

Exhibit A: Goleta West Sanitary District Letter

ROUTE TO:

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RETURN INSTRUCTIONS:

April 9, 2009

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Mr. John Baker
Assistant County Executive Officer
County of Santa Barbara
105 E. Anapamu Street
Santa Barbara, CA 93101

RE: Property Tax Exchange Negotiations Related to Proposed Detachment from Goleta West Sanitary District

Dear Mr. Baker:

This letter is submitted on behalf of the Goleta West Sanitary District (Goleta West) with respect to the application submitted to the Santa Barbara Local Agency Formation Commission (LAFCO) by the City of Goleta (City) proposing that certain Goleta West territory be detached from the District. Pursuant to Revenue and Tax Code Section 99, the County soon will be negotiating on behalf of the District a tax exchange agreement with the City. While we disagree with the County Counsel's decision not to recuse the County from this role as stated in his March 20 letter, we remain hopeful that the County will fulfill its fiduciary duty and negotiate this tax exchange at arms-length on behalf of Goleta West.

This letter sets forth Goleta West's positions with respect to the negotiations.

Need for Additional Information

The City's application to LAFCO was submitted on February 4, 2009. Goleta West sent a letter to LAFCO on February 11 pointing out significant omissions from the application. LAFCO forwarded Goleta West's letter to the City, but the City has not yet responded to it. A copy of our February 11 letter to LAFCO is enclosed.

The deficiencies Goleta West identified make it very difficult for the County to engage in meaningful negotiations over the terms of a tax exchange agreement. We believe that, at a minimum, the following questions must be answered by Goleta before the negotiations begin:

1. In light of the City's proposal that it receive 78% of Goleta West's current reserves and future property taxes, is the City willing to accept the obligation to pay 78% of all treatment plant costs, including O&M, the pending upgrade, and future capital needs that, absent the detachment, would be obligations of Goleta West? If not, what share of these three categories of cost is the City prepared to accept?
2. Is the City willing to commit to pay the costs of the pending upgrade with funds it receives from Goleta West's property tax reserves reserves by the deadline set by the Regional Board and the Goleta Sanitary District?

3. Will the City agree to a LAFCO term and condition requiring that it assume Goleta West's contractual obligations to the Embarcadero Municipal Improvement District (EMID), including providing wastewater collection system operations, maintenance, repair and rehabilitation, as set forth in the existing agreement between Goleta West and EMID?

4. Will the City agree to a LAFCO term and condition requiring that it enter into one or more extra-territorial service agreements with the owners of parcels north and west of the City boundary which are currently within the boundaries of the District?

5. Will the City agree to a LAFCO term and condition requiring that it pay Goleta West a "wheeling charge" to transport wastewater from the City boundary to the regional wastewater treatment plant to pay a fair share of the O&M and capital costs of the sewer mains and pumping facilities used by that wastewater stream?

The City's Proposal to Reallocate Property Taxes

The City has proposed that the tax exchange agreement provide for reallocation of 78% of the future property taxes from the District to the City. The City's position is based on its claim that the area proposed for detachment includes real property constituting 78% of the assessed value of all property in the District.

Goleta West believes the City's proposal is fundamentally flawed because it fails to reflect the actual shift in sewer service responsibilities that will occur if the detachment is implemented. Indeed, the shift in sewer service responsibilities to the City will be between 43% and 66%, depending on which measure of "service responsibilities" is chosen.

The proposed detachment area includes:

- o 43% of the registered voters of the District as of November 2008.
- o 47% of development potential of the District
- o 51% of the land area of the District
- o 52% of the total wastewater flow of the District for 2008-09.
- o 66% of the collection system (measured in linear feet without considering pipe diameter)

Goleta West respectfully submits that the appropriate measure of "service responsibility" should be based on two factors: current wastewater flow and future development potential, for the following reasons.

Historically, Goleta West has used property tax revenues (and associated interest earnings) for its capital projects and street sweeping. There are two kinds of capital projects: activities related to the regional wastewater treatment plant and activities related to the collection system. Goleta West is one of five participants in the treatment plant, which is owned by Goleta Sanitary District. Its participation is governed by a contract dating back to the 1960s, which requires Goleta West to pay approximately 40% of the costs of the plant. Under that contract, Goleta West has agreed to participate in periodic capital projects for the plant, including construction of the ocean outfall in the early 1990s.

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The most costly capital project involving the wastewater treatment plant is the planned upgrade to full secondary treatment levels. The upgrade was mandated by the Regional Water Quality Control Board as a part of a settlement agreement with Goleta Sanitary signed in 2004. Under the settlement agreement, all construction financing must be acquired by December 31, 2010. The settlement agreement also imposes a timeline for construction. The treatment plant is currently being engineered and designed, and is scheduled to be under construction in March 2010. For that schedule to be met, Goleta Sanitary District will want to have firm assurances that all treatment plant participants have the funds on hand to meet their obligations.

The current estimated cost of that project is approximately \$50 mm and the District's 40% share of that expense is approximately \$20 mm. The District has long planned to eschew borrowing and instead finance its obligation from its reserves, which consist of property taxes and associated interest earnings.

Goleta West intends to use future property tax revenues for similar purposes, including annual collection system rehabilitation, replacement and repair work. To cite one example: Goleta West recently completed construction of a new sewer main in Hollister Avenue to replace an existing main substandard in size and in need of rehabilitation and repair. The project cost \$3.2 mm, and was paid for with reserve fund derived from property tax revenues.

Goleta West's financial consultant has estimated that the District's Capital Improvement Plan ("CIP") expenditures between 2011 and 2029 will be \$47.7 mm, including \$31.8 mm for the treatment plant upgrade and other plant capital expenditures during this period.

If the City's proposal to reallocate 78% of future property taxes is accepted by the County on behalf of Goleta West, Goleta West will be left with **48%** of the wastewater flow and just **22%** of the capital funds needed for the facilities that handle that flow. Goleta West's capital improvement plan cannot be sustained if the District's share of the property tax revenues is reduced to 22%.

To make up the shortfall, the District will be compelled to quadruple annual sewer service charges to District customers.. This conclusion appears in a study of the fiscal impacts of detachment recently prepared for Goleta West by Raftelis Financial Consultants, Inc. Of course, since sewer service is considered a property-related fee under Proposition 218, the ratepayers could block the sewer service charge increase by a simple majority protest.

If that were to occur, the District would be unable to fulfill its contractual obligation concerning the treatment plant upgrade, and would be unable to implement its Capital Improvement Program, which is needed to ensure that the collection system operates in an environmentally-responsible way that complies with state and federal regulations.

There is one additional and important point. At present, the District uses about 55% of its contractual entitlement in the treatment plant. In other words, the District pays for capacity in the plant that it is not currently using, and that it is holding to accommodate future development. The amount of future development potential within the City of Goleta is about equal to the amount of future development potential in Isla Vista, based on a 2006 study of future development patterns completed by Dudek & Associates ("Dudek Study").

If the allocation of property taxes and treatment plant capacity rights fails to consider future development potential, the City or the District could find itself with additional plant capacity that it will never need or, possibly, an allocation of plant capacity that will be inadequate for its future development

needs. Thus, the split of property taxes and plant capacity should take account of the future development potential of the City compared to Isla Vista.

Proposed Negotiating Positions

Based on the foregoing, we urge the County to assert the following positions on behalf of Goleta West in the upcoming negotiations with the City of Goleta:

1. As a condition of a tax exchange agreement, the City must agree to execute an agreement with Goleta Sanitary District under which it will assume the following portion of Goleta West's existing obligations to Goleta Sanitary with respect to the regional treatment plant:

a. 52% of annual O&M expenses, to be adjusted annually to reflect actual wastewater flows from properties served by the City.

b. A share of the costs of the pending upgrade project, and all future capital expenditures related to the treatment plant, calculated as follows:

(i) Utilized Capacity. This term refers to the portion of the Goleta West contractual capacity of 3.11 mgd that is actually utilized. For 2008-09, Goleta West is utilizing about 55% of this capacity, or 1.7 mgd. This Utilized Capacity should be allocated to the City and Goleta West in accordance with their respective wastewater flows in any given year, and the allocation should be adjusted annually.

(ii) Additional Capacity. This term refers to the portion of the Goleta West contractual capacity of 3.11 mgd that is not actually utilized in a given year, but instead is above and beyond the District's needs in that year. For 2008-09, Goleta West is holding about 45% of its total contractual capacity as Additional Capacity, or 1.4 mgd. This Additional Capacity should be allocated to the City (47%) and Goleta West (53%) in accordance with their future development potential as analyzed in the Dudek Study, and should be adjusted every five years to reflect the most current available information concerning development potential.

2. As a condition of a tax exchange agreement, the City must agree to (i) reduce its proposal for a share of the Goleta West property tax reserves from 78% to 52% (as adjusted in accordance with paragraph 1,b) , (ii) legally pledge those reserves to funding the treatment plant obligation noted in paragraph 1 above and other projects identified in the Goleta West CIP within the City's boundaries, and (iii) adopt Goleta West's CIP as the City's Sewer CIP for the portions of the collection system within the City boundaries and the areas the City will be required to serve under an extra-territorial service agreement (e.g., EMID).

This proposal is based on the simple fact that detachment will not alter the reality that the City and the District will be inextricably dependent upon one another for the proper operation of the wastewater collection and disposal system. If the City is unable to make its payments for O&M and capital costs of the treatment plant, the other partners in that plant (including Goleta West) will be required to make up the deficit. This duty is not mitigated by Goleta West's ability to sue the City to recover any funds expended by Goleta West. Sewer plant operations cannot be suspended while lawsuits are being resolved.

3. The District's reserves of \$30.4 mm should be segregated into funds comprised of connection fees and capital facility fees (and interest earned thereon) ("Capital Fee Reserve"), which Goleta West estimates to be about \$2.5 mm of the total, and funds comprised of property tax revenues (and interest

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earned thereon). Funds in the Capital Fee Reserve cannot lawfully be transferred to purposes other than capital related to the wastewater system (under Gov't Code Sec. 66000), and those funds shall be allocated to the City and Goleta West in accordance with the Goleta West Sewer CIP.

4. The tax exchange agreement should provide that for the 2010-11 tax year, the City will receive 52% of the property taxes currently allocated to Goleta West (adjusted in accordance with paragraph 1,b to take into account Additional Capacity), which equals the estimated quantity of wastewater generated in 2008-09 by users within the City's boundaries. For each year thereafter, the City will receive an allocation of property taxes that equals its share of the capital costs for the treatment plant calculated per paragraph 1,b.

This allocation should be calculated annually to ensure the property tax exchange is revenue neutral in the future on both the City and Goleta West, and to account for the possibility that (i) development will be more intensive in Isla Vista than in the City, thus increasing wastewater flows and associated capital expenses, and (ii) development potential may be increased for properties in one area compared to another, thus requiring a reallocation of Additional Capacity.

5. The tax exchange agreement should provide that the City must place all property taxes received as a result of the tax exchange agreement into a dedicated reserve for operations (including street sweeping), maintenance, repairs, and long-term capital needs of the sewer system as shown on the Goleta West CIP, except to the extent that those revenues are replaced by revenues generated by sewer service charges. The purpose of this requirement is to ensure that there are adequate funds available for future capital needs, and that a failure to raise sewer service charges in the future (whether due to Prop 218 protests or other reasons) does not impair the City's ability to fund those needs. We believe that such a condition is needed for both public policy (as explained above) and CEQA reasons.

Request to Attend Negotiations

Goleta West respectfully request that the County invite District representatives to attend the property tax exchange negotiations.

Please contact me if you have any questions concerning the foregoing positions. We look forward to consulting with the County and providing input on the terms as they are negotiated.

Sincerely,



Steven A. Amerikaner

Enclosure

cc Board of Directors, Goleta West Sanitary District
Mark Nation, General Manager, Goleta West Sanitary District
Michael Ledbetter, Deputy County Counsel