Attachment 3

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OPTIMAL GOVERNANCE STRUCTURE STUDY OF COSTA MESA SANITARY DISTRICT AND MESA WATER DISTRICT

JULY 2016

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COSTA MESA SANITARY DISTRICT AND MESA WATER DISTRICT

Optimal Governance Structure Study

Prepared for:

Mesa Water District

Prepared by:

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Date:

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CONTENTS

Acronyms and Abbreviations iv
Executive summary 1
1 Introduction 3
1.1 Objective 3
1.2 Sources 3
1.2.1 Costa Mesa Sanitary District 4
1.2.2 Mesa Water District 4
1.3 Approach 4
2 Organization/Staffing 6
2.1 CMSD Current Organization 6
2.1.1 Governance 6
2.1.2 Organization Structure 6
2.1.3 Operations 8
2.1.4 Maintenance 8
2.1.5 Asset Replacement Plan/CIP 8
2.2 Mesa Water Current Organization 10
2.2.1 Governance 10
2.2.2 Organization Structure 10
2.2.3 Operations 12
2.2.4 Maintenance 12
2.2.5 Asset Replacement Plan/CIP 12
2.3 Proposed Organization/Staffing for Combined Agency 13
2.3.1 Customers/Service Area 13
2.3.2 Combined Organizational Structure 15
3 Real Estate/Maintenance 20
3.1 CMSD Facilities 20
3.2 Mesa Water Facilities 22
3.3 Proposed Properties for Combined Agency 22
4 Financial Management and Reserves 24

4.1 Overview of CMSD's Existing Financial Position 24
4.2 Overview of Mesa Water's Existing Financial Position 25
4.3 Combined Agency Financial Review 26
4.3.1 Financial Metrics 26
4.3.2 Combined Agency Available Cash 27
4.3.2.1 One-Time Savings 27
4.3.2.2 Annual Savings 28
4.4 Total Financial Management Savings 29
5 Optimization Opportunities 30
5.1 CMSD Contracting Opportunities 30
5.1.1 Wastewater System Cleaning 30
5.1.2 Contracting Assumptions and Analysis 30
5.2 Mesa Water Optimization Opportunities 33
5.3 Summary of Total Savings from Optimization Opportunities 33
6 Additional Qualitative Benefits 34
6.1 Potential Synergies 34
6.1.1 Vision/Mission/Values 35
6.1.2 Staffing/Cross-Training 35
6.1.3 Institutional 35
7 Summary and Next Steps 36
7.1 Next Steps 37
References 38

TABLES

Table 1. Summary of Estimated Annual Net Cost/Savings under Combined Agency Operations[1] 2
Table 2. Summary of the CIP included in the 2016 SSMP 9
Table 3. Mesa Water CIP Projects 13
Table 4. Summary of Combined Roles 17
Table 5. Total One-Time and Annual Organizational Savings by Fund and District 19
Table 6. Total One-Time and Annual Real Estate Savings by Fund and Agency 23
Table 7. CMSD Summarized Financials 24
Table 8. Mesa Water's Existing Summarized Financials 25
Table 9. Combined Agency Financial Snapshot 26
Table 10. Targeted Financial Metric 27
Table 11. One-Time Savings 27
Table 12. Annual Savings 28
Table 13. Total One-Time and Annual Financial Savings by Fund and Agency 29
Table 14. Summary of Wastewater Contracted Cleaning Analysis 32
Table 15. Total Annual Financial Savings by Fund and Agency 33
Table 16. Summary of Estimated Annual Net Cost/Savings under Combined Agency Operations[1] 36

FIGURES

Figure 1. Costa Mesa Sanitary District FY2015-16 and FY2016-17 Organization Chart 7
Figure 2. Mesa Water FY2016 Organization Chart 11
Figure 3. Costa Mesa Sanitary District Service Area and Mesa Water District Service Area 14
Figure 4. Combined Agency Potential Organization Structure 18
Figure 5. CMSD SSO per 100 Sewer Miles Annual Reporting and Percent of System Cleaned per Year 31

APPENDICES

A Real Estate

ACRONYMS AND ABBREVIATIONS

AGM	Assistant General Manager
CIP	capital improvement plan
CMSD	Costa Mesa Sanitary District
CSDA	California Special Districts Association
FOG	Fats, Oils & Grease
FTE	Full Time Equivalent
FY	Fiscal Year
GAP	Green Acres Project
GFOA	Government Finance Officers Association
LAFCO	Local Agency Formation Commission
LF	linear feet
LoS	Level of Service
Mesa Water	Mesa Water District
MG	Million Gallons
MWDOC	Municipal Water District of Orange County
MWRF	Mesa Water Reliability Facility
n/a	Not Applicable
NPS	National Plant Services
OCSD	Orange County Sanitation District
OCWD	Orange County Water District
O&M	operation & maintenance
RNG	Renewable Natural Gas
SDLF	Special Districts Leadership Foundation
SF	Square Foot
SSMP	Sewer System Management Plan
SSOs	Sanitary Sewer Overflows
SW	Solid Waste
WDR	Water Discharge Requirements
WW	Wastewater

EXECUTIVE SUMMARY

In order to explore opportunities to improve local government efficiency, reduce administrative redundancy and associated costs, and improve responsiveness, affordability and customer service, the Mesa Water District (Mesa Water) engaged Arcadis U.S., Inc. to analyze the potential combination of Mesa Water with the Costa Mesa Sanitary District (CMSD). Mesa Water and CMSD are both local independent special districts with independently elected Boards, serve primarily the same customers in the City of Costa Mesa, California, and the surrounding unincorporated areas of Orange County, and provide complementary water and wastewater services. CMSD also provides solid waste collection services.

This Study evaluates at a high-level the feasibility of combining CMSD and Mesa Water in order to capitalize on opportunities arising from economies of scale and operational synergies. The primary benefit from combination is the potential for significant up-front and annual cost savings, through various rate mechanisms, which could be passed on directly to customers through lower rates, rebates or stabilization of rates or reduction in future rate increase requirements. For example, the wastewater fund annual savings of $1.7 million represents over 28 percent of the annual revenue requirements of that fund and could be used to lower wastewater fees by 28 percent or offset future rate increases. The one-time savings of $15.6 million of the combined wastewater, solid waste and water funds is equivalent to approximately $650 per customer for those residents who receive wastewater, solid waste and water services (assuming approximately 24,000 customers per fund). The one-time savings can provide a one-time rebate or used to cash fund capital improvements to reduce debt and future rate increases.

Further, the combined agency also offers potential for increased flexibility, transparency and improved customer service.

Impacts of combining include costs and complications arising from developing and gaining approval for the proposed combined entity, including organizational structure and governance, union negotiations, and asset transfers.

Prior to proceeding, should CMSD and Mesa Water agree to move forward with a potential combined agency, both districts should engage appropriate legal, technical, and financial counsel. Transaction documents will be required; along with coordination with appropriate commissions, financial institutions, and regulatory agencies; and development of new by-laws and governance with appropriate regional representation.

Table 1 displays the estimated cost savings of the potential combined agency with approximately $15.6 million in projected one-time savings, and approximately $2.7 million in annual savings. Despite the duplication of certain jobs, it is expected that layoffs can be avoided through natural attrition/retirements.

Table 1. Summary of Estimated Annual Net Cost/Savings under Combined Agency Operations[1]

Item Description	Wastewater	Solid Waste	Water	Total
One-Time Cost Savings				
Combining Organizations[2]	($200,000)	($200,000)	($200,000)	($600,000)
Real Estate[3]	$1,300,000	$1,300,000	$0	$2,600,000
Financial Management[4]	$9,730,000	$2,860,000	$1,060,000	$13,650,000*
Operations Optimization[5]	$0	$0	$0	$0
Subtotal One-Time Cost Savings	**$10,830,000**	**$3,960,000**	**$860,000**	**$15,650,000**
Annual Cost Savings				
Organizational Optimization[2]	$367,000	$367,000	$366,000	$1,100,000
Real Estate[3]	$7,000	$7,000	$36,000	$50,000
Financial Management[4]	$1,040,000	$0	$0	$1,040,000*
Operations Optimization[5]	$289,000	$0	$250,000	$539,000*
Subtotal Annual Cost Savings	**$1,703,000**	**$374,000**	**$652,000**	**$2,729,000**

*Note, these savings, while best accomplished through the process of reorganizing and combining the two agencies, can be substantially achieved independently.

[1] Amounts shown are rounded to the nearest $1,000.

[2] Refer to Section 2

[3] Refer to Section 3

[4] Refer to Section 4

[5] Refer to Section 5

1 INTRODUCTION

This study focuses on evaluating the feasibility of combining CMSD and Mesa Water, including evaluation of organizational structure, real estate, contracts and the cost and benefits thereof. A high-level description of the current context of CMSD and Mesa Water governance, services, service area, staff organization and finances provides the basis for the evaluation.

In general, combining agencies provides opportunity to capitalize on economies of scale and reduce operations, maintenance and capital costs while enhancing environmental performance, thereby saving customers money while at the same time improving service delivery. Key determining factors to success, include transparency, governance, labor agreements, public support and other legal issues that affect the organizations, as well as technical and financial analyses.

Arcadis U.S., Inc. was competitively selected by Mesa Water to assess the potential savings to customers of a combined agency. Arcadis is an international leader in the fields of infrastructure, environment, and water. Dedicated to enhancing mobility, sustainability, and quality of life, the firm's multidisciplinary staff provides consultancy, design, engineering, and management services to public and private clients across the U.S. and around the globe. For over 100 years, Arcadis has been designing the human habitat, setting industry standards with patented technologies and published works. Arcadis has access to approximately 22,000 engineers, scientists, planners, management consultants, and support staff worldwide. Currently the combined organization is working on environmental and infrastructure projects in more than 70 countries.

1.1 Objective

The objectives of this preliminary study include the following for both CMSD and Mesa Water:

- Evaluate governance and staffing,
- Conduct a financial evaluation of the agencies' revenues and expenses,
- Identify cost savings at all levels,
- Evaluate the feasibility of a combined agency, and
- Identify the benefits of a combined agency to the community.

1.2 Sources

The study used publicly available documents from CMSD and Mesa Water, which are listed in the References section at the end of this Study.

1.2.1 Costa Mesa Sanitary District

The mission of CMSD is to "protect our community's health and the environment by providing solid waste and wastewater collection services."[1] CMSD was formed in 1944 under the Sanitary District Act of 1923 and governed by an elected district-wide (at large) five-member Board of Directors. The CMSD boundaries encompass all of the City of Costa Mesa and portions of the City of Newport Beach and unincorporated areas of Orange County with a population of approximately 116,700 including public, commercial, industrial and retail users.

CMSD has received several awards, most notably the District of Distinction Accreditation by the Special Districts Leadership Foundation (SDLF), known to be one of the most prestigious local government awards in the State of California. CMSD has received the SDLF District Transparency Certificate of Excellence and was recently named Collection System of the Year for 2015.

1.2.2 Mesa Water District

The mission of Mesa Water is "dedicated to satisfying our community's water needs."[2] Founded on January 1, 1960, and governed by a publicly-elected five-member Board of Directors, Mesa Water is an AAA-rated independent special district that provides water service to 108,000 residents in an 18-square-mile area. Mesa Water serves most of Costa Mesa, parts of Newport Beach, and some unincorporated areas of Orange County including John Wayne Airport. Mesa Water has received similar awards, most notably the District of Distinction Accreditation by the SDLF. Mesa Water also received the District Transparency Certificate of Excellence from the SDLF. For the past 21 consecutive years, Mesa Water received the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA).

1.3 Approach

In assessing the potential cost and benefits of a combined organizational structure, the objective is to achieve the technical and financial goals for a combined agency, including a AAA rating and same or better levels of service and customer satisfaction.

The approach used to develop a potential optimized organizational structure for a combined agency is based on conducting an analysis of the current organizational structure, job descriptions, budget documents and operational and maintenance performance of each of the agencies, then establishing a proposed organizational structure that is most technically and economically feasible for the combined agency.

Below are the assumptions upon which this high-level Study is based.

- The agencies' FY2015 Audited Financial Statements, existing FY2016 budgets, and proposed five-year capital plans are used as the basis for the cost projections.
- The combined agency will retain a strong financial position indicative of AAA standards.

[1] The above is from CMSDs website http://www.cmsdca.gov/index.php/about-us.
[2] The above is from Mesa Water's 2016 Strategic Plan.

- CMSD opportunities are based on historic pricing provided by contractors as detailed in Board memos and Contracts.
- Mesa Water opportunities are based on Mesa Water's strategic plan.
- Real estate values are based on Voit Real Estate Services Brokers' Opinions of Value.
- The organizational savings through elimination of duplicative staffing is based on an average of the salaries and benefits of the two roles from each organization.
- The expense savings are based on a review of the FY2016 budgeted expenditure levels and an estimate of the savings that could be achieved through elimination of duplicative services and improved economies of scale.
- The cost of implementing the combined agency is based on an estimated budget for an outside service to facilitate a transition, assuming all stakeholders are in support of the transaction.

The following analysis estimates savings anticipated from an optimized combined agency. Actual savings to be realized depends on a number of actions and conditions that cannot be predicted at this time and could be less than or greater than the estimate in this Study. No assurance is given that results forecasted herein will be achieved.

2 ORGANIZATION/STAFFING

2.1 CMSD Current Organization

CMSD provides wastewater collection and transmission services to its customers. Collected wastewater is transmitted to the Orange County Sanitation District (OCSD) wastewater treatment facilities for treatment and disposal. CMSD is also responsible for residential trash collection and recycling services. Wastewater and solid waste collection fees are collected on the property tax bill as special assessments imposed on the users of the service. The County of Orange collects the special assessments on behalf of CMSD and remits 100 percent for deposit to CMSD accounts. CMSD maintains separate accounts for wastewater and solid waste. The accounts are presented as enterprise funds and managed in a manner similar to private business enterprises, where the intent of the governing body is that costs of providing goods or services to the general public be financed or recovered primarily through user charges for those services.

2.1.1 Governance

CMSD is a California Special District established in February 1944. CMSD is a public agency and is governed by a five-member Board of Directors, with each Director elected to a four-year term. Board members are elected District-wide (at large).

2.1.2 Organization Structure

CMSD uses a combination of in-house staff and private contractors to provide wastewater collection/transmission and trash collection/recycling services. Nineteen positions (17.5 full-time equivalent employees) and various contractors operate CMSD's office, yard, sewer system and trash collection system. Figure 1 provides CMSD's current organization chart. CMSD contracts trash and recyclables collection and hauling and appointed services including an Attorney, Treasurer, Engineer, and Inspector. The appointed services contracted out are depicted in light green in Figure 1. CMSD uses a combination of internal and contracted services to maintain their quality and level of service.

Costa Mesa Sanitary District FY2015-16 and FY2016-17 Organization Chart

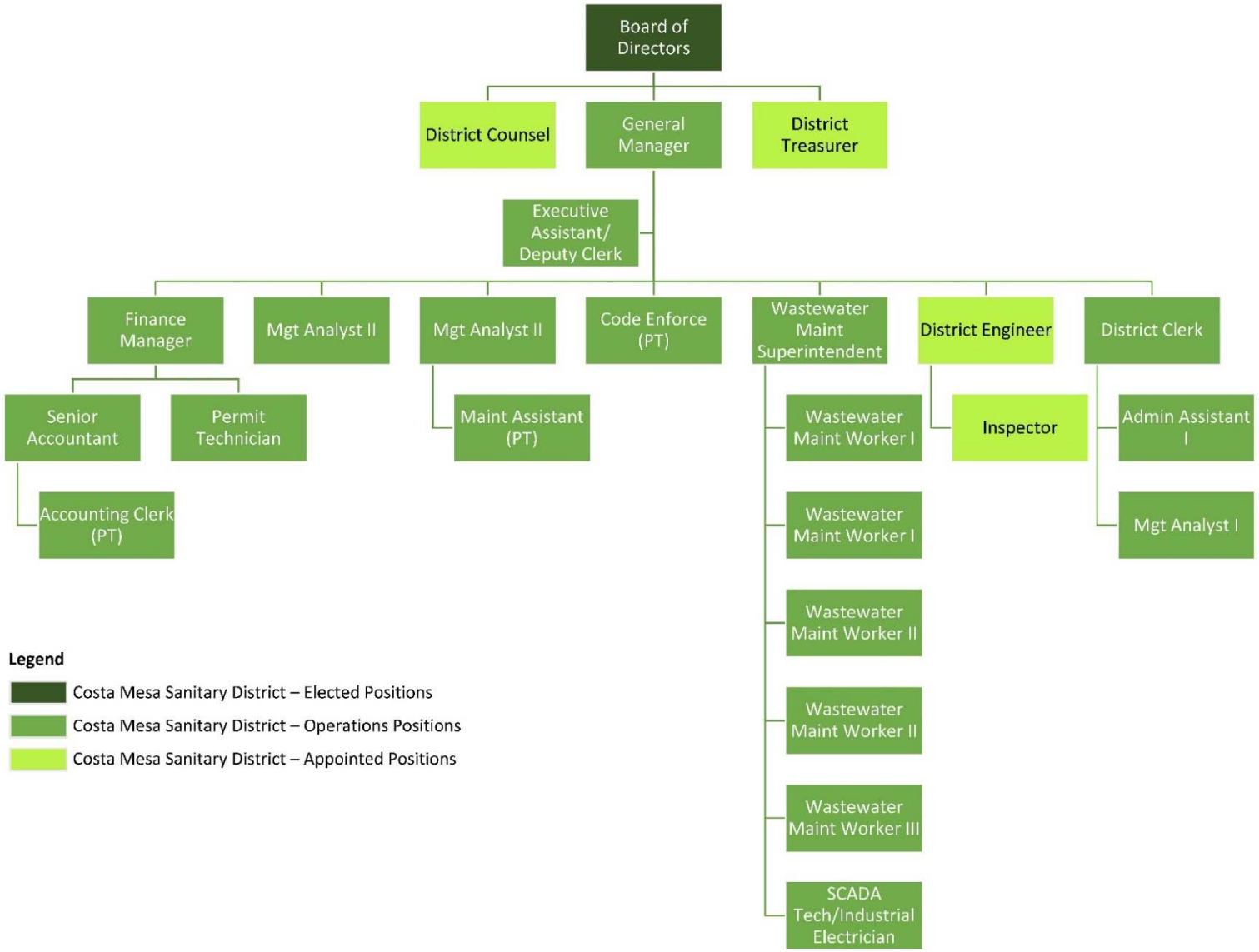


Figure 1. Costa Mesa Sanitary District FY2015-16 and FY2016-17 Organization Chart

2.1.3 Operations

CMSD is responsible for maintaining 224.2 miles of sewer mainline and 20 pump stations that transports 10.1 million gallons per day to treatment facilities for 116,700 residents residing in Costa Mesa, Newport Beach, and unincorporated Orange County. The maintenance standards utilized for CMSD's mainline and 20 pump stations help protect waterways and beaches from being contaminated by untreated sewage.

In addition to sewer service, CMSD also provides curb-side refuse and recycling collection services to over 21,500 households. CMSD has met the State mandate of diverting more than 50 percent of the community's refuse away from landfills and continues to strive to increase diversion rates for a cleaner and healthier environment with the implementation of an organic recycling program. The program is the first of its kind in Southern California where residential food scraps and green waste are recycled into Renewable Natural Gas (RNG). The methods of recycling allow residents to place all their trash in standardized containers. The trash is taken to a recycling facility in Stanton where it is mechanically and hand sorted, and the recyclables are removed. CMSD reached 50 percent diversion prior to the year 2000 and is in full compliance with all State mandates.[3]

In addition to organics recycling, CMSD offers many other recycling programs for children and adults such as the alkaline battery recycling program, safe disposal of hypodermic needles, composting and vermicomposting programs, household hazardous waste collections, waste-free lunches, large items and e-waste collections.

2.1.4 Maintenance

CMSD maintains 224 miles of mainlines, 4,707 manholes, 24,870 service laterals, and 20 pump stations. CMSD has a maintenance goal of cleaning and performing video inspection of its 224 miles of collection system annually. Pump station maintenance is performed with CMSD staff. The results of the video inspections are used to define future repairs and capital improvement projects. These maintenance services have been performed using a combination of in-house staff and contract support services. Refer to Section 5.1 for a more detailed contract support services analysis.

2.1.5 Asset Replacement Plan/CIP

CMSD has developed a comprehensive Sewer System Master Plan (SSMP), approved by the CMSD Board on December 17, 2015. The SSMP identifies key components of CMSD's asset replacement plan and provides a five-year capital improvement plan (CIP) that covers the period of fiscal year (FY) 2016 through FY 2020. CMSD anticipates funding the CIP through its asset management fund. Table 2 provides a summary of the proposed CIP included in the SSMP. It is our understanding, however, that the $7.0 million pump station abandonment project will no longer be undertaken within the next 5 years, if at all. As such, it is assumed that the revised total five-year capital investment will be reduced to $6.3 million versus $13.3 million, as noted in Table 2. CMSD's asset management fund maintains a minimum wastewater fund balance of $5.0 million. CMSD transfers funds from the operating budget or excess cash reserves to the asset management fund for payment of the improvements.

[3] The above is from CMSD's Green Guide Report, Cmsd_green_guide_final.pdf

Table 2. Summary of the CIP included in the 2016 SSMP

	Description	1	2	3	4	5	Sub Total	Year
		2016	2017	2018	2019	2020		
1.	West Side PS Abandonment				$7,016,363		$7,016,363	2019
2.	Indus Gravity Pipeline Relining	$353,000					$353,000	2016
3.	Harbor & South Coast Plaza FMU	$159,852	$800,000				$959,852	2016-2017
4.	Generator @ 23rd St PS	$300,000	$46,000				$346,000	2016-2018
5.	Elden PS Pipeline and Valve Replacement	$500,000	$25,000				$525,000	2016-2019
6.	Aviemore PS Upgrade	$100,000					$100,000	2016
7.	Victoria FM Upgrade		$100,000	$200,000			$300,000	2017-2018
8.	WW Pipeline Rehab (Grade 5)		$500,000	$500,000			$1,000,000	2017-2018
9.	Gister FM Upgrade			$520,000			$520,000	2018-2019
10.	Elden FM Upgrade			$500,000			$500,000	2018-2019
11.	IOWA FM Upgrade					$100,000	$100,000	2019-2020
12.	WW Pipeline Rehab (Grade 5)					$500,000	$500,000	2019-2020
13.	Rehan Brik MHs					$500,000	$500,000	2019-2020
14.	21st FM Upgrade					$200,000	$200,000	2020-2021
15.	Other, Including Solid Waste	$374,148					$374,148	2016
	Total	$1,787,000	$1,471,000	$1,720,000	$7,016,363	$1,300,000	**$13,294,363**	

Note: It is our understanding that since the publication of the 2015 SSMP, Item 1 (West Side PS Abandonment Project) has been eliminated from the CIP. As such, the revised subtotal CIP for 2016-2020 is anticipated to be $6.3 million (vs. $13.3 million).

CMSD has taken a proactive approach in developing a SSMP that has defined its five-year CIP. It is unclear if CMSD has a long-term (i.e., 100-year) asset replacement plan. Wastewater collection systems are typically comprised of vitrified clay pipe (VCP) infrastructure that has a much greater useful life (i.e., 120 years) when compared to standard water industry infrastructure of 60 to 80 years. There are wastewater collection systems throughout the U.S. that have provided over 120 years of service. Given CMSD's relatively young age (less than 60 years), the long-term service life of VCP, and CMSD's proactive annual video inspection and wastewater collection system maintenance, it appears that a long-term replacement of assets is not presently necessary for a long-term planning horizon.

2.2 Mesa Water Current Organization

Mesa Water was formed in 1960 by combining the City of Costa Mesa Water Department, Fairview County Water District, Newport Mesa Irrigation District, and Newport Mesa County Water District. Mesa Water receives no property tax revenue and currently over 90 percent of its income comes from water rates (including water meter charges) to customers.

2.2.1 Governance

A five-member Board of Directors governs Mesa Water. The service area is divided into five geographic divisions of approximately equal population. One individual from each division is elected by the voting public to serve alternating four-year terms on the Board. The Mesa Water Board of Directors is responsible for establishing policies and elects one of its members to serve as President and another to serve as Vice President.

Mesa Water represents a specific geographic area, collects no tax revenues, is not subject to the State's Public Utility Commission, and is not part of any city or the government of the County of Orange.

2.2.2 Organization Structure

Mesa Water currently employs 57.5 full-time equivalent employees with water operations, customer service and engineering services largely provided under one dedicated assistant general manager (AGM) and financial, legal, administrative and public affairs services provided under another dedicated AGM, as shown in Figure 2.

Mesa Water District FY2016 Organization Chart

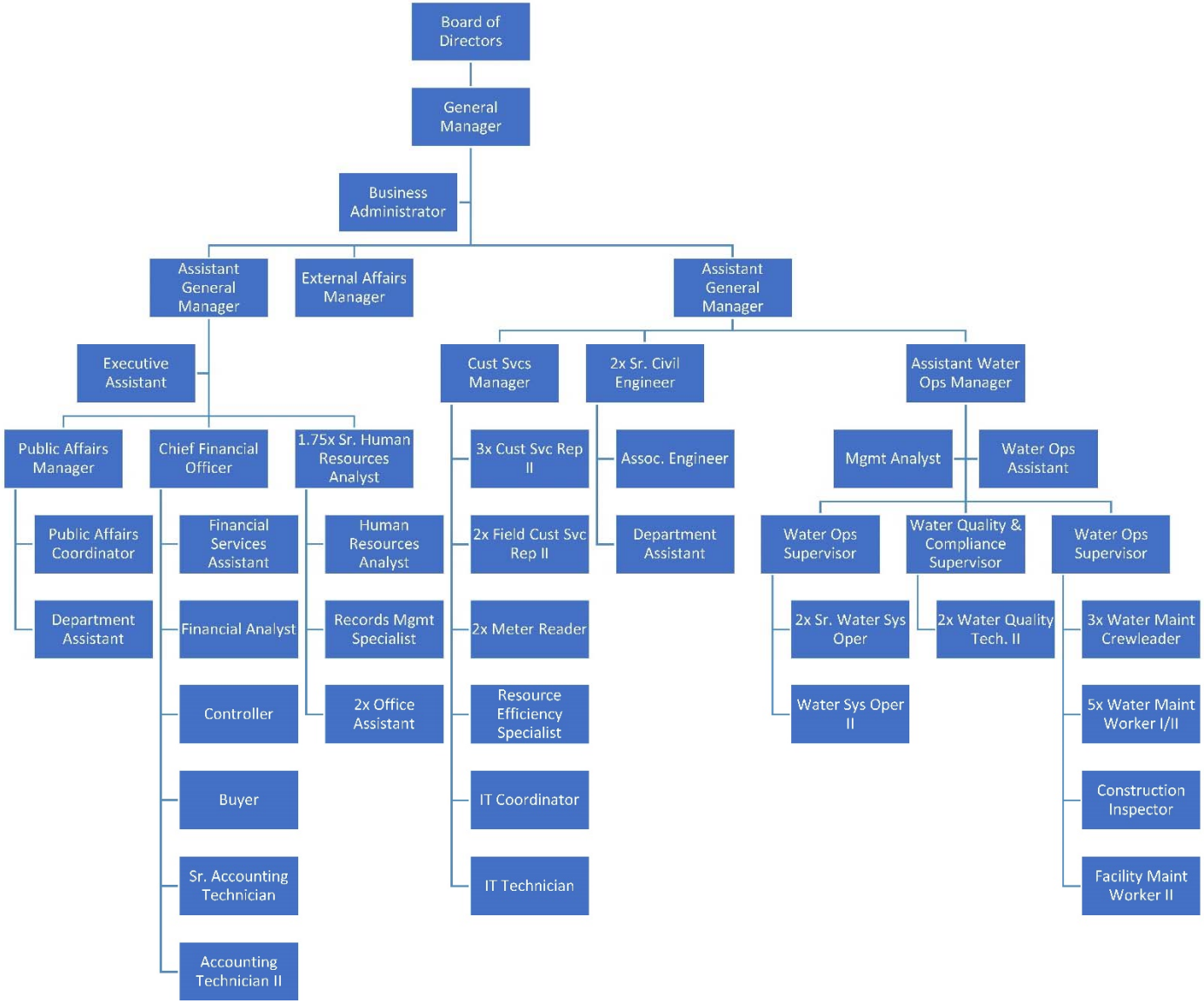


Figure 2. Mesa Water FY2016 Organization Chart

2.2.3 Operations

Mesa Water provides water service to approximately 110,000 customers through approximately 23,760 total metered service connections, of which 699 are fireline services. The service area is an 18-square-mile area that includes most of the city of Costa Mesa, portions of the city of Newport Beach, and a small portion of unincorporated Orange County. Mesa Water shares borders with Orange County and the cities of Huntington Beach, Fountain Valley, Irvine, Santa Ana, and Newport Beach.

Mesa Water supplies its water demands from a mix of groundwater from the Orange County Groundwater Basin, imported water when needed from the Municipal Water District of Orange County (MWDOC) and recycled water provided by the Orange County Water District (OCWD) via the Green Acres Project (GAP). Mesa Water predominately uses local groundwater, recycled water, and conservation to meet 100 percent of its demands.

Mesa Water operates seven groundwater wells and treats water at its groundwater treatment plant called the Mesa Water Reliability Facility (MWRF) before being pumped into the distribution system. Mesa Water has about 317 miles of pipelines to distribute the water and two reservoirs with pump stations for operational and emergency storage with a total storage capacity of 28 million gallons (MG). Mesa Water has two metered interconnections with the City of Huntington Beach and the Irvine Ranch Water District (IRWD) along with 15 emergency interconnections with the City of Santa Ana, the City of Newport Beach, and IRWD.

2.2.4 Maintenance

Mesa Water maintains 317 miles of mainlines, 5,139 mainline valves, 3,383 fire hydrants, 2 booster pump stations, 2 storage reservoirs, and 7 groundwater wells. Mesa Water's goal is to maintain its fire hydrants annually and mainline valves on a bi-annual basis. Distribution facility maintenance is performed with Mesa Water in-house staff. Production facilities maintenance (i.e., Pump stations, reservoirs, and groundwater wells) is performed with a combination of contract support services and in-house Mesa Water staff. Mesa Water routinely evaluates in-house maintenance performance costs with contract support services costs.

2.2.5 Asset Replacement Plan/CIP

The Mesa Water five-year Capital Improvement Plan (CIP) covers the period of FY2016 through FY2020. The plan anticipates $40.0 million of capital improvements including most notably $27.9 million for Distribution System improvements. The FY 2016 budget contains $1.1 million for Operations Routine Capital, $1.0 million for well rehabilitation and automation design, $700,000 for the IT Master Plan, $516,000 for Operations Capital, $440,000 for Pipeline Integrity Testing Program, $430,000 for OC-44 pipeline improvements, $345,000 for MWRF Parking Project, and $289,000 for MWRF improvements, along with other miscellaneous improvement projects. As shown,

Table 3 summarizes the proposed CIP projects included in the Water Master Plan.

Table 3. Mesa Water CIP Projects

Description	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Sub Total
Operations Routine Capital	$1,098,187					$1,098,187
Well Rehabilitation	$1,014,500	$3,055,000	$3,055,000			$7,124,500
IT Master Plan	$700,000					$700,000
Operations Capital	$516,100					$516,100
Pipeline Integrity Testing Program	$439,500					$439,500
OC-44 Pipeline Improvements	$429,500					$429,500
MWRF Parking Project	$344,500					$344,500
MWRF Improvements	$289,000	$85,000				$374,000
Distribution Systems Improvements	$1,000,000	$3,165,500	$3,165,500	$10,314,500	$10,314,500	$27,960,000
Miscellaneous		$735,500	$735,500			$1,471,000
Reservoir		$5,000				$5,000
BPS		$103,500	$103,500			$207,000
Total	$5,831,287	$7,149,500	$7,059,500	$10,314,500	$10,314,500	**$40,669,287**

Mesa Water has taken a proactive approach in strategically managing its long-term (i.e., 100-year) infrastructure replacement needs through its Pipeline Integrity Testing Program. Complete replacement of Mesa Water's infrastructure over a 100-year timeframe is estimated to cost approximately $560 million (2013 dollars). With the average useful life of a water main ranging between 65 and 85 years, the Pipeline Integrity Testing Program uses a combination of non-destructive and destructive testing to maximize the service life of each pipeline asset. This strategic approach will allow Mesa Water to recognize several millions of dollars of savings in extended useful infrastructure life.

2.3 Proposed Organization/Staffing for Combined Agency

2.3.1 Customers/Service Area

In Figure 3, CMSD (illustrated by a green bold boundary) has a very similar service area as Mesa Water (illustrated by the blue shading). CMSD's service area includes the entire City of Costa Mesa, portions of the City of Newport Beach and the unincorporated areas of Orange County. Whereas, Mesa Water's service area is located within Orange County, sharing borders with the cities of Huntington Beach, Fountain Valley, Irvine, Santa Ana, and Newport Beach. The overlap in service area lends itself to efficiencies in providing services to residents.

The assumption would be that the combined agency would continue with the same service areas, as the water and sewer services have separate enterprise funds, providing no issue of the non-overlapping service area.

Figure 3. Costa Mesa Sanitary District Service Area and Mesa Water District Service Area

2.3.2 Combined Organizational Structure

The potential savings opportunity for a combined organization can be realized using economies of scale and streamlining the personnel functions across the organizations.

Both agencies cover similar physical areas as previously shown in Figure 4, with offices in close proximity. After reviewing CMSD's and Mesa Water's budget documents, job descriptions, organizational charts, and other relevant information, select functions are combined with economies of scale resulting in cost savings related to labor and benefits for the combined agency.

The following summarizes the review of the duplicative functions provided by the two agencies. Note names of roles are provided with a "/" to indicate the names of roles at "Mesa Water/CMSD."

- General Manager – only one General Manager is required.
- Board Members – only one 5-member Board with combined functions is required in a combined agency given all Board members are both CMSD and Mesa Water customers.
- Chief Financial Officer (CFO)/Finance Manager – only one is required in a combined agency.
- Controller/Senior Accountant – only one is required in a combined agency.
- Accounting Technician II/ Part-time Accounting Clerk – part-time services will not be required in a combined organization. Instead, a full-time Accounting Technician I to support the above combined finance department is added.
- Office Assistant/Admin Assistant 1 – only one is required in a combined agency. This position would report to the Senior Human Resources Analyst (currently 1.75 full-time employee [FTE] at Mesa Water). In addition, it is suggested having two FTEs is more beneficial than a 1.75 employee from a productive and performance standpoint and thus being able to adequately handle the combined agency Human Resources requirements as well. Therefore the part-time (0.75 FTE) position will be replaced by a full-time position (1 FTE).
- AGM Sanitary Operations – this position is created in the combined agency to manage and oversee all Wastewater and Solid Waste Operations and will combine many of the responsibilities previously provided by the CMSD's General Manager. It is assumed that the AGM of Sanitary Operations earns a similar salary and benefit as the AGM of Water Operations.
- AGM Water Operations and Combined Engineering – this position is the same position Mesa Water has currently titled AGM who oversees Customer Service, Engineering and Operations. The responsibilities of this role would not change; however, the organization of the employees would change slightly by including a Combined Engineering group with engineers serving both water and wastewater as well as the addition of IT services.
- CMSD Executive Assistant/District Clerk – this position would be fulfilled by the AGM Administrative Services.
- CMSD Management Analyst II – this position is eliminated and a new position titled Solid Waste Supervisor is added in a combined agency. The responsibilities of a Solid Waste Supervisor include all of the responsibilities of a CMSD Management Analyst II, plus the added responsibility of oversight of the Solid Waste operations and staff.

- CMSD Appointed District Engineer – this position is not required as it is a contracted position and the Combined Engineering Services under the AGM Water Operations and Combined Engineering can oversee the work of the Appointed District Engineer.
- CMSD Inspector – CMSD identifies this as a contracted position, where the Inspector currently reporting to CMSD's Appointed District Engineer. Because of the cost of contracted services, an Inspector role is hired in the combined agency and reports to the AGM Water Operations and Combined Engineering at an equivalent cost.
- Appointed District Treasurer – CMSD identifies this as a contracted position, whereas Mesa Water's CFO is the appointed treasurer. Therefore, it is not identified as a position on the organizational chart. Treasury services in the combined organization is under the CFO/Finance Manager position.
- Appointed District Counsel – Both agencies contract for legal counsel services. For the combined agency, these services are combined into one professional services contract. Therefore, it is not identified as a position on the organizational chart.

A potential combined organizational chart is shown in Figure 4. The grey colored positions indicate the integration of common administrative services. CMSD Wastewater Operations are presented in green, CMSD Solid Waste Operations are presented in orange, Mesa Water Operations positions are presented in blue, and Common Engineering positions are presented in gold.

Note the combined agency organization chart presented in Figure 4 assumes wastewater system cleaning services remain in house; refer to Section 5.1 for potential savings from contracting wastewater system cleaning services. The total FTEs for the combined agency is 71 (not including Board members), with approximately 30 percent of the staff associated with common administrative services and 70 percent with water, wastewater and solid waste operations.

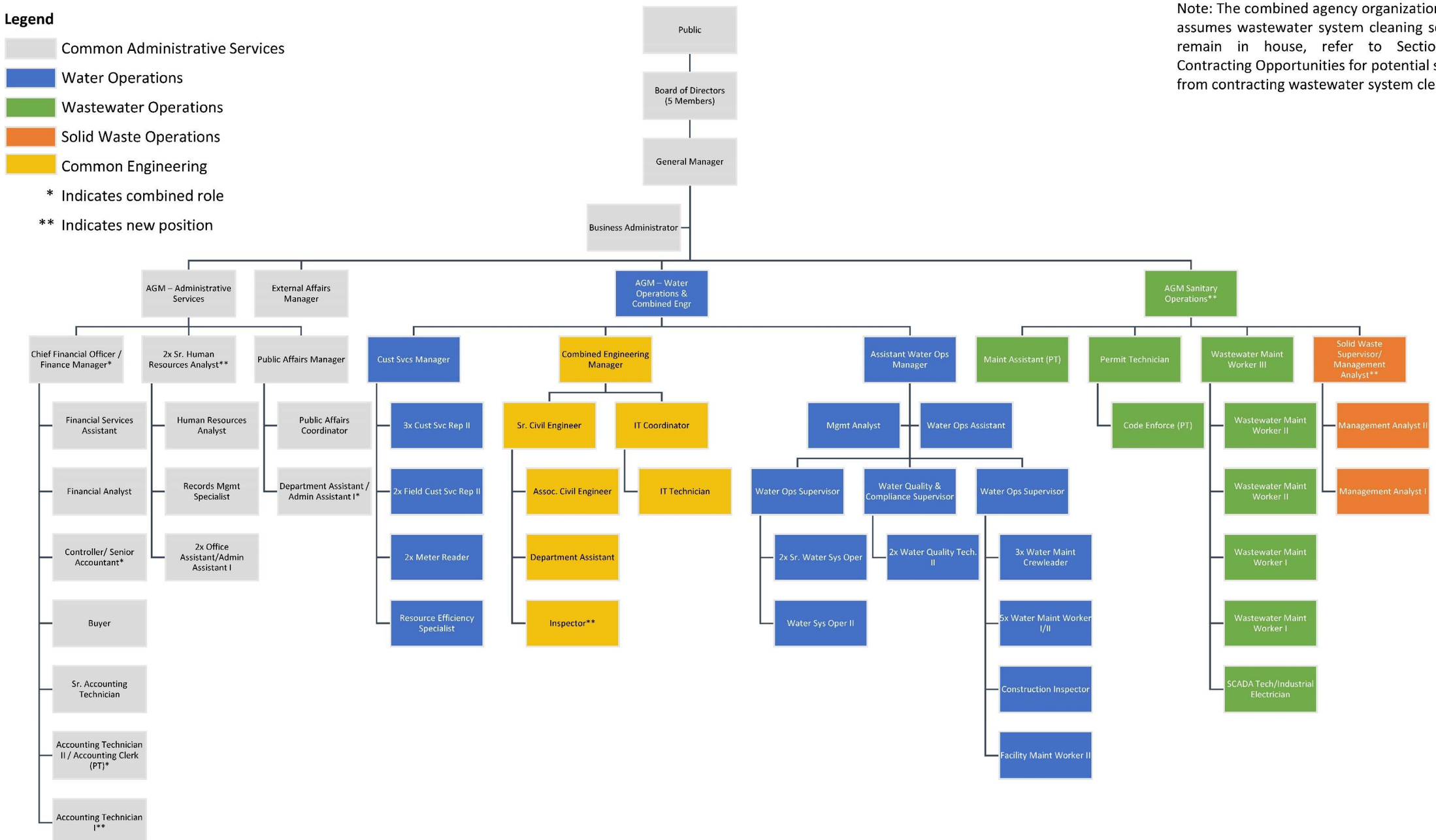
In sum, there is a net anticipated decrease of four FTEs (not including Board members) under the combined agency organizational chart presented in Figure 4 and summarized in Table 4. Furthermore, it is assumed that instead of having two separate 5-member Boards, only one 5-member Board is required. This reduction in duplicate services and increased economies of scale provides a potential savings of $900,000 in Administrative / Management staff salaries and benefits.

Table 4. Summary of Combined Roles

Organizational Changes	Existing Roles		Combined Roles
	Mesa Water Role	CMSD Role	
Combined Roles	Chief Financial Officer	Finance Manager	Chief Financial Officer / Finance Manager
	Controller	Senior Accountant	Controller / Senior Accountant
	Accounting Technician II	Accounting Clerk (PT)	Accounting Technician II / Accounting Clerk (PT)
	Department Assistant	Administrative Assistant I	Department Assistant / Administrative Assistant I
Eliminated Roles[1]	Board of Directors (5)	Board of Directors (5)	Board of Directors (5)
	General Manager	General Manager	General Manager
	n/a	WW Maintenance Superintendent	n/a
	n/a	Management Analyst II	n/a
	Executive Assistant	District Clerk	n/a
	Office Assistant (PT)	Admin Assistant 1	n/a
Renamed Roles	AGM	n/a	AGM Water Operations & Combined Engineering
	AGM	n/a	AGM Administrative Services
New Roles	n/a	n/a	AGM Sanitary Operations
	Inspector	n/a	Inspector
	Office Assistant (PT)	Admin Assistant 1	Office Assistant/Admin Assistant

[1] Board of Directors is not included in FTEs.

Combined Agency Potential Organization Structure



Note: The combined agency organization chart assumes wastewater system cleaning services remain in house, refer to Section 5.1 Contracting Opportunities for potential savings from contracting wastewater system cleaning.

Figure 4. Combined Agency Potential Organization Structure

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In addition to the above salary and benefit savings, it is anticipated that another $200,000 in savings could be realized through elimination of duplicative contracted professional services and expenses including: legal counsel, treasurer, engineering, GIS, financial audit, actuary services, human resources, IT services, temporary labor and other miscellaneous contract costs and expenses such as Board travel and related expenses. This expense reduction represents less than 5 percent of the total professional contracted services and related expenses. This is exclusive of the contracted operating costs for trash collection and recycling services.

The total of the above-anticipated organizational savings for a combined agency is approximately $1.1 million. These savings are primarily associated with elimination of duplication of common services. As such, for the purposes of this analysis these savings are shared equally among the three enterprise funds for the combined agency – Water, Wastewater, and Solid Waste Funds – and accrue to the customers of each fund. It is also noted, that CMSD/Mesa Water will need to hire legal counsel and technical and financial experts to assist in drafting the required transaction documents. A budget for the one-time implementation cost of $600,000 is anticipated for combining these agencies. Refer to Table 5 for the total savings and a breakdown of the allocated savings by fund.

Table 5. Total One-Time and Annual Organizational Savings by Fund and District

	Wastewater Fund	Solid Waste Fund	Water Fund
Annual Savings by Fund (1/3rd allocation)	$366,666	$366,666	$366,666
Savings by Agency	$723,333		$366,666
Combined Savings	$1,100,000		
	Wastewater Fund	Solid Waste Fund	Water Fund
One-Time Implementation Savings (Cost)	($200,000)	($200,000)	($200,000)
Total Implementation Savings (Cost) by Agency	($400,000)		($200,000)
One-Time Implementation Cost	($600,000)		

Combining Mesa Water and CMSD into one organization has the potential to save ratepayers an estimated $1.1 million annually. The Administrative/Management sections of the organizations would be streamlined, achieving this opportunity and eliminating duplicative positions.

3 REAL ESTATE/MAINTENANCE

3.1 CMSD Facilities

CMSD's facilities include 219.4 miles of gravity mainline, 4.8 miles of pressurized mainline, 24,870 service lateral connections, 4,707 manholes, and 20 pumping stations. CMSD's SSMP includes a detailed list of CMSD-owned sewer lines, including lengths and sizes. In addition to the wastewater infrastructure, CMSD owns and maintains three properties, which are described below.

CMSD's current headquarters is located at 628 W. 19th Street in Costa Mesa. The current market value range of this property is $1.2 - $1.3 million ($300-$320 per square foot [SF])[4]. CMSD is in the process of purchasing a new administration building as discussed further below and then selling this existing administration building. Refer to Appendix A for the valuation information.

[4] The above is from Voit Real Estate Services, Hefter Vernick Team.

CMSD's future headquarters is located at 290 Paularino Avenue in Costa Mesa. The current market value range of this property is $3.7 - $4.0 million ($295-$315 per SF)[5]. CMSD is in the process of purchasing this new administration building. Refer to Appendix A for the valuation information.

CMSD's District Yard is located at 174 W. Wilson Street in Costa Mesa. The current market value range of this property is $1.5 - $1.6 million ($330-$350 per SF)[6]. Refer to Appendix A for the valuation information.

[5] The above is from Voit Real Estate Services, Hefter Vernick Team.
[6] The above is from Voit Real Estate Services, Hefter Vernick Team.

3.2 Mesa Water Facilities

Mesa Water's combined headquarters and maintenance yard is located at 1965 Placentia Avenue in Costa Mesa. The current market value range of this property is $11.3 - $12.5 million ($190-$210 per SF). Refer to Appendix A for the valuation information.

3.3 Proposed Properties for Combined Agency

Reorganization provides an opportunity to capitalize on economies of scale and reduce capital costs related to real estate. CMSD owns one administration building (which is currently on the market), a separate maintenance yard facility, and is purchasing a new administration building to replace the one currently on the market. Mesa Water has a larger combined administration and yard building as its headquarters.

In the past CMSD shared offices with the City of Costa Mesa. Therefore, one area of savings is for CMSD staff to share Mesa Water's existing headquarters at 1965 Placentia Avenue. The Placentia Avenue location has adequate space available to accommodate the combined administrative roles, as well as the wastewater and solid waste operations roles and some yard equipment, which eliminates the need for CMSD's headquarters. Additionally, CMSD's maintenance yard facility may not be needed depending on its vehicle storage needs. If the sewer line cleaning, for example, was contracted in part or whole as per CMSD's historic practices (refer to Section 5.1) then equipment storage requirements would be reduced and the CMSD maintenance yard facility would not be required (note, as this is a high-level Study it is suggested that CMSD conduct an independent operations assessment). Based on current market values, a one-time savings of $2.6 to $2.9 million can be gained through the sale of CMSD's existing administrative headquarters and maintenance yard, as well as approximately $50,000 in annual savings

associated with the maintenance of these buildings (electricity, cleaning, landscaping, etc.). In addition, CMSD would not need to purchase the proposed new headquarters at 290 Paularino Avenue in Costa Mesa. The potential savings associated with the elimination of excess real estate assets would accrue to the enterprise fund of those assets. For the purposes of this analysis, it is assumed that the real estate savings is divided equally between the Wastewater and Solid Waste Funds. It is also assumed that maintenance costs of the combined agency headquarters (assumed to be the existing Mesa Water headquarters and yard) would be prorated to each of the funds based on a cost of service analysis. Mesa Water's current building maintenance costs are approximately $150,000 per year and they represent 76% of the combined revenue. As such, it is assumed that approximately 24% of this cost would be allocated to the Wastewater and Solid Waste funds, which would provide a savings to the Water Fund. Refer to Table 6 for the total savings and a breakdown of the allocated savings by fund. The annual savings are in addition to the one-time savings.

Table 6. Total One-Time and Annual Real Estate Savings by Fund and Agency

Categories	Wastewater Fund	Solid Waste Fund	Water Fund
Total One-Time Savings by Fund	$1,300,000	$1,300,000	$0
Total One-Time Savings by Agency	$2,600,000		$0
Total Combined One-Time Savings	$2,600,000		
Categories	**Wastewater Fund**	**Solid Waste Fund**	**Water Fund**
Total Annual Savings (Cost) by Fund: **-CMSD Headquarters/Yard** **-Mesa Headquarters/Yard**	$25,000 ($18,000)	$25,000 ($18,000)	$0 $36,000
Annual Savings by Agency	$14,000		$36,000
Combined Annual Savings	$50,000		

4 FINANCIAL MANAGEMENT AND RESERVES

A review of the financial position of CMSD and Mesa Water, as well as the combined financial position of both CMSD and Mesa Water, assuming a combination of the two agencies, was conducted to assess whether a combined agency would have the excess reserves and revenue to allow for a reduction in rates or rebate to customers.

An identification of target financial metrics (Target Days Cash and Target Debt Service Coverage) was established to maintain a AAA rating for the combined agency. Days Cash represents the number of days of operating expenses that the agency could pay with its current cash available, and Debt Service Coverage is the ratio of net operating income divided by debt service. Lastly, the current financial position was compared to the target financial metrics to determine whether one-time savings or annual savings exist.

Both CMSD and Mesa Water maintain strong financial metrics. Mesa Water has received a strong AAA credit rating from both Standard and Poors (S&P) and Fitch rating services. CMSD, although financially strong, is currently unrated. The estimate of the probable range of potential excess reserves and revenue from a combined agency is based on retaining strong AAA ratings.

The financial savings discussion includes the following:

- Section 4.1 Overview of CMSD's Existing Financial Position
- Section 4.2 Overview of Mesa Water's Existing Financial Position
- Section 4.3 Combined Agency Financial Review
- Section 4.4 Total Savings

4.1 Overview of CMSD's Existing Financial Position

CMSD separates its finances between its services for solid waste and wastewater, and as a result, each fund has a separate and distinct financial position, as summarized below. Unless otherwise noted, all financial information in this section is based on audited financial statements for the fiscal year ended June 30, 2015.

Table 7. CMSD Summarized Financials

Costa Mesa Sanitary District - Summarized Financials		
Categories	**Wastewater Fund**	**Solid Waste Fund**
Total Revenues	$ 5,958,461	$ 5,219,484
Total Expenses	$ 3,376,784	$ 5,258,128
Net Revenues	$ 2,581,677	-$38,644
Unrestricted Cash (Reserves)	$ 15,279,498	$ 5,743,237
Days Cash	**1,652**	**399**
Operating Margin	**76%**	**-0.7%**
Debt Service	$0	$0

The Wastewater Fund of CMSD has a very strong financial position. This includes both a strong operating margin of 76 percent of operating expenses and strong cash reserve position of 1,652 Days Cash.

The Solid Waste Fund of CMSD has a slightly negative operating position and a lower cash position of 399 Days Cash. While this cash position would be considered very strong by S&P, it is significantly lower than that of the Wastewater Fund and the water operations of Mesa Water. The negative operating position in and of itself would be inconsistent with any level of investment grade rating. However, this negative operating position was established by CMSD as part of a conscious decision to not increase rates but to use excess reserves to balance its budget. On a combined basis, CMSD has an operating margin of 29 percent and 889 Days Cash ($21.0 million total). On this combined basis, CMSD possesses very strong financial metrics consistent with a strong AAA rating.

Given that CMSD's Solid Waste Fund operations do not typically involve any major capital outlay (or likelihood of future debt), we would not expect the combined agency's debt service to involve the pledge of Solid Waste revenues, or factor the Solid Waste Fund into the credit rating process. Therefore, the Solid Waste Fund could potentially have excess unrestricted cash (reserves) offer rebates based on its strong cash position—and at a Days Cash level lower than required for the combined agency to retain an AAA rating.

4.2 Overview of Mesa Water's Existing Financial Position

Mesa Water has been rated AAA by both S&P and Fitch. Additionally, Mesa Water has adopted a formal "strong AAA" rating policy, which includes a 600 Days Cash target. As illustrated in the table below, Mesa Water has an operating margin of 36 percent and 617 Days Cash ($39.4 million). Unless otherwise noted, all financial information presented in this section is based on audited financial statements for the fiscal year ended June 30, 2015.

Table 8. Mesa Water's Existing Summarized Financials

Mesa Water District - Summarized Financials	
Categories	**Water**
Total Revenues	$ 35,092,402
Total Expenses	$ 23,352,348
Net Revenues	$ 11,740,054
Unrestricted Cash	$ 39,445,085
Days Cash	**616.5**
Operating Margin	**36%**
Debt Service	$ 3,446,193

4.3 Combined Agency Financial Review

Table 9 depicts the key financial metrics of a hypothetical combined agency of Mesa Water and CMSD. Though serving substantially the same service area and customer base, Mesa Water is financially around three times larger than CMSD in terms of total operating revenues. From a revenue perspective, Mesa Water would make up 76 percent of total combined agency revenues and 65 percent of combined agency cash.

Table 9. Combined Agency Financial Snapshot

Categories	Combined Agency - Proportionate Shares			
	FY2015	Water	Wastewater	Solid Waste
Total Revenues	**$46,270,347**	**76%**	**13%**	**11%**
Total Expenses	$31,987,260	73%	11%	16%
Net Revenues	$14,283,087	82%	18%	-0.3%
Debt Service	$3,446,193	100%	0%	0%
Debt Coverage Ratio	4.14	3.41	NA	NA
Operating Margin Total	$10,836,894	77%	24%	-0.4%
Operating Margin %	34%	36%	76%	-0.7%
Unrestricted Cash	**$60,467,820**	**65%**	**25%**	**9%**
Days Cash Ratio	690	617	1,652	399

In terms of the breakdown of the combined agency, there are disparities in the existing agencies' financial metrics. While both agencies on a combined basis are financially very strong, CMSD has relatively higher Days Cash metric than Mesa Water but a slightly lower operating margin. However, because CMSD does not have any debt service expense, a combined agency would have a stronger Debt Service Coverage ratio.

In total, the combined agency would possess very strong financial metrics, including $10.8 million in operating margin, or 34 percent of operating expenses, a Debt Service Coverage ratio of 4.14 and 690 Days Cash. Based on these metrics, the combined entity would have a financial position more than sufficient to retain a AAA credit rating.

4.3.1 Financial Metrics

As discussed previously, a combined agency provides strong financial metrics. As such, in terms of potential excess cash, the question becomes at what minimum key financial metrics could the combined agency operate and retain the AAA rating and what does that translate to in terms of potential excess cash.

It is assumed that in order to retain a "strong" AAA rating, the combined agency would need to maintain a debt service coverage of 3.5 times and 600 Days Cash for the Water and Wastewater funds. For the Solid Waste Fund, it is assumed that 200 Days Cash would be sufficient given its operating cost level and the fact S&P criteria views this level as "very strong." The Solid Waste Fund is not assumed to be part of the combined agency's pledge for debt service, or factor into the credit rating. However, a cash position at a minimum of 200 Days Cash would be advisable to limit any risk the other funds would have to ever

subsidize Solid Waste operations. Table 10 summarizes the financial metric levels anticipated to be required.

Table 10. Targeted Financial Metric

Categories	Target Financial Metric Level			
	Savings Type	Water	Wastewater	Solid Waste
Target Days Cash	One-Time	600	600	200
Target Debt Service Coverage	Annual	3.5	3.5	Not Applicable

4.3.2 Combined Agency Available Cash

4.3.2.1 One-Time Savings

Based on the above ranges and assumptions, a total of $13.6 million in one-time excess cash could be made available to provide rebates to customers, fund capital investments, reduce rates or provide for rate stabilization as illustrated in the below table. These estimates are based on the actual FY15 audited financial data and are subject to change based on FY16 budgeted performance.

Based on a Target Days Cash metric of 600 days for the Wastewater Fund and 200 days for the Solid Waste Fund, CMSD has over $12.5 million dollars in excess cash reserves; and, based on a Target Days Cash metric of 600 days, Mesa Water has over $1.0 million dollars in excess cash reserves as illustrated in Table 11.

Based on a Target Days Cash metric of 600 days, the Total One-Time Savings by fund has $13.65 million dollars in excess cash reserves as illustrated in Table 11.

Table 11. One-Time Savings

Categories	Wastewater Fund	Solid Waste Fund	Water Fund	Total
Current Days Cash	1,652	399	616.5	N/A
Target Days Cash	600	200	600	N/A
Difference	1,052	199	16.5	N/A
One Day's Cash	$9,251	$14,406	$63,979	N/A
Excess Cash (One-Time Savings)	$9,730,000	$2,860,000	$1,060,000	$13,650,000
Excess Cash Reserves (as % of FY15 Revenues)	163%	55%	3%	29%

4.3.2.2 Annual Savings

In terms of Debt Service Coverage, the Table 12 below shows the potential excess cash after meeting the Debt Service Coverage target of 3.5. It is important to note that excess revenues after meeting Debt Service Coverage, unlike Days Cash, can be permanent given the recurring annual nature of the metric. As discussed above, CMSD is currently debt-free and no new debt is anticipated for the Solid Waste Fund, as there are minimum capital assets associated with the Solid Waste Fund operations. The Wastewater Fund, while currently debt-free, does invest an estimated $1.1 million annually (average annual based on 5-year CIP) on capital improvements to its assets. However, the annual capital investment requirement could vary substantially from year to year and, as a result, require issuance of future debt. As such, for the purposes of the analysis below, a hypothetical debt service amount was assumed for the Wastewater Fund based on the Wastewater Fund's revenue share of 13 percent of total revenue and current combined agency debt levels. Using this assumption, a hypothetical debt service of $442,000 (13 percent of $3.4 million) was assumed for the Wastewater Fund.

Table 12. Annual Savings

Categories	Wastewater Fund	Solid Waste Fund	Water Fund
Current Debt Service Coverage	4.14	n/a	3.41
Target Debt Service Coverage	3.50	n/a	3.50
Difference	0.64	-	(0.09)
Current Net Revenue (FY 2015)	$2,581,677	-	$11,700,854
Target Net Revenue (3.5 times)	$1,547,000	-	$11,900,000
Annual Savings (Excess Cash Reserves)	$1,034,677	-	($199,146)
Percent Savings (Excess Cash Reserves)	17%	-	-1%

The analysis above indicates the potential for Wastewater Fund customers to realize annual savings through reduced net revenue requirements of approximately $1.0 million per year, which represents approximately 17 percent of the annual Wastewater Fund total revenue requirements. The Water Fund, however, cannot offer any savings based on these assumptions.

4.4 Total Financial Management Savings

Mesa Water currently has a AAA credit rating and CMSD has slightly stronger financial metrics. The combined agency would have reserves in excess of that required to maintain a strong AAA rating. Such combined reserves could be in excess of $13.6 million and available to provide a one-time rebate to customers or be used to offset future rate increase through investments, rate stabilization or rate reductions. In addition, on an annual basis the Wastewater Fund could reduce its net revenue requirements by approximately $1.0 million annually, which represents a 17 percent reduction over current revenue requirements. Refer to Table 13 for the total savings and a breakdown of the allocated savings by fund. The annual savings are in addition to the one-time savings.

Table 13. Total One-Time and Annual Financial Savings by Fund and Agency

Category	Wastewater Fund	Solid Waste Fund	Water Fund
Total One-Time Savings by Fund	$9,730,000	$2,860,000	$1,060,000
Total One-Time Savings by Agency	$12,590,000		$1,060,000
Total Combined One-Time Savings	$13,650,000		
Category	**Wastewater Fund**	**Solid Waste Fund**	**Water Fund**
Total Annual Savings by Fund	$1,040,000	$0	$0
Total Annual Savings by Agency	$1,040,000		$0
Total Combined Annual Savings	$1,040,000		

5 OPTIMIZATION OPPORTUNITIES

The following optimization opportunities were analyzed for both CMSD and Mesa Water. These opportunities to optimize operations exist for both CMSD and Mesa Water independent of a combined agency.

5.1 CMSD Contracting Opportunities

CMSD has the responsibility for wastewater collection system maintenance and pump station maintenance and repair. CMSD historically contracted with the City of Costa Mesa for wastewater system cleaning and pump station maintenance. In 2006, CMSD began contracting all or part of the services to private contractors, with more and more of the responsibility being provided with in-house staff over time.

5.1.1 Wastewater System Cleaning

National Plant Services (NPS) provided CMSD with wastewater system cleaning services and Closed Circuit Television (CCTV) inspection beginning in 2006. NPS cleaned all of the wastewater lines on a unit cost basis with a specified contractual goal of accomplishing 4,500 to 7,000 linear feet (LF) per day as a planned level of effort.

In 2013, CMSD went to a shared services approach where the in-house forces began performing approximately half of the line cleaning effort by adding three wastewater maintenance employees and purchasing required equipment, including a high velocity cleaning truck and some pickup trucks with toolboxes. CMSD also purchased a CCTV Inspection trailer. Prior to this, CMSD had existing staff periodically accompany NPS, as part of a three-man crew, to observe, assist, and learn.

In 2015-2016, CMSD made a strategic decision to take on 100 percent of the line cleaning effort with in-house staff and eliminated the private contract service with NPS. In order to accomplish this new approach to maintenance, CMSD added two more wastewater maintenance employees and purchased a second high velocity cleaning truck. To date, this reflects CMSD's current operations and is the basis for Scenario 1, the status quo or baseline, refer to Table 14 in the following Section.

5.1.2 Contracting Assumptions and Analysis

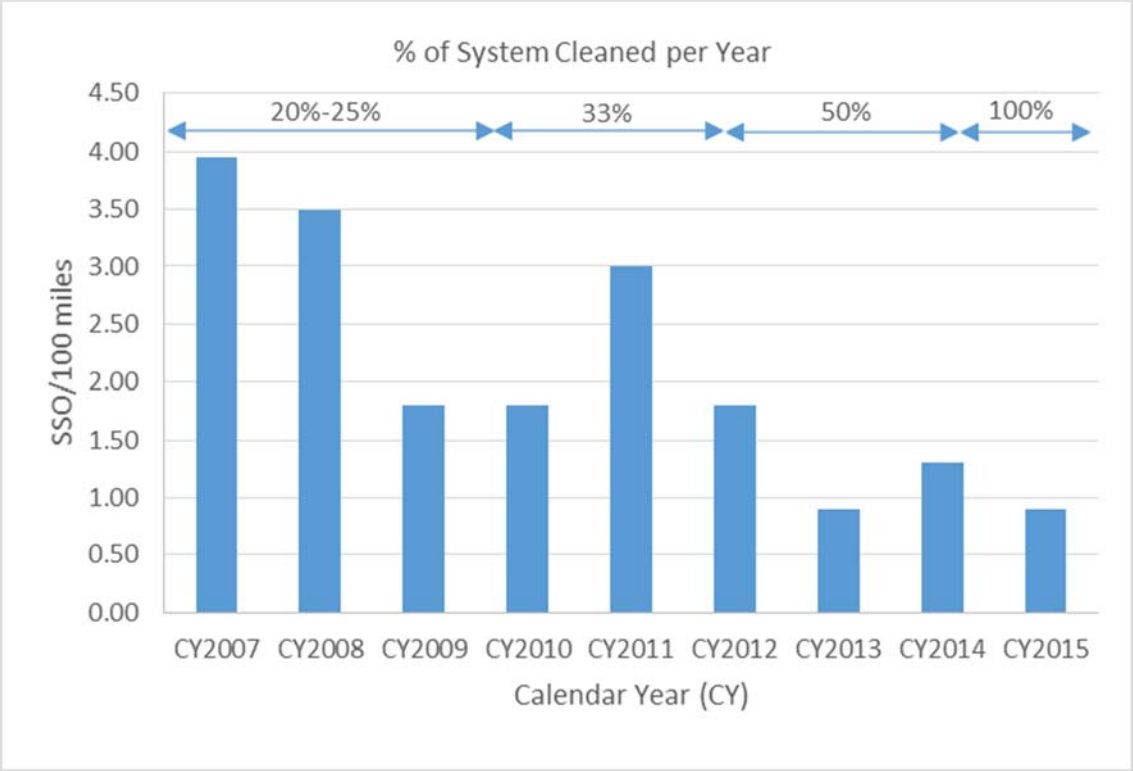
A preliminary analysis was conducted to understand the cost and/or benefits of providing in-house wastewater system cleaning or contracting the cleaning services as done in prior years. This analysis was conducted to identify potential additional savings in CMSD's current operations. The CMSD Wastewater Fund would realize all of the benefits from any such contracting optimization. While contracting wastewater services can and had been done independently of a combined agency, a larger agency could provide additional support services to improve economies of scale associated with procuring and administering the contracted services.

The following assumptions were used for analysis of CMSD sewer cleaning services, which are recommended to be confirmed by CMSD.

- Total linear footage to be cleaned is 1,187,592 LF (per 2014 sewer cleaning contract).

- A unit cost for cleaning of $0.38/LF (based on the estimated average pricing of the previous NPS contract escalated to today's dollars). This unit cost includes root cutting, manhole sealing, plugging, and grit removal (but assumes free grit disposal). The unit cost does not include emergency services.
- Emergency services were part of the initial contracts and were provided by NPS to CMSD on a time and materials basis in addition to the cleaning costs, as emergency services requirement cannot be readily predicted. The latest contract with NPS (when CMSD and NPS began sharing responsibilities, 2013-2014) does not include provisions for NPS providing emergency services. Therefore, assumptions are based on an estimated cost of $5,000 per Sanitary Sewer Overflow (SSO) and to be conservative an estimated total of three (3) SSOs per year (1.4 SSOs/100 miles of pipe). Figure 5 provides a summary of the number of SSOs per 100 miles of sewer pipe and percentage of system cleaned from 2007 to 2015. While the frequency of SSOs can vary naturally year over year due to rainfall events for example, Figure 5 shows a downward trend coinciding with the increasing percentage of system cleaned.
- CMSD owns six (6) pieces of equipment, where CMSD payed approximately $335,000 for one vactor/jetter, $100,000 for CCTV/Trailer, $460,000 for second vactor/jetter, and $90,000 for each of the three pick-up trucks with box tools. The capital cost of all of the equipment was then amortized over an assumed life of 10 years at a four percent escalation rate plus maintenance and diesel.
- Pump maintenance remains in house. Per review of contracts, CMSD is expending $32,790 while the cost of contract support is approximately $35,000.

Figure 5. CMSD SSO per 100 Sewer Miles Annual Reporting and Percent of System Cleaned per Year



Three scenarios were developed to understand the feasibility of 1) keeping the CMSD sewer cleaning in house per the current CMSD strategy, 2) contracting out half of the sewer cleaning (the model CMSD used previously), or 3) contracting out all of the sewer cleaning.

Table 14 provides a summary of the analysis.

Table 14. Summary of Wastewater Contracted Cleaning Analysis

Contracting Cleaning Services Evaluation		Annual Costs (FY15-16)			
		In-House	Contracted Cost	Total	Savings
Scenario 1 (Baseline)	100% In House Cleaning (Status Quo)	$ 755,000	$ 0	$ 755,000	$ 0
Scenario 2	50% In House, 50% Contract Cleaning	$ 396,000	$ 226,000	$ 622,000	$ 133,000
Scenario 3 (Recommen-dation)	100% Contract Cleaning	$ 0	$ 466,000	$ 466,000	$ 289,000

The assumptions for each scenario are broken down as follows:

Scenario 1. The LoS is assumed to include all lines (1,187,592 LF) being cleaned once per year. The number of CMSD staff currently dedicated to historically contracted services is six, which includes two Wastewater Maintenance Worker I, two Wastewater Maintenance Worker II, one Wastewater Maintenance Worker III, and one SCADA technician.

Scenario 2: CMSD contracts 50 percent of the cleaning to NPS, consistent or equal with similar pricing as previous NPS contracts. Three maintenance workers would be eliminated, one Wastewater Maintenance Worker I, two Wastewater Maintenance Worker II, with potential periodic support services to be provided by the larger combined agency.

Scenario 3: CMSD contracts 100 percent of the sewer cleaning services. All maintenance crews and the supporting SCADA Technician/Industrial Electrician position are eliminated. The SCADA Technician's role and responsibilities include inspecting and attending to assigned areas in a timely manner, and performing a wide variety of tasks in the maintenance and repair of main sewer lines, laterals, pumping stations and mobile equipment. The responsibilities of the SCADA Technician's role with respect to emergency services would be written into the contract for sewer cleaning services and the remainder absorbed by the larger combined agency, as required.

Scenario 3 provides the highest savings, therefore, for the purposes of this high-level Study it is assumed that the combined agency would contract 100 percent of the sewer cleaning services. It should be noted that the anticipated savings is based on the contracted rates historically provided by NPS, which appear to be highly competitive. Should bid pricing not be this competitive moving forward, then such savings, if any, would be less. Further analysis would be required upon receiving competitive wastewater system cleaning bids.

5.2 Mesa Water Optimization Opportunities

In 2000, Mesa Water had 71 FTE positions. Over the past 15 years, Mesa Water has reorganized and/or reassigned functions, and reduced the number of budgeted employees by 17.25 FTE or 24.3% to 53.75 FTE positions (March 21, 2015 Board Memo). Mesa Water currently maintains 57.5 FTEs.

Mesa Water is currently going through a Business Process evaluation and implementation. The purpose of this assessment is to investigate and document organizational operations and identify opportunities to improve various business processes including organizational structure, labor usage, technology utilization and needs, work management, effectiveness, and efficiency. For example, a recent analysis has determined that a combination of contract support services and in-house staff will most effectively provide the maintenance for the groundwater facilities called the Mesa Water Reliability Facility (MWRF). Mesa Water is anticipating an additional $250,000 in annual savings as this and other improved processes are implemented.

5.3 Summary of Total Savings from Optimization Opportunities

Table 15 provides a summary of the total savings and a breakdown of the allocated savings by fund. These opportunities to optimize operations exist for both CMSD and Mesa Water independent of a combined agency.

Table 15. Total Annual Financial Savings by Fund and Agency

	Wastewater Fund	Solid Waste Fund	Water Fund
Total Annual Savings by Fund	$289,000	$0	$250,000
Total Annual Savings by Agency	$289,000		$250,000
Total Combined Annual Savings	$539,000		

6 ADDITIONAL QUALITATIVE BENEFITS

CMSD and Mesa Water both strive to deliver services that maximize environmental protection for each dollar spent and create a fair, equitable and transparent system that meets the current and future needs of the customers within their respective service areas. By combining the two agencies, it could help meet these goals. Benefits and risks of combining the agencies include:

Benefits

Financial
- Can provide cash infusion to customers through rebates and lower rate increases resulting from release of excess reserves, system reorganization and expense reductions and increased efficiency of operations
- Continues to enhance financial position and credit worthiness to maintain highest bond ratings and lowest cost debt.
- Provides for increased stabilization of rates in event of unforeseen changes
- Enhances economies of scale and cost effectiveness
- Enhances opportunities to further increase economy of scale, service area and services provided

Operational
- Provides increased efficiency through combined focus on environment and utilization of common resources
- Leverages in-house expertise
- Allows for reorganization to enhance delivery of services
- Facilitates performance evaluation and improvement
- Combined regulatory oversight thereby facilitating opportunities to reduce costs and readily respond to changing conditions including expansion of service area

Environmental
- Enhances service delivery through focused water quality issues and integration and upgrading of systems
- Helps meet increasing operation and maintenance (O&M) costs and capital improvement requirements resulting from more stringent regulatory requirements and aging infrastructure

Risks

- Combination and relocation of staff may result in early retirement, increased attrition, or elimination of positions
- Potential labor issues associated with potential changes in benefits, pension liabilities, union job descriptions
- Need to achieve consensus on a combined agency, organizational structure and governance
- Potential transfer/defeasance of existing bonds
- Cost and effort to secure approval and effect change including public meetings and hearings, legal filings, union negotiations, and asset transfers.

6.1 Potential Synergies

The quantitative and qualitative synergies realized in combining CMSD and Mesa Water are summarized below.

6.1.1 Vision/Mission/Values

As public agencies dedicated to serving the best interests of the same community, both CMSD and Mesa Water's public service-orientated cultures lend themselves well to combining especially given benefits to all customers (both taxpayers and ratepayers). Additionally, capital improvement projects could be coordinated and more favorable bond issuances could be achieved.

6.1.2 Staffing/Cross-Training

CMSD and Mesa Water have common in-house services, including management, administration and finance, and contracted services namely IT, Engineering and Legal. Additionally both agencies have 5-member Boards of Directors, who are all residents (and customers of both CMSD and Mesa Water), and are elected by the residents. Both agencies also hire part-time staff to cover some of the above-mentioned roles and responsibilities.

When combining agencies, there are likely to be duplicate positions, which present an opportunity for savings. However, many staff leave through natural attrition, shifting people to part-time or retirement and the organizational strategy of not replacing those positions means layoffs can typically be avoided. It is estimated that $1.1 million can be saved annually once duplicate positions are eliminated.

6.1.3 Institutional

The Orange County Local Agency Formation Commission (OC LAFCO) determines the process for CMSD and Mesa Water to combine. There are 58 LAFCOs in the state—one in every county (Gov't. Code section 56325). OC LAFCO has jurisdiction over Orange County, its 34 cities, and 27 of its 38 special districts. The Legislature delegated to LAFCOs the power to oversee and change local boundaries (Gov't. Code section 56001).

LAFCO is an independent regulatory commission in each California County, created by the State Legislature to control and modify the boundaries of cities and special districts. LAFCOs are delegated authority from the Legislature to ensure orderly, efficient government through the logical structuring and restructuring of these local entities.[7]

[7] The above is Orange County Grand Jury report on OC LAFCO http://www.ocgrandjury.org/pdfs/2014_2015_GJreport/LAFCO_Website.pdf

7 SUMMARY AND NEXT STEPS

The initial findings identify that the combined agency potentially offers significant financial savings to its ratepayers, and increased flexibility and transparency. It also offers opportunity for increased environmental benefits and customer service. Customers receive savings through increased economies of scale that will result in lower rate increases than otherwise projected under the status quo arrangement.

Table 16 summarizes the estimated annual net cost/savings under combined operations as revised in this Study. While the combined agency is likely able to achieve operational savings in excess of the above amounts identified when taking into account the qualitative factors to maximize potential savings such as cross training of employees, as discussed previously, it also faces some increased internal costs associated with transitions that are difficult to quantify. The estimated cost of outside services such as legal, technical and financial advisors (estimated to be in the range of $600,000) to assist in facilitating the transition, however, has been included in the financial analysis.

Table 16. Summary of Estimated Annual Net Cost/Savings under Combined Agency Operations[1]

Item Description	Wastewater	Solid Waste	Water	Total
One-Time Cost Savings				
Combining Organizations[2]	($200,000)	($200,000)	($200,000)	($600,000)
Real Estate[3]	$1,300,000	$1,300,000	$0	$2,600,000
Financial Management[4]	$9,730,000	$2,860,000	$1,060,000	$13,650,000*
Operations Optimization[5]	$0	$0	$0	$0
Subtotal One-Time Cost Savings	**$10,830,000**	**$3,960,000**	**$860,000**	**$15,650,000**
Annual Cost Savings				
Organizational Optimization[2]	$367,000	$367,000	$366,000	$1,100,000
Real Estate[3]	$7,000	$7,000	$36,000	$50,000
Financial Management[4]	$1,040,000	$0	$0	$1,040,000*
Operations Optimization[5]	$289,000	$0	$250,000	$539,000*
Subtotal Annual Cost Savings	**$1,703,000**	**$374,000**	**$652,000**	**$2,729,000**

*Note, these savings, while best accomplished through the process of reorganizing and combining the two agencies, can be substantially achieved independently.

[1] Amounts shown are rounded to the nearest $1,000; [2] Refer to Section 2; [3] Section 3; [4] Section 4; [5] Section 5.

As illustrated above, the analysis of the combined agency indicates the potential to provide approximately $15.6 million in one-time savings plus an additional $2.7 million in annual savings. These savings can be passed on directly to customers through lower rates, rebates, stabilization of rates, or reduced future rate increases. For example, the annual savings of $2.7 million represents over 6% of the annual revenue

requirements of the combined wastewater, solid waste and water funds and can be used to reduce current rates or offset future rate increases. The wastewater fund annual savings of $1.7 million represents over 28% of the annual revenue requirements for that fund and could be used to lower wastewater fees by 28% or offset future rate increases. The one time savings of $15.6 million, which is equivalent to approximately $650 per customer for those residents who receive wastewater, solid waste and water service (assuming approximately 24,000 customers per fund),can be used to provide a one-time rebate or used to cash fund capital improvements to reduce debt and future rate increases.

As discussed previously, a significant portion of the savings discussed in Sections 4 (Financial Management) and 5 (Operations Optimization), can be substantially achieved independently of a combined agency, however, they are more readily accomplished through the process of reevaluation and reorganization as required for combining the agencies. The savings discussed in Sections 2 (Organizational Optimization) and Section 3 (Real Estate), however, can only be accomplished through combining the agencies.

Additional due diligence is required to confirm and update these findings. These findings are based upon the high-level analysis and information available as summarized in this Study. Further due diligence investigations are required to confirm the assumptions. The cost information presented herein is based on historical information available at the time of this analysis and any changed conditions occurring after this analysis could materially affect the findings.

The data reviewed in preparing this Study include existing publicly available documents available on CMSD and Mesa Water's web site and other information provided by Mesa Water. The Study summarizes the work completed up to the date of the issuance of the Study. Changed conditions occurring or becoming known after such date could affect the material presented and the findings reached herein. The accuracy of the information provided by the agencies has not been independently verified, however, it is believed that such sources are reliable and the information obtained is appropriate for the high-level analysis undertaken and the conclusions reached herein. To the extent that the information provided is not accurate, or changes occur, the findings contained in this Study may vary and are subject to change.

In completing this Study for Mesa Water, Arcadis, U.S. Inc. is not serving in the role of a "municipal advisor" under the regulations of the Securities and Exchange Commission. As such, Arcadis U.S. Inc., is not: (a) recommending any action regarding municipal financial products or the issuance of municipal securities; and (b) is not acting as a registered municipal advisor to districts and does not owe a fiduciary duty to the districts pursuant to Section 15B of the Securities Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, with respect to the information and material prepared in connection with this Study. The districts should discuss any information and material prepared in connection with this Study with any and all internal and external financial and other advisors that they may deem appropriate before acting on this information and material.

7.1 Next Steps

Should CMSD and Mesa Water agree to move forward with a potential combined agency, CMSD/Mesa Water would need to hire legal counsel and technical and financial experts to assist in conducting due diligence investigations and drafting the required transaction documents.

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Real Estate

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Broker Opinion of Value

Costa Mesa Sanitary District Headquarters Office
628 W. 19th St., Costa Mesa, CA

June 20, 2016

Prepared For: **Phil Lauri**
Mesa Water District

MesaWater DISTRICT

PROPERTY DESCRIPTION

The property is a freestanding, two story office building situated on a signalized intersection. The area is well located nearby lots of retail amenities as well as the affluent neighborhoods of Newport Beach, but also has a strong presence of homeless people. The parking on site is surface parking, but all stalls are private given the freestanding, fee simple nature of the property. The building is currently on the market for sale and is in escrow with a potential buyer. There are also multiple back up offers in place. The current contract price is $1,240,000.00.

- **Positives:** Corner location on a signalized intersection, private parking stalls, freestanding building.
- **Negatives:** Area has lots of vagrants and homeless. The architecture is dated. Concrete parking lot shows signs of deferred maintenance.

MARKET HIGHLIGHTS

The Orange County office market is continuing it's strong recovery brought about by a substantial increase in demand from an increasingly diverse tenant base. With so few alternatives, particularly in large blocks of space, expect to see the most substantial rental rate increase since 2007. Occupancy rates have increased to the point where some of OC's more prominent landlords are unable to accommodate the expansion needs of their existing tenants. Orange County's wealthy and highly educated population has contributed to rapid expansion in industries tied to technology, biotech, healthcare, professional / financial services and lending. These industries will continue to add jobs and help to increase demand in the coming quarters.

Vacancy	Net Absorption	Sales Prices	Lease Rates	Transactions
UP	POSITIVE	UP	UP	DOWN

COMPARABLES

Top Comparable Sales

Address	Size	Sale Date	PSF	Comments
201 S. Broadway Santa Ana, CA	6,990 SF	04/29/2016	$221.75	Comparable sized parcel Similar property image
17682 Cowan Irvine, CA	8,930 SF	12/04/2015	$305.38	Renovated in 2008 Fee simple property
17200 - 17288 Red Hill Ave., Unit 17256 Irvine, CA	4,770 SF	12/04/2015	$314.47	Renovated in 2005 Office condo
1528 Brookhollow Dr., Unit 100 Santa Ana, CA	6,851 SF	11/13/2015	$239.53	Master planned business park Office condo
AVERAGE	**6,885 SF**		**$270.28**	

PROPERTY SUMMARY

Address	628 W. 19th St. Costa Mesa, CA
Size	4,000 SF
Parking	3.5:1000
Stories	2
Year Built	N/A
Parcel	0.26 Acres
Condition	Good
Zoning	C1
Use	Office

MARKET VALUE RANGE

$1,200,000.00 to $1,280,000.00

$300.00 to $320.00 PSF

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Broker Opinion of Value

Costa Mesa Sanitary District Headquarters Office (New)

290 Paularino Ave., Costa Mesa, CA

June 20, 2016

Prepared For: **Phil Lauri**
Mesa Water District

MesaWater DISTRICT

PROPERTY DESCRIPTION

The property is a single story office building situated on 0.91 acres of land. The location is fantastic, as the building is at the corner of a signalized intersection of a major street within close proximity to John Wayne Airport. The building also has immediate access to the 55 freeway. The property condition is good and the image of the building is consistent with other properties in the area. The property was just purchased at a value of $3,750,000.00 in May 2016, which is considered a fair market value. Given the rising market conditions, the value now could possibly be higher.

- **Positives:** Great area on a major street, corner signalized intersection. Good surface parking. Excellent freeway access.
- **Negatives:** Single-story office.

MARKET HIGHLIGHTS

The Orange County office market is continuing it's strong recovery brought about by a substantial increase in demand from an increasingly diverse tenant base. With so few alternatives, particularly in large blocks of space, expect to see the most substantial rental rate increase since 2007. Occupancy rates have increased to the point where some of OC's more prominent landlords are unable to accommodate the expansion needs of their existing tenants. Orange County's wealthy and highly educated population has contributed to rapid expansion in industries tied to technology, biotech, healthcare, professional / financial services and lending. These industries will continue to add jobs and help to increase demand in the coming quarters.

Vacancy	Net Absorption	Sales Prices	Lease Rates	Transactions
▲ UP	▲ POSITIVE	▲ UP	▲ UP	DOWN ▼

COMPARABLES

Top Comparable Sales

Address	Size	Sale Date	PSF	Comments
1531 - 1555 Baker St. Costa Mesa, CA	9,501 SF	5/6/2016	$397.33	Large parcel of 1.20 acres
2042 Business Center Dr. Irvine, CA	11,240 SF	4/11/2016	$322.55	Building had deferred maintenance 0.53 acre lot
2801 Bristol St. Costa Mesa, CA	15,518 SF	2/11/2016	$337.03	Newer building built in 2002 Parcel size of 0.82 acres
17682 Cowan Irvine, CA	8,930 SF	12/04/2015	$305.38	Renovated in 2008 Fee simple property
1650 Adams Ave. Costa Mesa, CA	12,436 SF	9/17/2015	$312.40	Renovated 2005 Two-story office
AVERAGE	**11,525 SF**		**$334.94**	

PROPERTY SUMMARY

Address	290 Paularino Ave. Costa Mesa, CA
Size	12,696 Sq. Ft.
Parking	4:1000
Parcel	0.91 Acres
Stories	1
Year Built	1979
Construction	Concrete Tilt Up
Condition	Good
Zoning	Commercial
Use	Office

MARKET VALUE RANGE

$3,750,000.00 to $3,999,240.00

$295.36 to $315.00 PSF

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Broker Opinion of Value

Costa Mesa Sanitary District Garbage Service Building

174 E. Wilson Street, Costa Mesa, CA

June 20, 2016

Prepared For: **Phil Lauri**
Mesa Water District

MesaWater DISTRICT

PROPERTY DESCRIPTION

The property consists of a freestanding block building and secured yard area. The amount of office buildout is unknown, but the entrance and exterior are high image contemporary construction. The property is located with immediate access to the 55 freeway, but is not a typical industrial location. The secured yard area and oversized parcel are extremely desirable features of the property.

- **Positives:** Freestanding building with fenced yard, high image exterior, higher warehouse clearance.
- **Negatives:** Area is not a typical industrial property area. The busy street can create challenges for large vehicle access.

MARKET HIGHLIGHTS

The Orange County industrial market's average asking price at the end of the first quarter came in at $191.86, a slight increase of 1.42% over the previous quarter and a 6.74% increase over a year ago (Q1 2015). This is somewhat misleading as several quality properties have traded before hitting the market at record high pricing, while some of the listed inventory is of a lesser quality. Expect both sale activity and pricing to increase if interest rates remain low. With SBA financing (requiring 10% down payment) being the preferred vehicle for owner / users at the moment, the overall occupancy costs of ownership on a monthly basis are comparable to leasing, while providing favorable tax treatments.

Vacancy	Net Absorption	Sales Prices	Lease Rates	Transactions
▲ UP	▲ POSITIVE	▲ UP	▲ UP	▼ DOWN

COMPARABLES

Top Comparable Sales

Address	Size	Sale Date	PSF	Comments
16101 Construction Circle W - Unit A Irvine, CA	4,948 SF	5/13/2016	$303.15	Fenced yard area, built in 1978 0.5 acre parcel
151 Kalmus Dr. #11 Costa Mesa, CA	3,427 SF	3/25/2016	$315.00	Industrial condo, no yard
12 Mauchly, Unit O - Bldg O & P Irvine, CA	4,034 SF	12/28/2015	$270.00	Industrial condo, no yard Built in 1990
1327 E. Saint Gertrude Pl. Santa Ana, CA	5,016 SF	11/04/2015	$348.88	Fenced yard, medical marijuana buyer
AVERAGE	**4,356 SF**		**$309.26**	

PROPERTY SUMMARY

Address	174 E. Wilson St. Costa Mesa, CA
Size	4,500 Sq. Ft. (estimated)
Office Space	TBD
Parking	3:1000
Stories	1
Construction	Block
Condition	Excellent
Use	Warehouse/Office
Parcel Size	0.4 Acres

MARKET VALUE RANGE

$1,485,000.00 to $1,575,000.00

$330.00 to $350.00 PSF*

(*Based on estimated 4,500 square foot building size)

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Broker Opinion of Value

Mesa Water District Headquarters Office
1965 Placentia Ave., Costa Mesa, CA

June 20, 2016

Prepared For: **Phil Lauri**
Mesa Water District

MesaWater DISTRICT

PROPERTY DESCRIPTION

The property consists of approximately 38,000 square feet of warehouse space (most of which is a covered water reservoir, but could be repurposed for a warehouse) and 21,290 square feet of office space in a separate two story office building. The buildings are situated on a large 3.69 acre land parcel, offering the desirable feature of an immense fenced yard area. The location of the property is desirable, with significant redevelopment projects occurring in the immediate vicinity. The Mesa West Bluffs Urban Plan overlay to the zoning provides for conversion of industrial properties to higher density residential. Developers have aggressively pursued larger properties in this zone and are typically paying large premiums over traditional industrial users.

- **Positives:** Large land parcel, located in desirable area with lots of pending redevelopment.
- **Negatives:** Some highly specialized improvements that most buyers would not see value in, not contiguous office and warehouse structures.

MARKET HIGHLIGHTS

The Orange County industrial market's average asking price at the end of the first quarter came in at $191.86, a slight increase of 1.42% over the previous quarter and a 6.74% increase over a year ago (Q1 2015). This is somewhat misleading as several quality properties have traded before hitting the market at record high pricing, while some of the listed inventory is of a lesser quality. Expect both sale activity and pricing to increase if interest rates remain low. With SBA financing (requiring 10% down payment) being the preferred vehicle for owner / users at the moment, the overall occupancy costs of ownership on a monthly basis are comparable to leasing, while providing favorable tax treatments.

Vacancy	Net Absorption	Sales Prices	Lease Rates	Transactions
UP	POSITIVE	UP	UP	DOWN

COMPARABLES

Top Comparable Sales

Address	Size	Sale Date	PSF	Comments
9700 Toledo Way Irvine, CA	73,066 SF	6/9/2016	$179.16	3.70 acre land parcel Built in 1984
17681 Mitchell Irvine, CA	36,850 SF	3/30/2016	$244.00	2.11 acres of land, 54% office build out No yard
17353 Derian Ave. Irvine, CA	78,727 SF	3/1/2016	$149.90	3.20 acre parcel Built in 1980
3560 Cadillac Ave. Costa Mesa, CA	42,365 SF	1/6/2016	$170.19	2.1 acre parcel Built in 1978
3030 Airway Ave. Costa Mesa, CA	78,466 SF	11/18/2015	$175.01	Built in 1973, renovated in 2001

PROPERTY SUMMARY

Address	1965 Placentia Ave. Costa Mesa, CA
Size	59,290 SF (estimated)
Office Space	21,290 SF
Stories	2 story office
Parcel Size	3.69 acres
Construction	Block and concrete tilt up
Condition	Good
Zoning	General Industrial (Mesa West Bluffs Urban Plan)
Use	Corporate Headquarters / Office / Warehouse

MARKET VALUE RANGE

$11,265,100.00 to $12,450,900.00

$190.00 to $210.00 PSF*

(*Based on estimated 59,290 square foot building size)

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