

A Blueprint for the Future



*Santa Margarita
Water District*

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In Memoriam

Jim Mizell 1948 - 2005

The Santa Margarita Water District dedicates the 2004 Annual Report to our long-time colleague and friend, Jim Mizell. Jim served on the District's Board of Directors for nearly 12 years, including three terms as the Board's President. His dedication to the water industry and the community served our customers well and was only equaled by his love and commitment to his family. He will be deeply missed.

A Blueprint for the Future

When the Santa Margarita Water District formed 40 years ago, the City of Mission Viejo did not yet exist, and Rancho Santa Margarita was but a distant thought. Cattle far outnumbered the human population of the District's service area.

When the first board members met on January 27, 1965, they began the process of drawing the blueprint for what you see today – a District that serves over 150,000 customers and has become the second largest water agency in Orange County.

The District marked its 40th year with momentous achievements – and ongoing commitments to incremental improvements in the service we provide our customers. We were able to avoid a potential rate increase thanks to the forward planning principles set by the District's leadership. The Chiquita Water Reclamation Plant's upgrades were completed and it now serves the surrounding communities of Talega and Ladera Ranch with nearly five million gallons of recycled water a day for irrigation. We celebrated one of our most successful Water Awareness Day's to date.

We accomplished all of this for you, our customers and stakeholders – thanks to your support, your encouragement, and your expectation that your water district be the best it can be.

We invite you to read through our 2004 annual report and learn more about this year's events, achievements and the lengths we go through each day to serve you more efficiently.

Sincerely,

John J. Schatz
General Manager
Santa Margarita Water District



John J. Schatz
General Manager
Santa Margarita Water District

Quality You Can Count On

Water Supply and Reliability

When Gaspar de Portola set out to explore what is now south Orange County, little did he know that this semi-arid region would one day be home to hundreds of thousands of people. Had the thought crossed his mind, he probably would have asked, "Where would the water come from?"

Unlike nearly all other Orange County water districts, SMWD does not have a natural, near-

typical south Orange County neighborhood, SMWD recognized that it needed to become a leader in developing water recycling plants to reduce its need for imported water.

In addition, two new reservoirs were constructed in Talega, which increased storage capacity by 2.8 million gallons, or about three days of emergency supplies for the residents of that area. With these new

Water recycling and conservation are the District's most powerful tools in assuring adequate supplies.

by water source. Instead it must purchase most of its water from the Metropolitan Water District of Southern California, which imports it from the Delta via the State Water Project and the Colorado River via the Colorado River Aqueduct.

Although MWD's projections show that it will be able to meet 100 percent of SMWD's needs for at least the next 20 years, the District has chosen to not be completely dependent on this forecast. Instead, it is SMWD's goal to continue to take proactive steps to generate supplemental water sources.

Water recycling and conservation are the District's most powerful tools in assuring adequate supplies for tomorrow's future. For example, the recent \$27 million expansion of the Chiquita Water Reclamation Plant allowed SMWD to begin producing large amounts of recycled water, which is used for irrigation and construction purposes.

This will free nearly 1.8 million gallons of drinkable water a year, enough to serve over 9,000 families. Because irrigation accounts for almost 70 percent of all water used in the

reservoirs, SMWD's storage capacity has continued its program to add emergency water storage for increased reliability.



James Veyna of the District's field crew checks local meter readings.

2004 Election Recap



During the 2004 election there was one proposition on the ballot that greatly affected most water agencies in the state.

Proposition 1-A restricted the state from raiding the property tax revenues of local jurisdictions, including water agencies, more than twice in a 10-year period.

Special districts, like SMWD, were interested in stopping the state from taking property taxes because these funds are used to help cover annual operating expenses and keep rates down. On the other side of the coin, voters showed overwhelmingly that they are interested in reducing the state's deficit. Proposition 1-A will allow the state to take \$1.3 billion from special districts, cities and counties over the next two years for that purpose.

While many water districts across the state have been forced to raise rates as a result of Proposition 1-A, the District's board was able to keep rates at their current level.

Since 1994, SMWD has used 10-year operating budget projections, a tool that allows the District to evaluate and anticipate future revenues and expenses, and manage assets more effectively. Although no one could predict the amount and severity of the property tax loss, this long-term planning process has once again served its customers well.

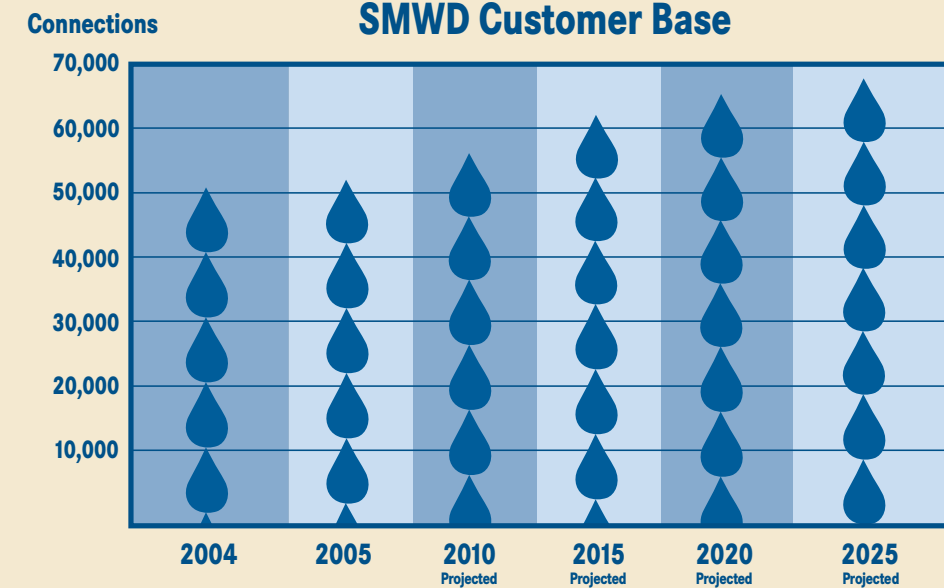


The Trabuco Ridge Reservoirs serve homes within Rancho Santa Margarita.

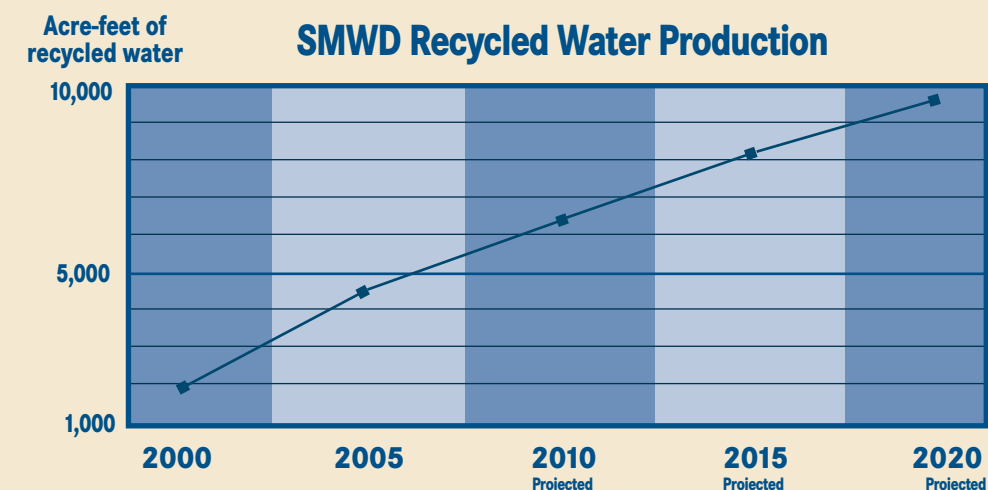
2004 Service Connections

Residential	Commercial	Irrigation	Other	Total
45,912	1,951	2,545	51	50,459

SMWD Customer Base



SMWD Recycled Water Production



SMWD's production of recycled water will increase nearly five-fold by 2020, reducing reliance on imported water from the Delta and the Colorado River.



Water Awareness Day pairs conservation with community involvement.

Lending a Hand *Community Outreach*

Employees at SMWD believe that contribution is an all-important aspect of being a member of the community. Through this commitment, the District has risen as a leader in conservation education and as a primary source of information regarding water-related issues.

Conservation Awareness

Each year SMWD sponsors Water Awareness Day, or *Fiesta de Agua*. In 2004, hundreds of local families joined the District in celebrating the fifth year of this community gathering held at the District headquarters. Guests participated in family-oriented events focusing on water-related issues including gardening tips, urban runoff prevention and conservation techniques.

Along with SMWD, three other water districts in south Orange County also held Water Awareness Day festivities, including the Moulton Niguel, Trabuco Canyon and El Toro water districts. All were recognized by their cities for excellence in conservation awareness.

SMWD also worked with local school districts to promote conservation through a series of fifth-grade field trips to its Chiquita Water Reclamation Plant. There, students learned the importance of conservation and the uses of recycled water.

Water Forums

SMWD sponsored a well-attended water forum in 2004 that explained many of the complex water issues impacting California and its water supplies, including desalination, water conservation, recycled water, urban runoff and

water-related legislation. U.S. Representative Ken Calvert, Assemblyman Joseph Canciamilla and former San Diego County Water Authority board chairman Mike Madigan participated in the forum to share their expert opinions with those in attendance.

Water Issues Study Course and Tours

This year, SMWD continued to host a series of water issues study courses for District customers. As always, the focus was conservation education. Topics ranged from controlling urban runoff by adjusting sprinkler settings to planting drought resistant landscaping.

In the fall of 2004, customers also had the opportunity to participate in a district-wide bus tour. The District received an overwhelming response from customers who were interested in learning more about SMWD's facilities. Additional tours are scheduled for 2005.



SMWD's Water Forums highlight relevant water related issues and current events. From left to right: Former San Diego Water Authority board chairman, Mike Madigan, Assemblyman Joseph Canciamilla and US Representative Ken Calvert.

Hands-On Community Involvement



In September, SMWD employees donned their hiking boots and work gloves and joined with more than 100 local volunteers to clean portions of Oso Creek in Mission Viejo and Tijeras Creek in Rancho Santa Margarita during the Annual Inner-Coastal Watershed Clean-up Day. The event was sponsored by the non-profit organization Trails4All and a number of other community organizations such as the Explorer Scouts (pictured above).

The team removed debris along waterways and trails before it had a chance to wash onto local beaches. They collected more than 350 pounds of trash in all.

Not all of SMWD's work to promote urban runoff education is so hands-on. Through informational articles in its monthly newsletter, *On Tap*, and through participation in community-wide partnerships with the County of Orange and neighboring cities, the District encourages its customers to reduce runoff.

After all, every time we eliminate a gallon of runoff, it means we've conserved a gallon of water – and we've protected local streams and beaches.



SMWD employees answer students' questions about water recycling.



Students learn how wastewater is recycled for use within the community.



SMWD partners with local school districts to teach students about conservation and water awareness.



Planning Today For Tomorrow's Needs *Improvements*

Behind those blueprints and heavy equipment is a simple goal: Making sure water is available every time customers want to slip into a hot bath or reach for a cool, replenishing drink.

Here is a glimpse at the major capital improvement projects SMWD worked on in 2004:

The upgrades to this 15-year old facility will provide added emergency power to this Mission Viejo pump station.

Benefit: Increased reliability for recycled water irrigation systems in Mission Viejo

6. Gobernadora Pipeline Crossing Repairs:

Measures were taken to stabilize several pipelines in the area.

The District works hard to keep existing infrastructure strong.

1. Oso Creek Water Reclamation Plant

Upgrades: The plant's disinfection system was upgraded to use hypochlorite instead of chlorine gas.

Benefit: Increased production of recycled water through a more efficient and environmentally safe operation

2. Covenant Hills Reservoirs and Pump Station

Station: The project includes storage for both household and recycled water in two reservoirs, plus a pump station to serve the lower pressure zones of Ladera Ranch.

Benefit: Increased water reliability for the Ladera Ranch community

3. Horno Lift Station: The facility pumps wastewater from Ladera Ranch to the Chiquita Water Reclamation Plant.

Benefit: Increased recycled water reliability for Ladera Ranch

4. Ladera and Talega Pipelines: These pipelines were constructed to serve the build-out of Talega and Ladera Ranch.

Benefit: Increased water reliability for Talega and Ladera Ranch

5. Eastbrook Pump Station Upgrades:

Benefit: Lessen threat to pipelines caused by bank erosion along Gobernadora Creek

7. Talega Zone B Non-Domestic Pump Stations

Stations: These new facilities will assist in the transportation of recycled water to Talega.

Benefit: Increased reliability and recycled water supply in the Talega area

8. Tesoro Pump Station Expansion: The facilities at this pump station, located in Chiquita Canyon near Oso Parkway, were improved and expanded.

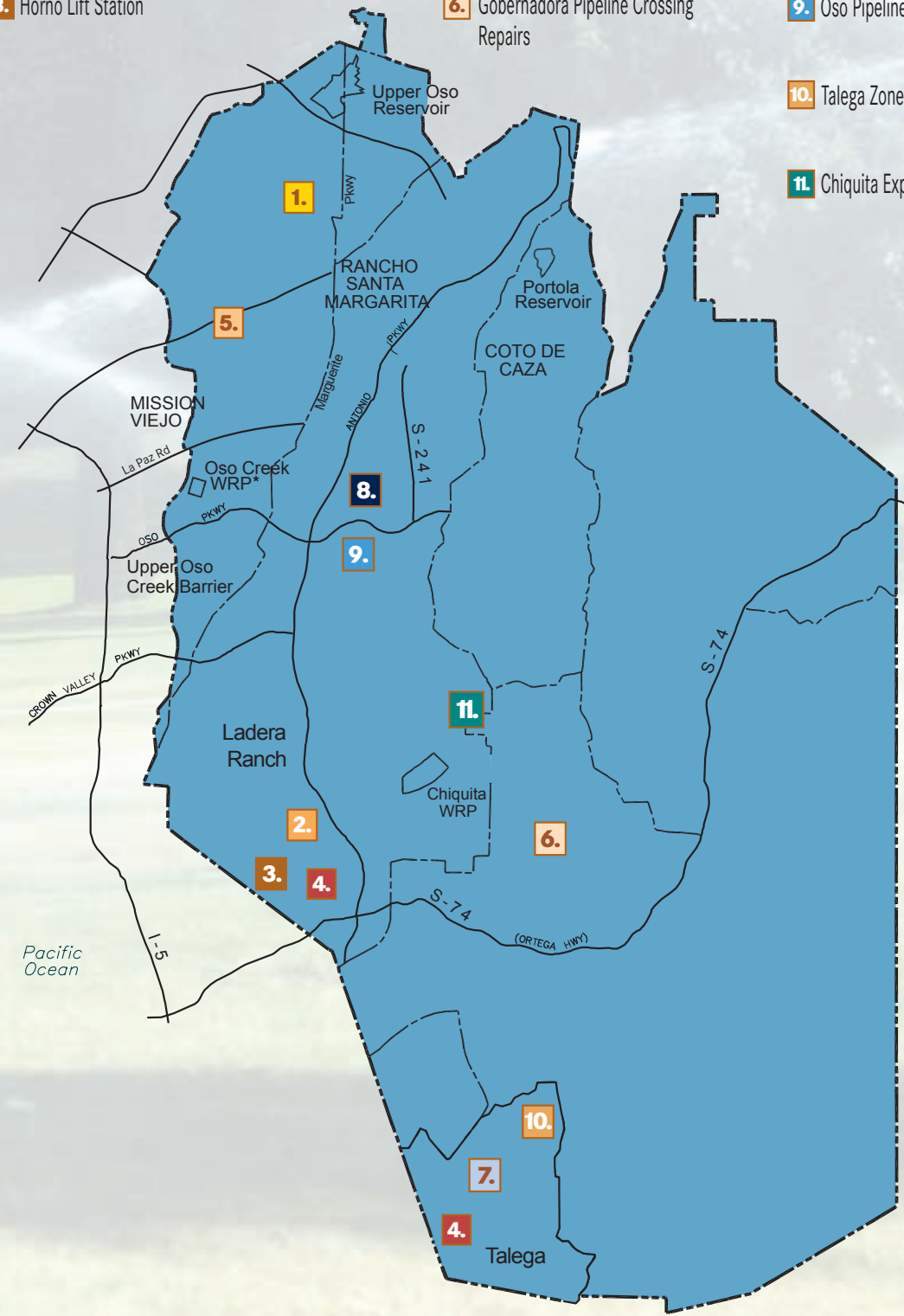
Benefit: Increased water reliability for Coto de Caza and reduced costs for delivering resources to the area

9. Oso Pipeline: The construction of this new pipeline was started in 2004 and is expected to be completed in 2006. It will deliver domestic and non-domestic water across the District from Mission Viejo to Coto de Caza.

Benefit: Increased water reliability for the communities of Mission Viejo, Las Flores and Coto de Caza

SMWD Capital Improvement Projects

- 1. Oso Creek Water Reclamation Plant Upgrades
- 2. Covenant Hills Reservoirs and Pump Station
- 3. Horno Lift Station
- 4. Ladera Talega Pipelines
- 5. Eastbrook Pump Station Upgrades
- 6. Gobernadora Pipeline Crossing Repairs
- 7. Talega Zone B Non-Domestic Pump Stations
- 8. Tesoro Pump Station Expansion
- 9. Oso Pipeline
- 10. Talega Zone II Reservoirs
- 11. Chiquita Expansion





On Tap is designed to give customers information about District-wide events, conservation and water related news. The publication reaches more than 40,000 homes each month.



The above cover art entry by Taylor Krebs, a fifth grader at St. John's Episcopal School in Rancho Santa Margarita, was one of three winning entries in 2004.

Spreading the Word *Communication*

SMWD has done much this year to improve upon its communications goals through various mediums and efforts. Whether it's *On Tap*, smwd.com, or an informational guide, the District strives to bring important, up to date water information to its customers.

Customer Service with a Smile

SMWD's mission is to provide quality water and quality service. Any customer with a question or a service need can reach help day or night, 365 days a year. Customer service representatives are available Monday through Friday during work hours, and help is available after hours on the District's emergency line.

Many of SMWD's customer service and



Customer Service guides cover a wide variety of topics and are available for new and existing District customers.

field staff have been with the agency for many years and know many of their customers by name. It's truly a family atmosphere.

Read All About It

SMWD's main tool for spreading the word of conservation is its award-winning newsletter, *On Tap*. The publication is distributed monthly throughout the District with news of important water issues, a glimpse of upcoming District activities and conservation tips. The *On Tap* Kids Cover Art Contest received an unprecedented number of entries this year. Of the many received, three were featured as *On Tap* covers that reached more than 40,000 homes.

In addition, SMWD produces a wide variety of informational pamphlets for its customers including a customer service guide with separate inserts dealing with water quality, cost, conservation and runoff.

Also in 2004, the District began planning a revamping of its Web site, which will be unveiled in 2005.



These are just a few of the smiling faces of SMWD's customer service team. Pictured from left to right: Lisa Detrick, Letty Alferez, and Laurie Boede.



SMWD Celebrates 40 Years of Excellence



In 2004, SMWD celebrated its 40th year, capping four decades of growth and leadership. So much has been involved in the transformation of an old Spanish land grant ranch into some of the world's leading planned communities, that a timeline can't do it justice. Nevertheless, here is a summary of some of the key events in SMWD's history:

- 1964 – The Santa Margarita Water District was formed to serve the planned City of Mission Viejo and other future development in inland south Orange County.
- 1974 – By the end of this year, SMWD was serving more than 800 connections and was working to lay the foundation for the thousands of connections it serves today.
- 1980 – Recycled water supplied by SMWD was used for the first time in the City of Mission Viejo.
- 1981 – Construction on the O'Neill Reservoir, the first of four large water tanks that would be built during the 1980s, was started.
- 1985 – Construction of water and sewer lines, pump stations, reservoirs and sewage treatment plants were well underway in the developing new community of Rancho Santa Margarita, which saw its first residents in the late 1980s.
- 1990 – Construction of the South County Pipeline, SMWD's primary source of water from the Metropolitan Water District of Southern California, began.
- 1996 – SMWD's board of directors voted to decrease water rates for the fourth time in 10 years and cut taxes for fiscal year 1996/97.
- 1997 – SMWD's water management awareness program was certified by the Association of California Water Agencies.
- 2002 – SMWD entered into agreement with the El Toro and the Moulton Niguel water districts to expand the R-6 Reservoir in Mission Viejo. Today it provides 138 million gallons of emergency water storage for the District.

Fiscal Responsibility Pays Off



In the spring of 2004, SMWD refinanced its 1994 infrastructure improvement bonds and started a process that will save District customers nearly \$13.8 million over the next 16 years.

The new refinancing bonds received top credit evaluations from national rating agencies based on the District's underlying financial stability, diverse customer base, overall financial management excellence and first-rate bond insurance.

Ten years ago, SMWD sold bonds totaling \$132.9 million, known as the Santa Margarita/Dana Point Authority Series B Revenue Bonds, which were used to finance infrastructure construction. The bonds became callable in 2004.

SMWD was able to refinance the bonds at 4.022 percent, nearly two percentage points lower than the interest rate of the original bonds. SMWD received ratings of AA from the Fitch rating agency and AA- from Standard & Poor's. These exceptionally high ratings allowed the District to obtain a low premium for the mandatory bond insurance.

Solid Foundations Financials

SMWD has weathered the Orange County bankruptcy in 1994, the 2002 energy shortage and the current State budget crisis, managing to stay financially balanced amidst the budget storms surrounding it. The District's standing commitment to long-term financial planning allows it to anticipate future cost increases and revenue levels, then plan accordingly to avoid rate increases.

As explained on page two, District customers benefited from this forward



The District works to keep rates low and provide quality water and wastewater services for its customers.

which was implemented in 2001, when SMWD's finance department projected that

The District's Rate Stabilization Fund kept customers safe from a rate increase this year.

planning in late 2004, when a rate increase was avoided despite the loss of property taxes. Because the District looks at least a decade forward in managing its finances, it was able to plan for such a revenue loss and stop the imposition of a reactive rate increase.

The District's forward planning principles are reflected in its Rate Stabilization Fund,

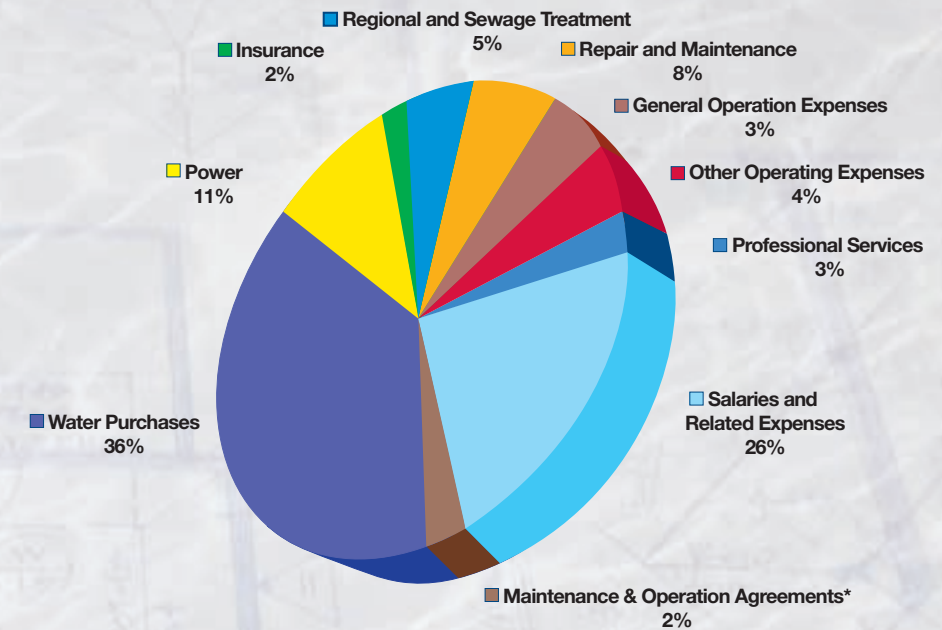
a rate increase would be needed in 2005 to offset rising water and power costs.

Through the Rate Stabilization Fund, the District's board has been able to forestall the anticipated rate increase until at least 2008. Since the fund was started, nearly \$5 million earned from interest on its reserve accounts has been applied for rate stabilization.



Board members participate in monthly finance meetings to ensure fiscal responsibility amid changing times.

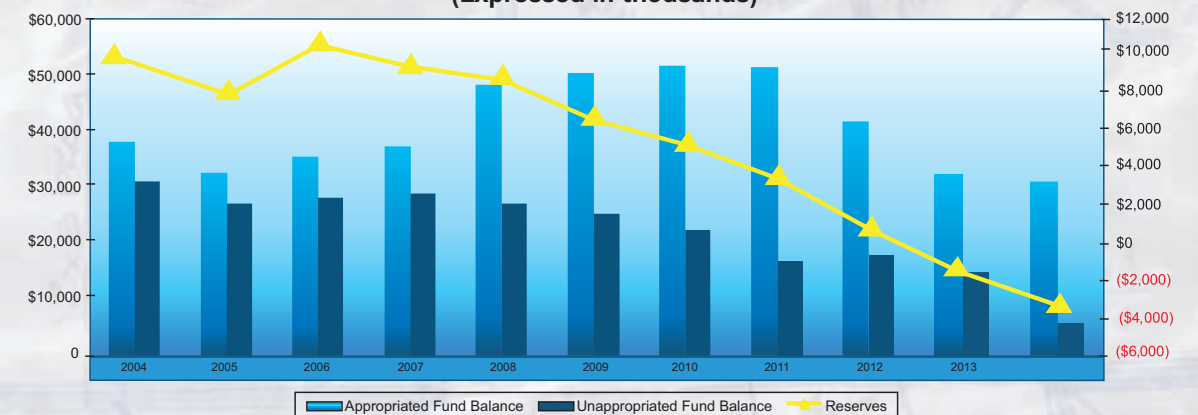
Annual Operating Budget



SMWD uses nearly half of its budget for water and power purchases.

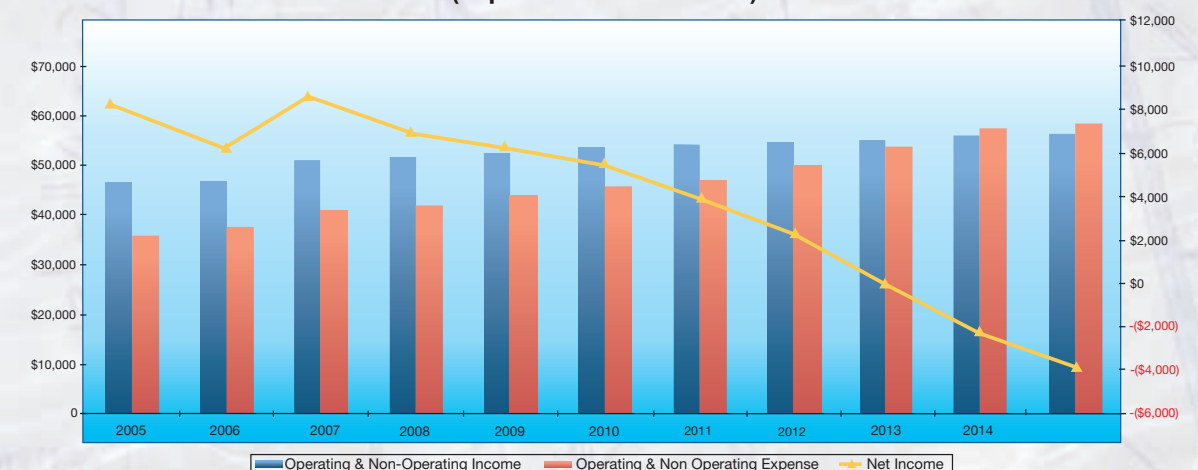
*Refers to maintenance and operation of main building.

Reserves (Expressed in thousands)



The District's commitment to long-term planning allows it to anticipate future costs and plan accordingly.

Net Income Forecast (Expressed in thousands)



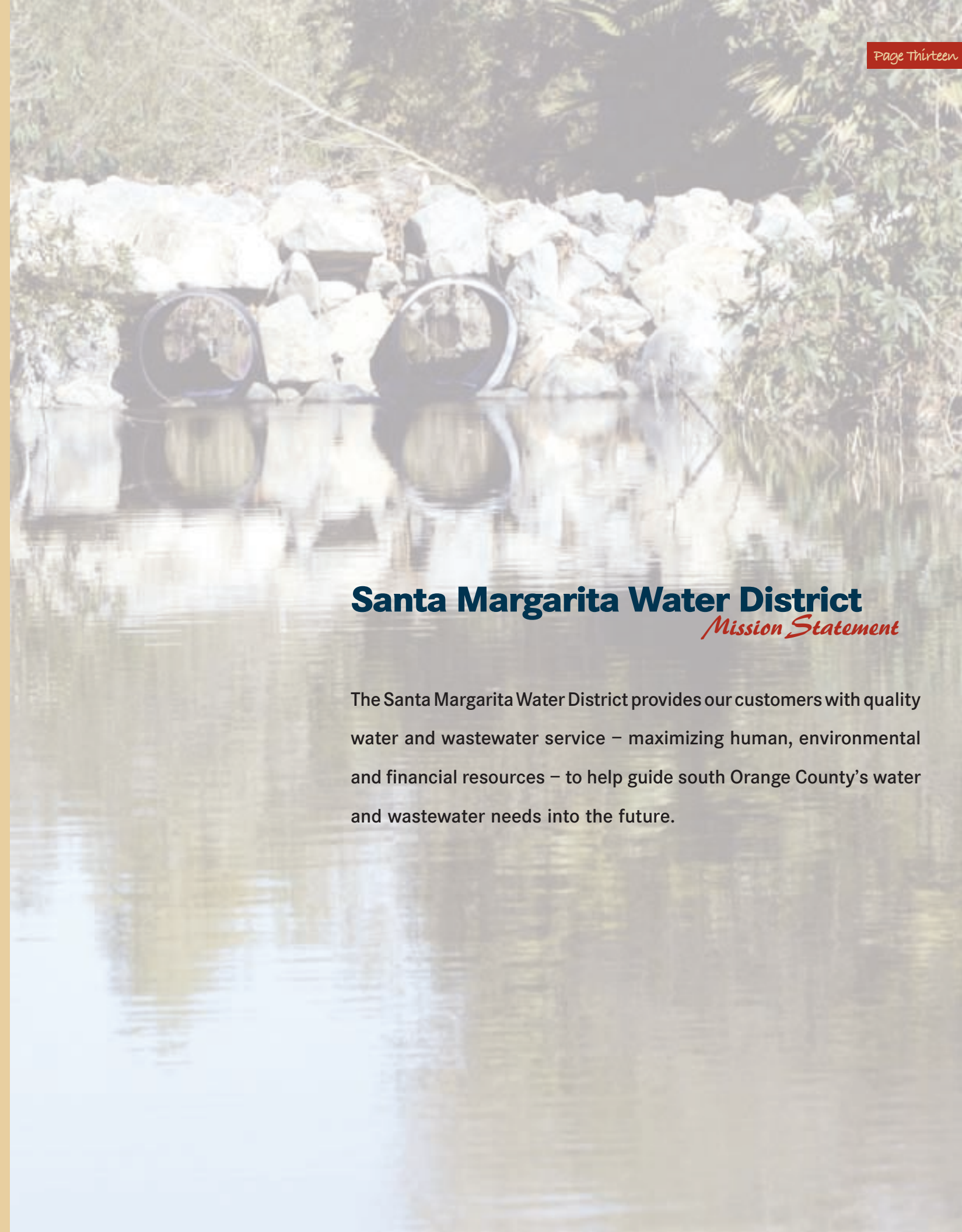
The District continues to evaluate alternative resource and energy options to offset costs.



Strong Leadership, Clear Mission

2004 Board of Directors

President	Sam Johnson
Vice President	Sandra F. Jacobs
Treasurer	Betty H. Olson, Ph.D.
Director	Jim Mizell
Director	Charley Wilson
General Manager	John J. Schatz



Santa Margarita Water District

Mission Statement

The Santa Margarita Water District provides our customers with quality water and wastewater service – maximizing human, environmental and financial resources – to help guide south Orange County’s water and wastewater needs into the future.