



SAN MATEO LAFCO
LOCAL AGENCY FORMATION COMMISSION
Wednesday, November 15, 2023



CORTESE-KNOX-HERTZBERG
LOCAL GOVERNMENT REORGANIZATION ACT OF 2000

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Item 2. Public Comment for Items Not
on the Agenda and on Consent Agenda

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Item 3. Consent Agenda

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Item 4. Consideration of File No. 22-09:
A proposal to establish the East Palo Alto
Sanitary District (EPASD) as a subsidiary district
of the City of East Palo Alto (City) and an
alternative application received from EPASD

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What is LAFCo?

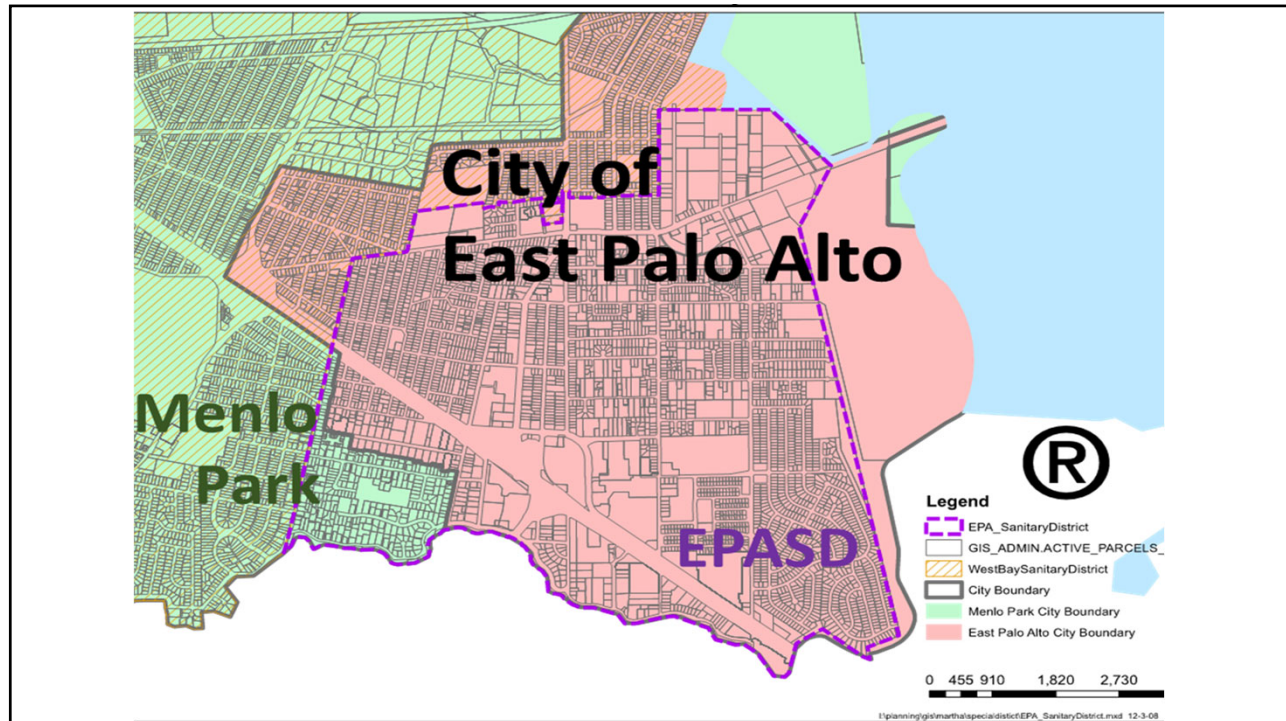
- The San Mateo Local Agency Formation Commission (LAFCo) is a State-mandated, independent agency with countywide jurisdiction over changes in organization and boundaries of cities and special districts including annexations, detachments, incorporations and formations, such as the formation of subsidiary districts.
- LAFCOs encourage the efficient delivery of government services and orderly formation of local agencies

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City of East Palo Alto and East Palo Alto Sanitary District

- East Palo Alto Sanitary District (EPASD)
 - Formed in 1939
 - Created to provide sewer service to unincorporated areas that now are portions of the cities of East Palo Alto and Menlo Park
- City of East Palo Alto
 - Incorporated in 1983
 - Provides a range of services, including police, parks and recreation, land use, public works, and domestic water
 - Several former special districts have been dissolved, and the services transferred to the City since incorporation

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Municipal Service Reviews (MSR) & Sphere of Influence Updates (SOI) for EPASD

- In 2021 LAFCo initiated an MSR for the City, EPASD, and West Bay Sanitary District (WBSD)
- Key findings of the report included:
 - EPASD's sewer system capacity was an impediment to development in East Palo Alto, and that the City, EPASD, and developers were unable to resolve this issue
 - EPASD lacked a Capital Improvement Plan (CIP) to upgrade the sewer system
 - LAFCo recommended that EPASD review capacity charges, develop a CIP for the District, evaluate funding opportunities for capital projects
 - MSR also recommended that the City explore the formation of EPASD as a subsidiary district of the City
- MSR also reaffirmed the SOI for EPASD as dissolution (zero), as first adopted in 1985 and reaffirmed in 2009

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LAFCo application review process

- November 10, 2022 – City of East Palo Alto submits proposal to LAFCo to establish EPASD as a subsidiary district of the City
- September 19, 2023 - East Palo Alto Sanitary District Board submits an alternative application in response to the City's proposal
- Both documents were sent to affected agencies for review and comments
- LAFCo contracted with V.W. Housen & Associates, an engineering firm that focus on sewer and water services, to conduct an independent peer review of the City's proposal

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City of East Palo Alto Proposal

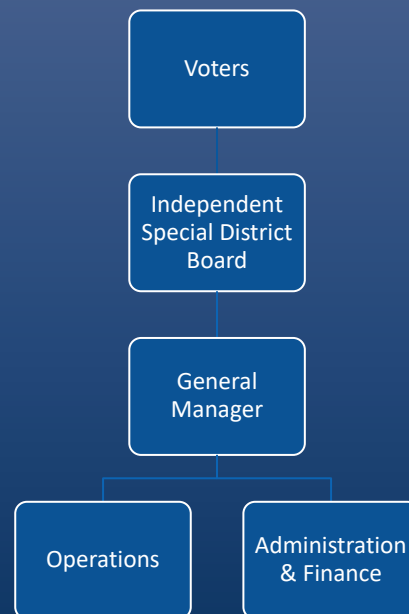
- City proposal to establish the East Palo Alto Sanitary District, an independent special district, as a subsidiary district of the City
- The subsidiary district would remain as a separate agency, and the City Council would be designated as board of directors of the district
- Revenue collected by EPASD would be separate from the City's General fund and could only be used for sewer operations and maintenance

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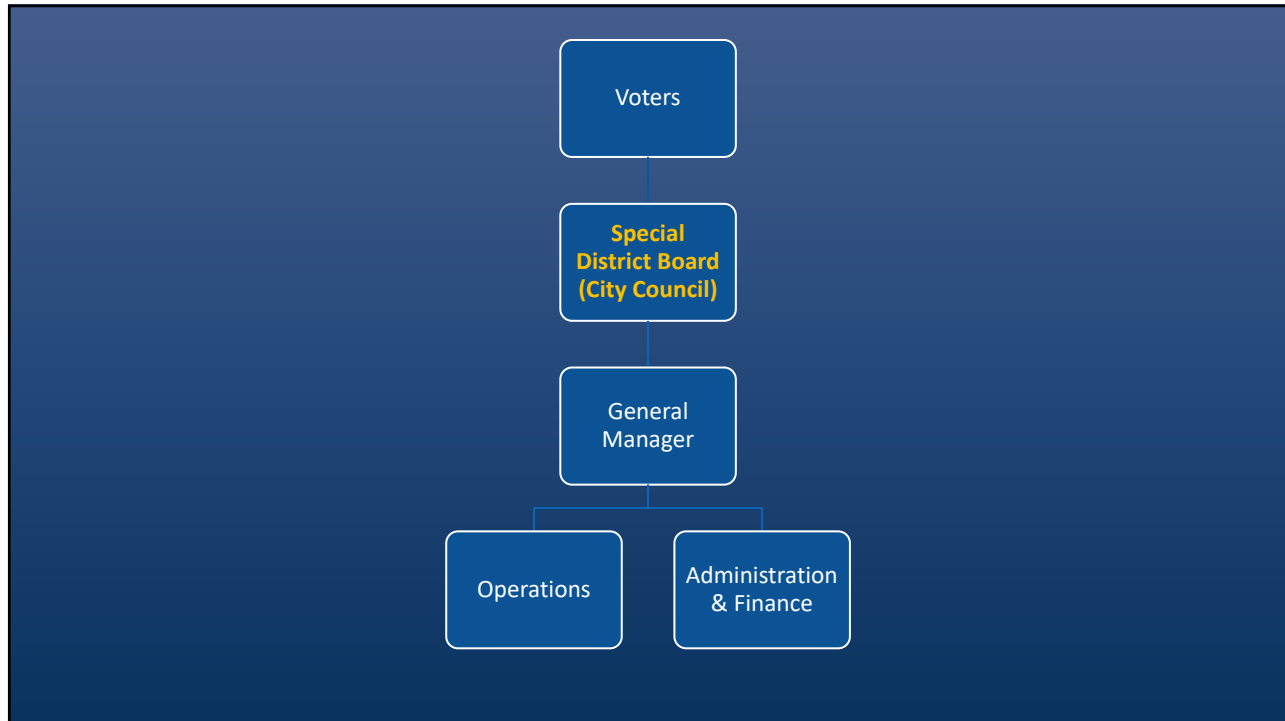
What is a subsidiary district?

- As defined by Government Code Section 56078, a "subsidiary district" means a district in which a City Council is designated as the board of directors of a district.
- The City Council of the City of East Palo Alto would become the governing body of EPASD if the proposal is approved
- EPASD would remain intact, and its service area would not change
- EPASD's funds, service charges and revenue, and expenditures would remain as part of the District and would not be merged into the City's general budget

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City of East Palo Alto Proposal

- City states that the proposal would provide for more efficient operation and coordinated planning of sewer service, allow for infrastructure and capacity to accommodate for planned growth and to improve transparency, accountability and environmental health to meet the current and future needs of all District ratepayers
- City prepared a plan for service and submitted a memo that included a five-year operation and maintenance and capital improvement budget for the subsidiary district
- Plan for services includes contracting for sanitary sewer services. WBSD has responded to an RFP issued by the City to provide services to EPASD if the City's proposal is approved.

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Staff Analysis of City Proposal

- Government Code Section 56001 provides some guidance to the Legislature’s priorities as it relates to district governance regarding a preference for a single multipurpose governmental agency, such as the City
- Several factors to for the Commission to consider in review of the proposal:
 - Growth and development in the City and EPASD service area
 - The cost to provide services and the adequacy of those services
 - City submitted a plan for service and a proposed five-year budget for EPASD

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Wastewater Enterprise Fund Cash Flow Projections from City

	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27
Overall Rate Adjustment	0%	5%	5%	5%	5%
Annual Sewer Charge (per Equivalent Dwelling Unit EDU)	\$690	\$725	\$761	\$799	\$839
Connection Fee (per EDU)	\$6,060	\$6,363	\$6,681	\$7,015	\$7,366
Total New EDUs	-	33	709	555	-
Total EDUs	4,443	4,476	5,186	5,741	5,741
Interest Earnings Rate	0.5%	0.5%	0.5%	0.5%	0.5%

- EPASD would continue to be subjects to the same laws they currently are related to rate increases and funding of capital projects for both existing and new customers
- Approval of the subsidiary proposal does not automatically increase sewer rates. Rate increases would need to occur in a separate process governed by EPASD/City

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	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27
REVENUES					
Sewer Service Charges	\$3,065,986	\$3,243,224	\$3,945,075	\$4,585,641	\$4,814,923
Connection Fees	\$0	\$210,244	\$4,739,878	\$3,893,440	\$0
Other Revenue	\$907,900	\$908,714	\$917,115	\$933,697	\$954,595
Total Revenues	\$3,973,886	\$4,362,183	\$9,596,162	\$9,412,778	\$5,769,518
EXPENSES					
Operations & Maintenance					
Salaries & Benefits	\$990,000	\$1,020,000	\$1,051,000	\$1,083,000	\$1,115,000
General liability & Workers Comp Allocation	\$1,365,000	\$1,406,000	\$1,448,000	\$1,491,000	\$1,536,000
Pre-Fund Existing EPASD Net Pension Liability	\$93,000	\$93,000	\$93,000	\$93,000	\$93,000
PARWQCP Wastewater Treatment	\$2,435,000	\$2,510,000	\$2,591,000	\$2,665,000	\$2,496,000
O&M Subtotal	\$4,883,000	\$5,029,000	\$5,183,000	\$5,332,000	\$5,240,000
Capital & Other Non-Operating					
Sewer Rehab Improvements	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000
Capacity Assurance Improvements	\$0	\$0	\$1,093,000	\$1,093,000	\$1,093,000
Capital and Non-O&M Subtotal	\$1,500,000	\$1,500,000	\$2,593,000	\$2,593,000	\$2,593,000
Debt Service					
Debt Service Subtotal	\$554,000	\$554,000	\$639,000	\$724,000	\$724,000
Total Expenses	\$6,937,000	\$7,083,000	\$8,415,000	\$8,649,000	\$8,557,000
Revenues Less Expenses	-\$2,963,114	-\$2,720,817	\$1,181,162	\$763,778	-\$2,787,482
Ending Reserve Fund	\$14,416,886	\$11,696,069	\$12,877,231	\$13,641,008	\$10,853,526

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Staff Analysis of City Proposal

- Effects on the community and governmental structure
 - Governance would transfer from the EPASD Board of Directors to the City of East Palo Alto City Council
 - Voters of Menlo Park who reside within the EPASD service area would not be able to directly vote for the EPASD Board of Directors
 - Menlo Park EPASD customers would continue to be able to voice concerns and protest rate increases as they currently do
 - Condition of approval is for the creation of an advisory committee body for subsidiary district that reserves at least one seat on the advisory committee for a resident of the City of Menlo Park portion of the District
- Consistence with previously adopted Sphere of Influences

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Peer Review

- LAFCo contracted with V.W. Housen & Associates, an engineering firm, to conduct an independent peer review of the City's proposal
- Key findings from the report include:
 - The City's proposed budget plan addresses the highest-priority, near-term capacity needs, and that improvements could reasonably occur in the proposed 5-year timeline
 - The proposed budget is sufficient to cover the CIP and O&M
 - The City may have underestimated some construction costs, but that District's master plan may have overstated replacement needs for new development thereby reducing overall costs
 - The City's plan for service allows for surcharging conditions, and the consultant confirmed that there is no industry standard or specific criteria for surcharging and that this amount is consistent with the EPASD 2015 Master Plan

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Comment letters in response to City's Proposal

- EPASD: The District submitted three comment letters and a resolution objecting to the City's proposal.
- Key points from the letters include:
 - Costs associated with increased capacity and expansion for development should be paid for by developers and not existing customers
 - EPASD increased sewer connections fees from \$6,060 fee to \$14,464, and will serve letters have been issued by EPASD to developers even after the increase
 - District states that the City's proposal omits funds for the of future rehabilitation for the existing sewer system
 - EPASD asserts that is best equipped to provide sanitary sewer services and to fund the structural and capacity capital improvements

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Comment letters in response to City's Proposal

- City of Menlo Park: Menlo Park City Manager, Justin Murphy, asked how City of Menlo Park residents served by EPASD would participate in elections if the East Palo Alto City Council becomes the governing board.
- County Controller's Office: As the boundaries and service of the District do not change, there is no tax increment that will be changed related to the Proposal to establish EPASD as a subsidiary district of the City of East Palo Alto.
- Two comment letters from members of the public

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EPASD Alternative Application

- Government Code Section 56861 allows the subject district of a subsidiary proposal to adopt a resolution of intent to file an alternative proposal to the subsidiary district proposal.
- EPASD submitted an alternative application that seeks to:
 1. Retain EPASD's current governance structure
 2. Amend its Sphere of Influence (SOI) to be coterminous with EPASD boundaries
 3. Remove EPASD's territory from the SOI of the West Bay Sanitary District

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Staff Review of EPASD Alternative Application

- EPASD's submission does not meet definition of "alternative proposal", which means a desired change of organization or reorganization.
 - Under LAFCO law, alteration of a SOI is not a governance change
- EPASD's submission is not needed for EPASD to retain its existing structure.
- Changing EPASD's SOI is inconsistent with prior LAFCo determinations that have affirmed the District's SOI of dissolution (zero).

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Staff Review of EPASD Alternative Application

- Current and future needs of EPASD customers & rate increases
 - EPASD states that City's proposal will increase sewer rates to pay for, among other issues, a contracted sewer provider. City intends to contract with WBSD if subsidiary district proposal is approved which the City has factored into their proposed budget
- EPASD states the total cost of needed infrastructure improvements is \$64M, \$40M of which is attributable to new development

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Staff Review of EPASD Alternative Application

- Over the last two years, EPASD has contracted with Sierra West to conduct a closed-circuit television (CCTV) surveys of the District's sewer system.
 - October 2022 report (Areas 1, 3, and 4): \$53 million in rehabilitation and replacement, \$44 million for structural replacement only and \$9 for capacity improvements; 65% of the lines inspected are classified by the consultant as pipelines with substantial structural defects
 - October 2023 report (Area 2 and Trunk Line): \$12 million in high priority projects for this area
 - City's proposal includes a capital improvement plan based on EPASD's CCTV survey of the majority of the system's pipes, which identifies existing system deficiencies that cannot wait for future development connection fees to fund.

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Staff Review of EPASD Alternative Application

- EPASD states that retaining its governing structure would ensure that existing rate payers only pay their fair share
- EPASD's submission contends that it will not increase current sewer service fees, and the City's proposal will. However, the alternative application notes that there may be annual Consumer Price Index rate increases, which is a rate increase.
- EPASD does not appear to have an adopted funding mechanism or budget for capital projects related to existing system deficiencies
- Challenges for EPASD to fund improvements

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Staff Review of EPASD Alternative Application

- Voter disenfranchisement
 - EPASD states that a subsidiary district would disenfranchise residents of Menlo Park that reside within the EPASD service area.
 - If the City's proposal is approved, governance of the District would transfer from EPASD Board of Directors to East Palo Alto City Council, and Menlo Park residents would not be able to vote for the EPASD Board of Directors.
 - However, the affected Menlo Park residents would be able to voice their opinions regarding EPASD services at City Council meetings in compliance with Prop 218.
 - In addition, a condition of approval is that the City shall submit a plan for the creation of an advisory committee that includes at least one reserved seat for a resident of Menlo Park that resides within the EPASD service area.

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Staff Review of EPASD Alternative Application

- EPASD states that is being cooperative in efforts to support new development and has issues 27 will serve letters since 2021, including 11 that were issued after the EPASD Board increased capacity fees to \$14,464.
 - LAFCo staff does not know how many have entered into an agreement with EPASD for sewer services.

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Comment letters in response to EPASD's Alternative Application

- West Bay Sanitary District:
 - Not supportive of EPASD's submission, particularly the proposed reduction of WBSD's SOI.
 - Supportive of the recommendation in the 2022 MSR of either the creation of EPASD as a subsidiary district or annexation of the EPASD service area to WBSD.
 - WBSD Board's consensus was to support the City's proposal

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Comment letters in response to EPASD's Alternative Application

- City of East Palo Alto:
 - The two Sierra West studies for EPASD indicate that there are significant structural deficiencies within the existing system that would need to be addressed with or without new development
 - Based on the amount of structural and capacity upgrades required, additional revenue will be required.
 - Notes several discrepancies in EPASD submission
 - Treatment capacity at Palo Alto treatment plant
 - Sierra West Consultant reports undermine EPASD's claim that improvements can be largely funded by developer fees
 - EPASD's assets, liabilities, reserves, revenue and expenses would be maintained separately from City's general budget

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Determinations for an SOI amendment

- The present and probable need for public facilities and services in the area.
 - Deficiencies in existing EPASD sewer system for current customers (at minimum of \$44 million)
 - The data that EPASD submitted to LAFCo as part of their alternative application highlights the existing sewer deficiencies of the EPASD maintained system
 - EPASD has not adopted a budget or CIP to addresses these current issues
- The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.

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Merger Alternative

- Government Code Section 56118 states that any proposal for a merger or establishment of a subsidiary district shall contain a request in the alternative.
- A merger of EPASD into the City was considered but not recommended by staff because, in this case, it is desirable to maintain the district separate for services and accountability reasons.
- In addition, a merger is not applicable because a portion of the EPASD service area (Menlo Park) is not within City boundaries.

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Comment received

- Comments received after agenda packet publication and sent to Commission
 - Ravenswood Shores Business District – support of City’s proposal
 - Ravenswood Family Health Network – support of City proposal
 - Member of the public – support for WBSD to annex service area and not EPASD or City of East Palo Alto
 - EPASD – Updated sewer system management plan and draft proposal for a CIP for EPASD

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Staff Recommendation

- Staff recommends that EPASD be established as a subsidiary district of the City, with the East Palo Alto City Council acting as the EPASD Board, for the following reasons:
 - Wastewater system planning could align with the City’s envisioned land use planning and established master plans.
 - The City could address and balance infrastructure requirements, funding options, and developer requirements, to facilitate needed new housing, jobs and municipal revenues to improve public services.
 - The organizational and management structure of the City may provide enhanced wastewater services
 - Removing a layer of government would enhance efficiencies and enhance ease of use for constituents, with single provider of services.

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Terms & Conditions

- The City shall execute an agreement for the operation and maintenance of the sewer system with a private or public agency prior to the recording of the Certificate of Completion.
- The effective date of the action is the first day of the next month after the conclusion of the protest hearing if the requisite protest thresholds are not met.
- Upon the effective date, the East Palo Alto City Council shall be designated as, and empowered to act as, *ex officio*, the EPASD Board of Directors. EPASD shall continue in existence with all the powers, rights, duties, obligations, and functions provided for by the principal act that formed the District.
- Within 90 days of the issuance of the Certificate of Completion, the City shall submit a plan for the establishment of an advisory committee to EPASD. The committee shall include at least one reserved seat for a Menlo Park resident who resides in the EPASD service area.

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CEQA

- On November 10, 2022, the City filed a Notice of Exemption for the creation of a subsidiary district under CEQA guidelines Section 15320, which allows an exemption when a change in organization of local agencies does not change the geographical area in which previously existing powers were exercised.
- Staff recommends that the Commission determines that the City's proposal and LAFCo's action on the proposal is exempt from CEQA under CEQA guidelines Section 15320.

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Noticing

- Public notice of the hearing was mailed and emailed to affected agencies and interested parties at least 21 days prior to today's hearing.
- Public notice was published in 1/8th ads in the San Mateo County Times, The Almanac and the Palo Alto Weekly at least 21 days prior to today's hearing
- Notices were published in both English and Spanish
- Notice of the public hearing were also published on the San Mateo LAFCo website and available in English, Spanish, Chinese, Samoan, Tagalog, Tongan and Vietnamese.

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Recommendation

1. Open the public hearing and accept public comment
2. By resolution, approve LAFCo File No. 22-09 - Proposal to establish the East Palo Alto Sanitary District (EPASD) as a subsidiary district of the City of East Palo Alto subject to terms and conditions
3. Determine that LAFCo File 22-09 is exempt from CEQA per CEQA Guidelines Section 15320 and direct staff to file a Notice of Exemption
4. Delegate to the Executive Officer the authority to conduct protest proceedings

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Next Steps (Protest Period)

- Protest proceedings will follow a 30-day reconsideration period.
- LAFCo will give notice of the protest hearing to all landowners and registered voters in the EPASD service area via a 1/8th page ad
- Landowner protest:
 - If protests filed by less than 25% of the number of landowners owning less than 25% of the assessed value of land = Formation of subsidiary district
 - 25-50% protest = Election
 - Greater than 50% protest = Proposal is terminated
- Registered Voter protest:
 - If protests filed by less than 25% of the number of registered voters in the affected area = Formation of subsidiary district
 - 25-50% protest = Election
 - Greater than 50% protest = Proposal is terminated