MEMORANDUM

To: Sebastopol City Council
From: Enterprise Fund Oversight Committee
Date: July 21, 2026
Subject: Comments on Proposed Response to Sonoma County Civil Grand Jury Report

The Committee believes the proposed response does not address the substance of the Grand Jury's findings or the majority of the recommendations previously provided by the EFOC. While the response identifies future cost allocation studies, time tracking, rate studies, and loan forgiveness for the Sewer Enterprise Fund, these actions do not address the immediate needs of Prop. 218 compliance and securing financing for the critical Water Infrastructure capital improvements identified in the Grand Jury report, specifically, the Pleasant Hill Loop and Well #4 Replacement. These two infrastructure pieces have catastrophic consequences if they fail. The Grand Jury's central concern was the financial impact of past Prop. 218 violations which resulted in current critical infrastructure needs. The misallocation of Ratepayer funds resulted in a lack of capital spending on vital Water Infrastructure. Specifically, the Grand Jury report outlined immediate infrastructure needs which include the Pleasant Hill Loop and Well #4 Replacement. The Grand Jury report identified $5,500,000 in money, which should be returned to the Enterprise Funds for Capital Improvements.

The Committee respectfully requests that the City Council consider the following points that were outlined in the EFOC's finance committee Grand Jury Recommendations, which the Council has received and can be found attached to this document.

Highlights for immediate action include:

Repayment of Enterprise Funds: The Committee previously identified approximately $350,354 in attorney fees, approximately $588,000 in engineering and contract service charges. The EFOC askes that the attorney's fees be immediately reimbursed due to the fact that there is no documentation to support these charges. While the engineering fees show that the City overcharged the Enterprise Funds. The EFOC is not seeking immediate reimbursement. Immediate request is $350,354 in attorney's fees. $130,867 would be restored to Water Fund. $219,487 would be restored to Sewer Fund.

Correction of Current Cost Allocation Plan: The Committee recommends 1) removal of Council Time, 2) 15% of each department budget for Finance, City Manager, City Clerk be allocated to Water and 15% of department budget for Finance, City Manager, City Clerk be allocated to Sewer. This should be done by mid-Budget review.

Shift the ongoing Syserco Payment Obligation from the Water Fund to the General Fund: The Syserco Loan was committed to the Ratepayers with no due diligence and drove the fund into financial distress and did not address any significant capital improvement needs such as Well #4 Replacement and Pleasant Hill Loop. There seems to be no reason why this loan was taken and why this debt was passed onto Ratepayers. The Water Enterprise Fund and Ratepayers should not be responsible for this debt. The General Fund should absorb this debt, which would ease the debt burden on the Water Fund and make it more attractive to lenders for Well #4 Replacement.

Repay Past Syserco Payments to the Water Fund over the Next 4 Years. The General Fund should reimburse the Water Fund for previous Syserco Lease Payments of $843,965 over four years from Measure U Funds or the City's reserves.

Loan Forgiveness of 1.2 Million Dollar Loan from General Fund to Sewer Fund: This loan was mandatory due to the City's financial mismanagement of Sewer Funds as outlined in the Grand Jury Report.

Many of the issues identified by the Grand Jury were also identified by the EFOC and brought to the Council's attention. The Committee believes the City should take immediate actions so that funding for Well #4 remains viable.

Reconsider Rate Freeze and Tier Structure Changes: The Committee remains concerned that the recent decision to freeze water rates and eliminate tiered rates was adopted without the broader financial reforms previously recommended by the EFOC. Based on analyses previously provided to Council, the rate freeze is projected to reduce Water Fund revenues by approximately $775,000 over the next five years. Without offsetting these rate freezes, reserves are projected to decline from approximately $2.4 million today to a deficit position within the planning horizon, reducing the City's ability to fund critical infrastructure projects, maintain adequate reserves, and finance major capital improvements.

The Committee recommends that the Council reverses the rate freeze and restoration of the water rate tiers, and evaluates any future rate modifications within the context of a comprehensive financial strategy for the Enterprise Funds.

The Committee recommends that if Council wants to retain the rate freezes that they implement the recommendations by mid-year budget review.

Infrastructure and Deferred Maintenance Must Remain the Priority: The Committee believes the most important message of the Grand Jury Report is that years of underfunding have resulted in deferred maintenance and neglected infrastructure improvements throughout the City's water and wastewater systems.

The Grand Jury concluded that the City's violation of Prop. 218 and misappropriated Ratepayer Funds through unjustified Cost Allocation resulted in Enterprise Funds that lacked sufficient resources for maintenance and capital improvements and that the systems have suffered from years of underfunding. The Committee believes the City's response should place greater emphasis on restoring the financial capacity necessary to address critical infrastructure needs rather than focusing primarily on future studies and administrative reforms.

In terms of Water infrastructure, the Committee and Grand Jury have grave concerns about Well 4 and the Pleasant Hill loop. These are vulnerable parts of the infrastructure and if they fail during a fire would have devastating impacts. In terms of Sewer Infrastructure, aging sewer mains, inflow and infiltration issues, and other projects identified that will be identified in the Sewer Master plan need to be addressed. These are existing liabilities that continue to become more expensive the longer they are deferred.

Conclusion

The Committee is concerned that the City's response does not provide a clear commitment to restoring money to the Enterprise Funds so that critical capital improvements can be initiated and completed in a timely manner. The City's response does not address current Prop. 218 violations, specifically regarding allocations of the City Council, City Manager, City Clerk and Finance Department. Historical over allocation has robbed Ratepayers of a safe and secure Water Supply and functioning Sewer system. The City needs to pay restitution for the past and current Prop. 218 violations and the fraudulent Syserco Loan.

The Committee further recommends that the Council revisit the analyses, recommendations, and supporting documentation previously submitted by the EFOC and its subcommittees. Many of the concerns identified by the Grand Jury were also raised by the Committee, and numerous recommendations have already been provided regarding cost allocation reform, repayment strategies, infrastructure funding, and long-term financial sustainability. The Committee believes those recommendations warrant formal consideration as part of the City's corrective action plan.

The Grand Jury identified $5,500,000 that the City of Sebastopol owes the Enterprise Funds due to the misallocation of Ratepayer Fees and rates based on undocumented, unjustified and unverified expenses. The Finance Committee agrees that the City owes the Enterprise Funds $5,500,000.

The Finance Committee also realizes the City is in a state of financial hardship.

To remedy the situation, the Finance Committee puts forth the following solutions.

1) Correct the Cost Allocation plan for 2026/2027 by reducing City Manager from 63% to 30% of Department budget, reducing Finance/Administration from 40% to 30% of Department budget and reducing City Clerk from 20% to 15% Department Budget. Move all contractors, including Engineering, to Contract Services. Removing City Council Allocation from Enterprise Budgets until Council time is documented. Currently 52% of Council's budget is allocated to Water and Sewer. There is zero documentation to support this. Reduce anticipated legal expenses to $12,500 for Water and Sewer for a combined total of $25,000.
2) Time track starting September 1, 2026 and use time tracking to develop next Cost Allocation for 2027/2028. This will provide transparency and accurate budgeting.
3) Establishment of a Water and Sewer Municipal Utility Board to provide continuing oversight on Capital Improvements and all financial decisions to maintain separation between Ratepayer and Enterprise Fund needs and the needs of the City's General Services and to provide Ratepayer advocacy.
4) With the Water and Sewer Oversight Committee (or Water and Sewer Municipal Utility Board), review Cost Allocation Transfers based on Adopted Budget vs. Audited Expenses. This review should take place once Audited Expenses are complete. This review should determine if the General Fund owes the Enterprise Fund a refund for excess allocation or if the Enterprise Fund owes the General Fund for underpayment of services. It is not clear that this review and reconciliation has taken place in the last 20 years.
5) Refund Enterprise Funds $350,354 for excessive attorney's fees. This reimbursement to the Water and Sewer Funds could be split between FY 2026/2027 and 2027/2028. There is no documentation to support this unprecedented spike in legal fees. No legal invoices have been provided to support claims despite repeated requests.
6) Suspend Rates and remove tiered water pricing until new Cost Allocation based on time tracking is completed, Sewer Master Plan is completed and Grand Jury resolution is reached. All water should be priced at the lowest tier until pricing can be based on data.

7) Forgive $1,200,000 "loan" to Sewer as this insolvency was forced by Council's and City's negligence and bad financial management of the Sewer Enterprise Fund. Financial negligence is documented in the Grand Jury report.
8) Starting July 1,2026 General Fund to pay the Water Enterprise's Syserco Loan annual of payment $168,593 as Council took out this loan without doing any due diligence as to whether or not there was a benefit to the Ratepayer. There was no benefit to the Ratepayer and in fact, costs increased. In addition, Ratepayers were never told that this loan and SmartMeters would incur debt and produce higher rates. The City circulated a survey to Ratepayers regarding digital water meters and financial impacts to the Enterprise Funds and water prices were not mentioned. Council and Staff never discussed the Syserco Loan and its impact to the Enterprise Funds, Ratepayers and Water and Sewer bills. Financial impact should be a standard discussion of any loan and capital improvement project. The loan is a breach of fiduciary duty and This shows negligence and lack of financial stewardship.
    a) The Syserco Loan dedicated to Sewer Infrastructure appears to be legitimate and therefore the Sewer Enterprise Fund will continue its repayment of that portion of the loan.
9) The General Fund to reimburse Water Enterprise Fund for Syserco Payments from July 2022 through June 30, 2026, which totals $842,965. This reimbursement could be made by directing 15% of Measure U Funds to the Water Enterprise Fund through 2036. With any remaining balance paid by the end of the Fiscal Year 2037. Moving forward starting with FY 2026/2027, Measure U funds would be divided as follows: 40% Infrastructure, 15% Water Enterprise Fund repayment, and 45% General Fund.
10) As Sebastopol sits on a substantial aquifer and next to the Laguna, water supply is stable. The area surrounding Sebastopol is known for agriculture because it has a stable water supply. Given the strength of our water supply, the City should promote Green Infrastructure by rewarding businesses and residents for reducing surface temperatures via Green Infrastructure by planting trees, shrubs, and grasses. Green Infrastructure is the best way to mitigate storm water, reduce temperatures and provide wildlife habitat during a transitioning climate. Until Sebastopol needs to reduce water, the best way to help our aquifer and reduce the impacts of climate change is to support Green Infrastructure which lowers surface temperatures and also helps reduce storm water runoff. The City should support schools and other institutions with large green spaces to sustain plants and trees. Trees and plants can reduce surface temperatures by 5 to 15 degrees. The City should be committed to Green Infrastructure as a means to help mitigate climate change and help keep surface temperatures within the City down.

11) Develop new rates for all categories once time tracking has been implemented, the Sewer Master Plan has been completed, the Enterprise Funds have been reimbursed for excessive fees and previous Syserco Payments, the Water Fund is not longer responsible for Syserco Loan and the Sewer Fund no longer has $1,200,000 debt.
12) After the Cost Allocation plan is built on time tracking, implement tiered pricing in accordance with PG&E rates. This would encourage people to reduce impact on the grid during high use times, thus avoiding brown outs, and lower overall energy costs for the City and Ratepayers. This would save both the City and Ratepayers money.
13) The City of Sebastopol has extremely poor roads, many of which require full reconstruction. The EFOC requests that the City work to develop a pavement plan that coordinates Water and Sewer infrastructure work with pavement replacement.
14) The EFOC would like to see a Sewer Plan developed by the City that prioritizes the mitigation of storm water incursion into the sewer system. In addition, the City needs to develop a fee structure to offset the infrastructure demands of new development on the existing sewer system.
15) These adjustments would satisfy the Grand Jury recommendation:
    a) Refund of Attorney's Fees and Systerco Loan $1,193,319.
    b) General Fund payment of Water Enterprise Fund Syserco Loan Moving forward from FY 7/1/2026 until Loan's Termination on 7/1/2036 $1,685,930.
    c) Correction of Cost Allocation moving forward to be Prop. 218 and Prop. 26 compliant with time tracking.
    d) Establishment of a Water and Sewer Municipal Utility Board to provide continuing oversight on Capital Improvements and all financial decisions to maintain separation between Ratepayer and Enterprise Fund needs and the needs of the City's General Services and to provide Ratepayer advocacy. This board would review Allocation Transfers and Audited Budgets to ensure that Enterprise Funds are either reimbursed for overpayment or the General Fund is reimbursed for underpayment after the Transfers are compared against the Audited Budgets.
    e) Promote Green Infrastructure with trees, shrubs and grasses. Support schools, parks and other large public areas with Green Infrastructure to lower surface temperatures, create shade, and mitigate stormwater.
    f) Establish a new rate structure based on new financial information and a new cost attribution plan.
    g) Established tiered rates based on PG&E costs if tiers are deemed necessary.

h) Develop Water and Sewer Infrastructure upgrades with a Pavement Plan.
i) Using the Sewer Master Plan, develop a Sewer Upgrade Plan that prioritizes the mitigation of stormwater incursion and also creates a financial plan for fees associated with new development to support necessary sewer upgrades.

While these recommendations are significantly less in dollar value reimbursement than the $5,500,000 Grand Jury recommendation ($2,880,000 instead of $5,500,000), the Finance Committee sees this as an achievable remedy which would move the City into prop. 218 and prop. 26 compliance, produce more transparency and accurate budgeting now and in the long term, create accurate information for future rates, allow Enterprise fund viability while rates are determined, establish long-term ratepayer advocacy and oversight, and not be overly burdensome on the City.