Docusign Envelope ID: FC6B0038-ADC9-8650-812C-AE565C59FC89

Mayor Jill McLewis
Vice Mayor Maurer
Councilmember Carter
Councilmember Hinton
Councilmember Zollman

READ AND CONSIDERED
DATE 8/5/26 BY

July 22, 2026

City of Sebastopol

Honorable Christopher Honigsberg
Presiding Judge
Superior Court of Sonoma County
Hall of Justice
600 Administration Drive
Santa Rosa, CA 95403

Re: Response to Sonoma County Civil Grand Jury Report "City of Sebastopol's Water and Sewer Systems – Deferred Action Has Consequences" (Report dated May 2026)

Dear Judge Honigsberg:

The City of Sebastopol appreciates the time, effort, and public service of the 2025-2026 Sonoma County Civil Grand Jury. The City acknowledges that in the past we fell short in our communications and clear and transparent report regarding the Water and Wastewater Enterprise Funds. We sincerely apologize for this shortcoming and are committed to significantly improving transparency moving forward, including through the work of the Enterprise Fund Oversight Committee and more open, regular reporting to the community. The City takes the report seriously and welcomes input that advances transparency, fiscal accountability, and the long-term sustainability of essential water and wastewater infrastructure.

The City has already implemented meaningful reforms, including a new activity-based Cost Allocation Plan (ClearSource, FY 2024-25), a comprehensive Water and Wastewater Rate Study with cost-of-service analysis (Raftelis, 2024), establishment of the independent Enterprise Fund Oversight Committee (EFOC), and adoption of rate adjustments following a full Proposition 218 process. A formal response to each finding and recommendation appears below, in accordance with California Penal Code §§ 933 and 933.05.

Response to Findings

Finding F1: The Grand Jury estimated that the City's failure to update its Cost Allocation Plan for more than 20 years resulted in the City over allocating approximately $5.5 Million of indirect costs to the Enterprise Funds. This was non-compliant with Proposition 218 and left the Enterprise Funds without sufficient money for maintenance and capital improvements.

The City partially agrees with this finding. Prior to 2023–2024, the City had not conducted a formal, comprehensive cost allocation study for more than two decades and relied on annual percentage-based adjustments. This practice was outdated relative to best practices and industry standards. The City recognized the need for an updated cost allocation plan, and retained an independent consultant, ClearSource Financial Consulting to prepare a new cost allocation plan.

The City acknowledges that relying on the old cost allocation plan for an extended period of may have resulted in overallocation. The City is proactively taking steps to ensure this does not occur in the future. The industry standard is for cost allocation plans to be updated every 3-5 years. The City Council has directed staff to begin the process of retaining a consultant to prepare a new cost allocation plan that can be in place for the start of FY 27/28, 3 years after the current cost allocation plan was adopted. Additionally, the City is expanding its use of time-tracking and direct billing to supplement and refine the cost allocation plan. The City has begun charging the Enterprise Funds for legal costs using direct billing, and the City is currently exploring different tools and software to facilitate more detailed time tracking by staff.

Finding F2. When the City updated its Cost Allocation Plan in 2024, reduced allocation of indirect costs left approximately $714,000 in the Enterprise Funds to be used for systems maintenance and capital improvements.

The City partially agrees with this finding. The Cost Allocation Plan adopted in 2024 uses detailed cost pools and allocation bases (e.g., compensated labor hours, gross expenses, capital asset values, utility accounts) for allocating costs to the Enterprise Funds. As a result of this approach, the Cost Allocation Plan calculates lower maximum interfund charges to the Water and Wastewater Funds than were previously budgeted under the old method. Specifically, charges under the 2024 Cost Allocation Plan were approximately $510,000 less for Water and $204,000 less Wastewater. The savings from these reductions are not allocated to a specific purpose. They may appear in the form of increase spending on operation and maintenance, additional capital improvements, and additional reserves, or offset the need for otherwise necessary rate increases.

Finding F3. Because the rate study conducted by the City in 2019 underestimated a reduction in consumption due to conservation measures, the rate adjustment for 2019-2023 was insufficient to keep pace with escalating costs. This resulted in the need for a 37% increase on July 1, 2024, which has been difficult for many ratepayers to accept.

The City partially agrees with this finding. The 2019 rate study did not fully anticipate the revenue effects of successful conservation efforts. The 2021-2022 drought was one of the most severe in Sonoma County's history, and many agencies were subject to mandatory conservation measures. This results in significant public awareness and efforts regarding conservation. The effect in Sebastopol, like many cities, was decreased water demand, which also resulted in decreased revenue. The 2024 Raftelis Rate Study properly identified the need for adjustments to achieve financial sufficiency, cover operations and maintenance, fund capital improvements, and build appropriate reserves. The resulting rate adjustments (approximately 37% combined impact in the first year under the adopted lower-rate option, with subsequent annual increases) were implemented following a Proposition 218 process.

The City recognizes that any increase in water and sewer rates can impact families struggling to make ends meet. Each household's consumption and use is unique, but any time there is a significant rate increase, it can put pressure on tight budgets. However, the City also believes that failure to implement the 37% increase in 2024 would have resulted in the need for even greater increases in the future. Years of insufficient rate adjustments combined with the prior allocation methodology contributed to underfunding of the Enterprise Funds, resulting in deferred maintenance and the need for significant infrastructure investment.

Finding F4. In November 2025, the City Council reinstituted an Enterprise Fund Oversight Committee. This promises to provide the City Council with insights and expertise regarding decisions concerning oversight of these critical systems.

The City partly agrees. An Enterprise Fund Oversight Committee was not reinstituted, it was proactively created by the City Council for the first time in November 2025 based on the City Council's desire to create additional citizen oversight of the enterprise funds. No other city in Sonoma County has such a committee, and we're not aware of any other city in California that has such a committee. The City Council created the Committee shall act in an advisory capacity to the City Council and perform the following duties:

a) Reviewing Annual Budgets and Financial Reports: The Committee will analyze the financial health of the Enterprise Funds, ensuring that budgets and financial statements reflect accurate and sustainable practices.
b) Analyzing Rate Studies and Rate Adjustment Proposals: The Committee will evaluate proposed rate changes, including providing recommendations on cost allocation methods to ensure fairness and financial viability.

c) Evaluating Long-Term Financial Planning and Capital Improvement Needs: The Committee will assess capital improvement plans (CIP), master plans, and long-term financial forecasts related to Enterprise Fund operations, ensuring that projects are properly prioritized and funded and that master planning efforts align with Enterprise Fund financial sustainability.
d) Engage with the public and other stakeholders to ensure that the community's interest and concerns are reflected in the Committee's recommendations.
e) Such other duties as assigned by the City Council.
f) Shall submit an annual report to the Council in early June before the next fiscal year budget is adopted.

Response to Recommendations

Recommendation R1: By October 1, 2026, commit to fully comply with Proposition 218 by conducting cost allocation and rate studies at least within 3-5 years intervals and adjusting its cost allocation and ratepayer fees accordingly.

This has been implemented. The City adopted the ClearSource activity-based Cost Allocation Plan in 2024 (FY 2024-25). Additionally, the Raftelis Rate Study was completed and implemented following Proposition 218 procedures in June 2024. The City Council recently directed staff to retain consultants to prepare new cost allocation plan and rate study to be implemented no later than FY 27-28, 3 years after the current cost allocation plan and rate study were approved. The City Council included money for these studies when adopting the FY 26/27 Budget.

Recommendation R2. By October 1, 2026, reach an agreement on the dollar value of mis-allocated indirect costs and commit to a repayment schedule to restore funds transferred from the Enterprise Funds to the general fund by overallocation of indirect costs. This money can be used to implement critical improvements identified in the Master Plan.

The recommendation requires further study and analysis. While the City acknowledges the likelihood that outdated cost allocation plan may have resulted in overallocation of General Fund costs, the City has not yet determined a specific dollar amount. However, the City has already begun taking steps to address this matter. On July 21, the City Council approved the forgiveness of a $1,100,000 loan from the General Fund to the Wastewater Enterprise Fund, resulting in a significant fiscal benefit to the Wastewater Enterprise Fund due to the elimination of the repayment obligation.

Recommendation R3. By October 1, 2026, consider adding a Certified Public Accountant to the Enterprise Fund Oversight Committee to assist the City Council and City Manager with fiscal compliance, analysis, and transparency.

The City agrees. The EFOC is currently required to include "at least one person who has expertise in accounting, auditing, or another financial field." Unfortunately, during the last open recruitment process, the City did not receive any applications from a person with those qualifications (even though the recruitment process was extended twice due to lack of applications). During the next recruitment cycle, the City will make a concerted effort to solicit applications from certified public accountants, including by reaching out to relevant professional organizations.

The City remains committed to responsible stewardship of ratepayer funds, long-term infrastructure sustainability, open communication, and rebuilding public trust. The recent actions by the City Council reflect responsiveness to community input while the City works to address the issues raised in the Grand Jury report.

A copy of this response is being provided electronically to the Sonoma County Civil Grand Jury and will be placed on file with the City Clerk as a public record. The City Council considered and approved this response at its meeting on July 21, 2026.

Sincerely,

Signed by:
Jill McLewis
7C6BCED0A8914A1

Jill McLewis Mayor,
City of Sebastopol On behalf of the Sebastopol City Council

cc: Sonoma County Civil Grand Jury
(grand.jury@sonomacounty.gov)

City Manager Mary Gourley
City Attorney Alex Mog