in the developer (or capacity) funds. That first requisition amount is that much less that VWD has to “borrow” from ratepayers and increase water and sewer rates.

Since delaying issuing debt in the 2017 budget and not adopting resolutions of intent, VWD has potentially squandered the opportunity to eliminate the developer fund deficit. VWD has maintained upward pressure on water and sewer rates by funding their entire Capital Improvement Program, both for replacement and growth-related assets that are the responsibility of developers, with ratepayer cash.



\* Fiscal Year 2021 is for the nine months ended March 31, 2021

The Capital Improvement Projects (CIP) funded with ratepayer cash as displayed above include \$7 million in growth-related CIP which should have been funded with Cap Fees assessed to developers, or debt-financing with the burden of repayment on developers. Ratepayers have cash financed all \$7 million in growth-related CIP in addition to making all payments to bondholders for debt to finance growth-related CIP. The total CIP, including CIP replacements which are the burden of ratepayers, is shown, as a prudent strategy would be to debt finance replacement CIP as well as growth CIP and then shift debt for cash from ratepayer funds to the developer fund, essentially replacing amounts financed with ratepayer cash that should have been financed with debt in the developer funds. The developer Cap Fee calculations assume all growth-related CIP is debt financed.

Only projects currently under construction can be reimbursed for prior costs. Once a project is completed, the opportunity for reimbursement of costs prior to issuance from debt proceeds is lost.

Reimbursement resolutions are not as critical for other water districts as no other water district in San Diego County has a deficit in their developer fund or subsidizes urban development with ratepayer money.

[Resolution 1522](#), dated July 19, 2017, was the last reimbursement resolution adopted by VWD. At the April 27, 2021, Finance Committee meeting, staff said they will present a Resolution of Intent at the May 19 Board meeting for consideration of approval. All but two projects (the San Marcos Interceptor and Encina Capital Projects) identified in the 2017 Resolution of Intent have either been completed or incurred only insignificant costs. VWD needs to size the next debt issuance considering (including) CIP costs of the two projects incurred since July 19, 2017. The May 19 Resolution will make little difference since it was delayed for so many years. And if VWD delays issuing debt until after completion of the Interceptor Project, at least \$5.2 million in potential instant reimbursement from debt proceeds will be lost.

#### Debt Issuance – Involved Parties and the Process

Complexities of a debt issuance require many forms of expertise and a team approach. There is not one person that does it all.

The **Issuer** is the entity selling bonds to investors, or underwriter(s). Bonds become debt of the issuer and a fixed-income investment to bondholders (creditors). The issuer must pay bondholders a return of their investment (principal) and interest, collectively referred to as debt service. The Issuer, like VWD, is a team within a team with tasks typically assigned to the Finance Manager, Financial Analyst, Engineer, General Manager, general legal counsel, and the Board of Directors.

**Reimbursement Resolutions** should be adopted with every annual budget (as previously discussed) and can be prepared by staff and reviewed by general legal counsel – it's a simple one-pager.

**Long-Range Financial Planning** is a highly collaborative process that combines operating and capital forecasts, a plan to meet objectives identified through formal strategic planning, and scenarios of assumptions regarding the District, the industry, and the economy, in order to present strategic financing alternatives. The financing alternatives could be those discussed previously, or a combination of Pay-Go, different types of debt, and rate adjustments. Different scenarios driven by varying assumptions should be presented in the Long Range Financial Plan (LRFP) along with their impacts on reserves and financial Key Performance Indicators. The LRFP typically incorporates a planning horizon between five to ten years and should be revisited frequently. The LRFP provides management and the Board with information necessary to assess consequences of tactical and strategic decisions. One specific objective is to present an annual budget to the Board for approval that supports the best alternative analyzed in the LRFP. VWD does not engage in long range financial planning. They incorporate what they call "Long Range Planning" in their budget, but it is merely a projection of reserve

activity and balances. Olivenhain Municipal Water District provides a good example of a LRFP that they include in their [budget](#) document, page 103.

**Budgeting** is the formal process of requesting Board approval for expenditures (for operating and capital acquisitions) and a financing plan for the coming year.

**Authorization to Issue Debt by the Board** to the General Manager can occur any time there is a foreseeable need to incur debt. There is no need to wait for the next budget to be approved. Delaying increases the chance to miss the optimal time to close a bond sale or loan agreement. Formal action to initiate the sale of bonds or finalize negotiated terms of a loan will come back to the Board for approval towards the end of the process. To date, the VWD Board has still not authorized the General Manager to issue debt.

**Timing and Sizing of the Issuance** - Once the General Manager is authorized to issue debt and contract with involved parties, debt can be issued in about four to five months. The closing process can be delayed or accelerated. The first step in the issuance process should be to size (how much to borrow) and time the issuance (closing of the bond sale or loan agreement) by projecting required monthly cash flows for construction of capital projects identified in the Resolution(s) of Intent. The primary objective of timing and sizing is to attempt to spend all bond proceeds within one-and-a-half to two years of the issuance date to avoid compliance issues with arbitrage rules, which could result in losing tax-exempt status. Issuers should never size the debt amount to 100% of projected capital expenditures and should identify all significant capital improvement projects (even if they do not plan to debt finance some of them) in the Resolutions of Intent and the bond documents in case expenditure projections fall short of actual expenditures (they usually do). Identifying all projects, even those intended to be cash financed, provides a cushion to be able to request funds from the trustee to expend all bond proceeds before legal time limits expire. All expenditures from date of adoption of the Resolution(s) of Intent to the projected date of issuance (closing) should be included the bond/loan amount. For VWD, these are the amounts that will directly and instantly reduce the developer fund deficit. Discussion on arbitrage rules is beyond the scope of the intent of a basic understanding of debt and, therefore, omitted from this release.

**Request for Proposals (RFPs)** for the various services needed to issue debt should occur very early in the process, even before formal approval to avoid missing the optimal time to close a bond sale or loan agreement. VWD is formed under County water law and therefore not subjected to the same rigorous competitive bid process as municipal water districts. However, the competitive bid process is prudent and in the best interest of the public. Staff can prepare and issue RFPs for the services involved, but a reputable Financial Advisor (FA) would be better suited for the RFP preparation and evaluation of proposals. Any other agency would consider VWD's continued reliance on ratepayer money for developer subsidies to be a financial crisis and should, therefore, acquire the services of an FA immediately (ahead of a time consuming RFP process). RFPs should be issued for Bond Counsel, Disclosure Counsel, Investment Banker (Underwriter), Paying Agent, and Trustee.

The **Financial Advisor (FA)** takes a lead role with other members of the team relying on the FA's coordination efforts, scheduling, communicating, directing, financial analysis, bond pricing, and preparing for rating agency presentations. The FA is contracted and works for the issuer. In VWD's case the FA should take on a bigger role and at least review (if not prepare) RFPs for the team members, evaluate proposals, and make recommendations for which bond counsel, disclosure counsel, investment banker, insurer (if insured), and credit rating agency (or agencies) to engage.

**Bond Counsel** provides necessary legal opinions (tax certificate) that the issuance qualifies for tax-exempt status and is in full legal and regulatory compliance.

**Disclosure Counsel** – Recent law changes requiring more rigorous public disclosure and enhanced responsibilities of issuers (including elected officials) have given rise to the need for separate disclosure counsel. Advising on disclosure used to be within the duties of bond (or special) counsel. Disclosure counsel will assist and educate the Issuer on required roles and responsibilities and drafting required documents (preliminary official statement, official statement) and continuing disclosure requirements.

**Investment Banker(s)** underwrite (or purchase) all the bonds from the Issuer and then market the bonds to other financial institutions, mutual funds, and sophisticated investors.

**Rating Agencies** assess the credit worthiness of the issuer and provide a rating for disclosure in a press release and in the official statement. The FA and Issuer will provide a slide presentation to one or two rating agencies attempting to support the highest possible credit rating. The big three credit rating agencies (Fitch, Moody’s, and Standard & Poor’s) have similar ratings as follows:

Moody's	S&P	Fitch	Credit worthiness
Aaa	AAA	AAA	An obligor has EXTREMELY STRONG capacity to meet its financial commitments.
Aa1	AA+	AA+	An obligor has VERY STRONG capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree.
Aa2	AA	AA	
Aa3	AA-	AA-	
A1	A+	A+	An obligor has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
A2	A	A	
A3	A-	A-	
Baa1	BBB+	BBB+	An obligor has ADEQUATE capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.
Baa2	BBB	BBB	
Baa3	BBB-	BBB-	
Ba1	BB+	BB+	An obligor is LESS VULNERABLE in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitments.
Ba2	BB	BB	
Ba3	BB-	BB-	
B1	B+	B+	An obligor is MORE VULNERABLE than the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.
B2	B	B	
B3	B-	B-	
Caa	CCC	CCC	An obligor is CURRENTLY VULNERABLE, and is dependent upon favourable business, financial, and economic conditions to meet its financial commitments.
Ca	CC	CC	An obligor is CURRENTLY HIGHLY-VULNERABLE.
	C	C	The obligor is CURRENTLY HIGHLY-VULNERABLE to nonpayment. May be used where a bankruptcy petition has been filed.
C	D	D	An obligor has failed to pay one or more of its financial obligations (rated or unrated) when it became due.

**Trustee and Paying Agent** have distinct roles and responsibilities but are typically the same entity (financial institution). The paying agent collects and distributes the principal and interest payments on the bonds. The Trustee holds the bond proceeds and has the ability to enforce the bond payment obligations. The Trustee will release proceeds to the Issuer only when the Issuer presents a formal request for reimbursement of construction costs with supportive documentation (invoices). If VWD does issue debt, on the very first day proceeds are deposited with the Trustee, VWD should present its first requisition for all costs incurred on identified and uncompleted projects, since the date of the 2017 Resolution of Intent and all adopted subsequent Resolutions. The amount associated with growth projects will directly reduce the deficit. The amount association with replacement projects should be transferred to the developer fund in exchange for assumption of debt in that fund (shift debt owed to ratepayers to debt owed to bondholders).

**Preliminary Official Statement (POS)** – The FA and Disclosure Counsel will assist the Issuer and take part in preparing the POS which contains preliminary information on the terms and conditions of the bond sale including the purpose and type of debt, and discloses required economic, financial and legal information necessary for the investor to assess the issue.

**Official Statement** (completed/finalized POS) is used by the underwriter to sell bonds to potential investors and provides disclosures required by the SEC in order to protect investors' interest.

**The Closing Process** is similar to escrow where all parties have to satisfy their obligations (sign documents) before the Underwriter receives the bonds and the Issuer receives payment. Discussion of types of bond sales (competitive versus negotiated) is omitted from this release.

### Recommendations

1. **Adopt Resolution(s) of Intent** to Incur Debt for all CIP projects, both for replacement projects (ratepayer burden) and growth projects (developer burden) that have at least a remote chance to incur construction costs from the date of resolution adoption through two years after the projected date of debt issuance. Resolutions of Intent should be adopted every year with the annual budget.
2. **Authorize the General Manager to Incur Debt** at the next Board meeting. There is no need to wait unless delaying the issuance is intended.
3. **Size the issuance** including 100% of construction costs on uncompleted CIP projects identified in Resolutions of Intent since the date of adoption through the anticipated date of issuance, plus 100% of growth-related CIP expenditures projected from the anticipated date of issuance through two years after the anticipated date of issuance, plus 50% of replacement CIP expenditures projected from the anticipated date of issuance through two years after the anticipated date of issuance. The 50% (rather than 100%) provides a cushion in case VWD does not spend what they anticipate and avoids potential compliance issues with arbitrage rules. Also, consider rolling existing debt into the issuance to increase the issue size, which looks favorable to investors and credit rating agencies, and reduces interest rates to the lower current market rate (ratepayers may still be on the hook for debt service if all recommendations are not embraced).
4. **Engage the Financing Team** as soon as possible. It looks as though VWD has an FA on Board – and one of the best in the business. That's good news. But now they need to get busy and send RFPs for Bond Counsel, Discloser Counsel, Investment Banking, and Trustee/Paying Agent services.
5. **Induce a Premium on Bonds** by setting the bond price below par (having a stated interest rate above the market rate) allowing for bond proceeds to be received in excess of principal.
6. **Transfer Replacement Debt to Developer Funds** – VWD finance staff should be using tracing rules to include the debt in the fund from which debt-financed capital expenditures are incurred. VWD has four funds: Ratepayer funds, Water Replacement and Sewer Replacement, and developer funds, Water Capacity and Sewer Capacity. Capacity Funds have had a spiraling negative (deficit) balance since the Board starting making accommodation to developers in 2013. Of course, you cannot pay contractors or bondholders with IOUs, so the Replacement (ratepayers') funds have been "loaning" money to developers, who are responsible for their impacts, to pay for growth related construction (and financing). The negative balance represents the amount "borrowed" from ratepayers. **Debt proceeds deposited in Capacity funds may not be adequate to restore the deficit. VWD needs to transfer debt traced to Replacement Funds to Capacity Funds in exchange for cash (from the Replacement Fund to the Capacity Fund). If the deficit balance can be restored to a surplus, the burden of repayment is with developers to bondholders as it should have been all along. Such transfers were a strategy used in the past when VWD had a ratepayer-focused and responsible Board. It's not magic. Ratepayers will never actually be paid back for the increases in rates in past years that accommodated developer subsidies, but at least future rate increases to pay developer obligations can be averted if a surplus is maintained in Capacity funds.**

7. **Embrace non-debt-related recommendations** to restore ratepayer equity. Debt alone will not restore ratepayer equity. There is still the issue of VWD’s unconventional reserve policy that VWD has used as justification for accumulating excessive reserves – funded by increased rates – see [FVC Educational Release 2](#) for more details on reserves. Eliminating Cap Fee deficiencies, reversing policy that favored developers at the expense of ratepayers, and other recommendations are noted in [FVC Educational Release 1](#).

Tentative Release Schedule

Educational Series Topic	Anticipated Release Date
<b>Introduction and the Deficit</b>	April 8, 2021
<b>Reserves</b>	April 14, 2021
<b>Debt</b>	April 29, 2021
<b>Master Plan and Cap Fee Study Overview</b>	May 15, 2021
<b>Cap Fee Study Methodologies (Buy-In component)</b>	May 31, 2021
<b>VWD Current Cap Fee Deficiencies</b>	June 15, 2021
<b>District Legal Counsel (responsibilities and strategies)</b>	June 30, 2021
<b>Ethics and Transparency</b>	July 15, 2021
<b>Water and Sewer Rates (overview, revenue requirement)</b>	July 31, 2021

Additional Information

Please consider obtaining additional background from the following:

FVC Educational Series, Release 1, Introduction and the Deficit

<https://friendshipvallecitoswater.files.wordpress.com/2021/04/fvc-educational-series-release-1-introduction-and-the-deficit.pdf>

FVC Educational Series, Release 2, Reserves

<https://friendshipvallecitoswater.files.wordpress.com/2021/04/fvc-educational-series-release-2-reserves.pdf>

Letter to VWD General Manager, February 23, 2021

<https://friendshipvallecitoswater.files.wordpress.com/2021/03/feb-23-2021-email-to-vwd-gm.pdf>

Letter to VWD General Manager, February 18, 2021

<https://friendshipvallecitoswater.files.wordpress.com/2021/03/feb-18-2021-email-to-vwd-gm.pdf>

*Vallecitos Water District Hidden Subsidies - A case study in the need for transparency and accountability*  
October 8, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/10/vallecitos-brief.pdf>

*San Marcos Water Rates and Politics*, a presentation to the San Marcos Democratic Club, June 13, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/san-marcos-dems-presentation-print-version.pdf>

Attorney General Consumer Complaint, May 22, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/ag-consumer-complaint-support.pdf>

*California Water Politics and Pricing*, a presentation to the American Institute of Certified Public Accountants Government Performance & Accountability Committee May 5, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/aicpa-california-water-politics-and-pricing.pdf>

San Diego County Taxpayers Association Golden Fleece Nomination, February 12, 2020  
<https://friendshipvallecitoswater.files.wordpress.com/2020/02/sdcta-vwd-golden-fleece-nomination.pdf>

Rate Protest Letter, February 3, 2020  
<https://friendshipvallecitoswater.files.wordpress.com/2020/03/scaglione-rate-protest-letter.pdf>

*San Marcos Water Rates and Politics*, a presentation to the Republican Women of California, February 3, 2020  
<https://friendshipvallecitoswater.files.wordpress.com/2020/07/rwc-hand-out.pdf>

*San Marcos Water and Politics – The Price We Paid*, Palomar College Political Economy Days, October 23, 2019  
Presentation slides – <https://friendshipvallecitoswater.files.wordpress.com/2019/10/san-marcos-water-and-politics-print-version.pdf>  
Recorded lecture – <https://www.youtube.com/watch?v=0AXsalWSWjl>  
News article – <https://thecoastnews.com/140102-2/>

Press release regarding developer subsidies  
<https://friendshipvallecitoswater.files.wordpress.com/2019/09/fvc-article-20191002.pdf>

Letter to VWD General Manager regarding Cap Fee deficiencies, May 28, 2019  
<https://friendshipvallecitoswater.files.wordpress.com/2019/08/vwd-letter-to-glenn.pdf>

#### Caution – Open Meeting Act Compliance

Article IX of the California Constitution requires the business of the public to be conducted in open meetings. The Board can take action, arrive at consensus, and take positions only in open meetings. While two Board Members do not constitute a majority, the potential for stating a position or attempting to gain consensus could happen, either intentionally or inadvertently, with a series of replies or communications. FVC's Educational Series communications cannot be a means to reach a consensus of the Board majority or communicate a position on an issue. That must be done at meetings posted and open to the public. These communications are strictly to mitigate the current lack of transparency at VWD, educate, and inform.

Excerpt for Article IX of the California Constitution:

#### **11122.5.**

(a) As used in this article, "meeting" includes any congregation of a majority of the members of a state body at the same time and place to hear, discuss, or deliberate upon any item that is within the subject matter jurisdiction of the state body to which it pertains.

(b) (1) A majority of the members of a state body shall not, outside of a meeting authorized by this chapter, use a series of communications of any kind, directly or through intermediaries, to discuss, deliberate, or take action on any item of business that is within the subject matter of the state body.

[https://leginfo.ca.gov/faces/codes\\_displaySection.xhtml?lawCode=GOV&sectionNum=11122.5.](https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=GOV&sectionNum=11122.5)