



**COUNTY OF LOS ANGELES  
DEPARTMENT OF AUDITOR-CONTROLLER**

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February 17, 2004

TO: Supervisor Don Knabe, Chairman  
Supervisor Gloria Molina  
Supervisor Yvonne Brathwaite Burke  
Supervisor Zev Yaroslavsky  
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley *tm*  
Auditor-Controller

SUBJECT: **AGUA DULCE MELLO-ROOS AUDIT – FOLLOW UP  
(COMMUNITY FACILITIES DISTRICT NO. 6)**

On January 7, 2004, we issued an audit report on the Agua Dulce Mello-Roos Acquisition Fund (Community Facilities District (CFD) No. 6). The purpose of the audit was to review concerns expressed by residents of Sierra Colony Ranch and the management of the privately held water company, Sierra Paloma Valley (SPV) Mutual Water Company, that serves the development. These concerns focused primarily on the appropriateness of reimbursements to the developer, Watt Land Inc., from the Mello-Roos Acquisition Fund for expenditures the developer incurred in completing a water system. We conducted the audit at the request of the Fifth District.

We noted that the residents questioned a \$313,000 County-authorized reimbursement to the developer from the Acquisition Fund related to two pre-existing wells (Wells Number 1 and Number 2). The reimbursement represented a valuation of the wells for purposes of transferring the wells to the privately held water company. In our January 2004 report, we stated that we would report back to your Board on the reasonableness of the wells' valuation. At the Fifth District's request, we also confirmed the allowable use(s) of the advances the developer made to Southern California Edison (SCE), which the developer has agreed to return to the CFD. This is our report on these issues.

**CONCLUSION**

The cost estimates used in the valuation were reasonable and several private water companies and districts in the County stated they typically use a well's replacement cost in valuing a well. Nevertheless, the valuation of Well Number 2 reimbursed to the developer might have differed from an actual purchase and sale transaction price

between two disinterested parties, had a transaction occurred at the time. This difference may be related to a number of factors including, but not limited to, the well's age, production, expected life of aquifer, whether the well would be used as a primary or secondary source of water supply, and the number of additional wells in the area. Because the valuation of the well occurred over ten years ago, and because we could not determine the extent one or all of the factors noted would have been considered in a purchase and sale transaction at the time, we were unable to estimate the well's selling price at the time. Accordingly, we do not have sufficient justification to recommend disallowance of all or a portion of the valuation reimbursed to the developer.

Based on information contained in a water engineer's report from 1991 and subsequent written attestations by the water engineer, Well Number 2 had a water production capacity at the time of transfer, even though it was not operational (i.e., was not equipped with a pump and sanitary seal). The developer stated that he did not bring Well Number 2 on line because Well Number 2's production was not required to meet the County's water supply requirement for the development, based on the County's estimated water usage of 700 gallons per day (or approximately 20,000 gallons per month), per dwelling. The Department of Public Works (DPW) approved the developer's deletion of Well Number 2 for this reason. We confirmed that the production of Well Number 1 was sufficient to meet the requirement. However, actual water usage in the development has significantly exceeded estimated usage. For example, the water company has allowed residents a minimum allotment of 75,000 gallons per month. The combined production of Wells Number 1, 2 and 3 in the Sierra Colony Ranch area at the time would not have been sufficient to meet the County's requirement at this usage level, and the County would not have approved the development based on this usage.

Finally, we reviewed with the Treasurer Tax Collector (TTC) the disposition of the advances to SCE which the developer has agreed to return to the CFD. The TTC stated that the only allowable use of these funds is to pay down the principal of the bonds.

These issues are discussed in more detail below.

### **Valuation of Pre-Existing Wells**

In March 1993, DPW authorized a reimbursement to the developer of \$313,000 related to Wells Number 1 and Number 2. This represented a valuation of the wells for purposes of transferring them to the SPV Water Company, the private water company established to serve the development. The Mello-Roos statute allows for the purchase by the CFD of pre-existing facilities, in this case, the wells. The valuation, prepared by an environmental engineer, represented the estimated costs that would be incurred if new wells with the same specifications were drilled (e.g., depth of drilling, gravel pack, etc.) The residents have claimed that the reimbursement of \$143,320 related to Well Number 2 should be disallowed because Well Number 2 has never been operational.

In our review, we determined the following.

- **Well Number 2 had a water production capacity at the time of transfer.**

Documentation we reviewed stated that the well had a water production capacity at the time of transfer, even though it was not operational (i.e., was not equipped with a pump and sanitary seal.) Specifically, the water engineer's (Donald G. Rosenberg and Associates) report of August 1991 stated that Well Number 2 had been tested in 1986 and 1989 and had a production capacity of 75 and 65 gallons per minute (gpm), respectively. The testing data is included as an attachment to the August 1991 report.

Some residents have alleged that the water engineer colluded with the developer to supply false water production data to the County. However, the related tests conducted to determine Well Number 2's production capacity were not performed by the water engineer himself, but by a separate drilling company. The fact that a third party performed the production tests makes the possibility of collusion less likely.

- **Replacement cost is a legitimate valuation method, although a valuation based on replacement cost might have differed from an actual purchase and sale transaction price between two disinterested parties, had a purchase and sale occurred at the time.**

We contacted a well driller who corroborated the cost estimates the water engineer used in preparing the replacement cost valuation. Further, several private water companies and districts in the County stated they typically use a well's replacement cost in valuing a well. Nevertheless, the valuation of Well Number 2 might have differed from an actual purchase and sale transaction price between two disinterested parties, had a purchase and sale occurred at the time. This difference may be related to a number of factors including, but not limited to, the well's age, production, the aquifer's expected life, whether the well would be used as a primary or secondary source of water supply, and the number of additional wells in the area. Because the valuation of the well occurred over ten years ago, and because we could not determine the extent one or all of the factors noted would have been considered in a purchase and sale transaction at the time, we were unable to estimate the well's selling price at the time. Accordingly, we do not have sufficient justification to recommend disallowance of all or a portion of the reimbursement to the developer based on a replacement cost valuation.

- **DPW approved the developer's decision to not make Well Number 2 operational because the production of Well Number 1 alone was sufficient to meet the County's domestic water supply requirement of twice the development's estimated average daily usage. However, actual water usage in the development has significantly exceeded estimated usage.**

The developer stated that he did not bring Well Number 2 on line because Well Number 2's production was not required to meet the County requirement that a development's water supply be equal to twice the development's estimated average daily water usage. This statement is supported by correspondence from the water engineer to the County and the State in 1993 and 1994 in which the water engineer "confirms" discussions with DPW staff that the staff approved the elimination of Well Number 2 for this reason. DPW confirmed they approved the elimination of Well Number 2.

For Sierra Colony Ranch, the County estimated average daily water usage of 700 gallons per day, per dwelling (100 gallons per day multiplied by 2 with 3.5 persons per dwelling), or approximately 20,000 gallons per month. However, residents with whom we spoke stated that the water company had never limited their usage to 20,000 gallons per month. In fact, residents stated their actual water consumption far exceeded this estimated usage. For example, one resident stated that when she first purchased her home, the water company allowed her a minimum monthly allotment of 75,000 gallons per month (or 100 units at 750 gallons per unit.) This is more than three times the water consumption estimates used to approve the development.

DPW stated that had this actual consumption figure of 75,000 gallons per month, per dwelling, been used in calculating the minimum well yield back in 1993, Well Number 1 alone would not have met the County's requirement that a development's water supply be equal to twice the development's average daily water usage. In fact, using an actual consumption figure of 75,000 gallons per month, per dwelling, the production of Wells Number 1, 2 and 3 combined would not have been sufficient to meet the County's requirement, and the County would not have approved the development with this usage. (Well Number 3, located in the planned Phase II of the development, is currently used exclusively by a vineyard/winery neighboring the development.) See Attachment I for details.

### **Allowable Uses of Refundable Deposits**

In the audit, we identified \$32,431 in advances to SCE which SCE had returned to the developer and \$26,429 still subject to refund by SCE. We recommended the developer, in conjunction with DPW and TTC, return the refunds it has received to the CFD and assign the balance still subject to refund to the CFD. We reviewed the disposition of these refunds with the TTC who stated that the only allowable use of these funds is to pay down the principal of the bonds.

If you have any questions, please contact me or have your staff contact DeWitt Roberts at (626) 293-1101.

JTM:DR:JK  
Attachment

c: David E. Janssen, Chief Administrative Officer  
Lari Sheehan, Assistant Administrative Officer  
Lloyd W. Pellman, County Counsel  
Steve Cooley, District Attorney  
Timothy Gallagher, Director, Department of Parks and Recreation  
James A. Noyes, Director, Department of Public Works  
James Hartl, Director, Department of Regional Planning  
Leroy D. Baca, Sheriff  
Mark J. Saladino, Treasurer and Tax Collector  
Violet Varona-Lukens, Executive Officer  
Mello-Roos Task Force  
Audit Committee (6)  
Watt Land, Inc.  
Public Information Officer

**Agua Dulce Mello-Roos Audit – Follow Up**

**Minimum Well Yield Calculations: Estimated vs. Actual Usage**

The County requires that a development's water supply be equal to twice the development's estimated average daily water usage. This formula includes a safety factor to provide for fire protection, seasonal fluctuations, peak uses and pump cycles.

**Minimum Well Yield Formula**

The minimum yield of a water well to meet this requirement is calculated from the following formula:

$$M. Y. = D \times P \times 2Q_d \times 0.0028$$

Where:

**M.Y.** = Minimum Yield in gallons per minute (gpm)

**D** = Number of dwellings

**P** = Persons per dwelling

(Assumes 3.5 persons per dwelling for residential uses)

**Q<sub>d</sub>** = Average daily consumption per capita

.0028 = an industry factor which considers capacity/demand over a 12 hour period

(The average daily consumption is based on the historical requirements of the inhabitants of the area. In the event such records are not available, a per capita estimate of 100 gallons/day is used.)

**Yields of the Wells in Sierra Colony Ranch Area**

The production yields of the three wells in the Sierra Colony Ranch area in the period in question were:

<b>Well</b>	<b>Yield (gpm)</b>	<b>Cumulative Yields (gpm)</b>
Number 1	280	280
Number 2	50	330
Number 3	260	590

**Required Minimum Well Yield based on Estimated Consumption**

The required minimum well yield based on the estimated consumption of 700 gallons per day, per dwelling, was 120 gpm. The yield of Well Number 1, 280 gpm, exceeded this requirement. The exact calculation follows.

$$M.Y. = 61 \text{ lots} \times 3.5 \text{ persons/lot} \times 2 \times 100 \text{ average daily consumption per capita} \times 0.0028 = 120 \text{ gpm}$$

**Required Minimum Well Yield based on Actual Consumption**

The required minimum well yield based on actual consumption of 2,500 gallons per day (or 75,000 gallons per month/30 days), per dwelling, would have been 854 gpm. This exceeded the cumulative yields, 590 gpm, of all three wells. The exact calculation follows:

$$\text{M.Y.} = 61 \text{ lots} \times 3.5 \text{ persons/lot} \times 2 \times 714^1 \text{ average daily consumption per capita} \times 0.0028 = 854 \text{ gpm}$$

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<sup>1</sup> Equal to 75,000 gallons per month/30 days in the month/3.5 persons per dwelling.