

EXECUTIVE SUMMARY

A long-term financial plan (LTFP) is not a static, one-time document, but represents a process where the Board and management review financial strategies to help achieve the Agency's overall strategic plan. This FY 2010/11 LTFP represents an updated look at individual financial strategies and serves as the basis for future analysis and decision making. The LTFP helps to identify potential financial issues and risks. This FY 2010/11 LTFP groups financial strategies into near-term, mid-term and long-term issues, to help prioritize the work. Based on the decisions and guidance provided by the Board, the Plan is a rolling "look-ahead" to help identify priorities and focus. The Agency's management team has collaborated on this long-term financial plan by taking a thoughtful look at the Agency's programs and the financial implications of those programs. The management team has also (1) reviewed the work prepared by CDM Consulting in 2006 as part of the update process for Facility Capacity Fees, (2) "A Strategic Assessment of the Future of Water Utilities" prepared by Ed Means for the AWWA Research Foundation in 2006; and (3) the August 2007 presentation prepared by Ed Means of Redoak Consulting, a division of Malcolm Pirnie.

This LTFP is separate from the Agency's Strategic Plan and its objectives, goals and action items. This plan is intended to discuss financial strategies to achieve the Agency's strategic plan as well as respond to challenges and opportunities presented by economic, demographic, regulatory, political and environmental conditions.

The LTFP is not intended to address every fiscal issue, but identify high priority fiscal programs and strategies to be monitored over time, so that the Agency is positioned to address them at the appropriate time. The LTFP is a companion piece to the multi-year financial forecast, which estimates budget line items for the near future. The LTFP addresses broader, more strategic issues that will impact the forecast over time.

None of these issues can be definitively answered nor fully addressed now. However, ongoing review of the LTFP will help to keep the Agency focused on high priority financial issues.

As discussed by Ed Means during his August 2007 presentation to the Board, the political environment for water utilities is growing more complex. Rate rises will be politicized and the water utility industry should prepare for this future by improved financial and capital improvement program transparency. This long-term financial plan is intended to help the Agency to achieve this objective.

Each of the sections of this Plan has been reviewed and updated. Some sections have changed significantly, and those areas are highlighted in each section.

The individual financial issues include:

Ongoing

- ◆ Total Cost of Water
- ◆ Diversity and Security of Revenues
- ◆ Debt Financing of the Capital Improvement Program

Near-Term

- ◆ Facility Capacity Fees
- ◆ Water Conservation
- ◆ Buena Vista/Rosedale Rio Bravo Water Program Funding
- ◆ Reliability Programs Funding/Semitropic Banking Program

Mid-Term

- ◆ Operations and Maintenance
- ◆ State Water Contract Fund
- ◆ Impact of Health Care Reform

Long-Term

- ◆ Structure of the Wholesale Water Rate
- ◆ Recycled Water
- ◆ Energy
- ◆ Security

TOTAL COST OF WATER (Ongoing)

The Agency has funded the ongoing purchase and treatment of water from three sources – wholesale water rates, State Water Contract Fund (ad valorem taxes) and one percent property tax funds. (Note that purchases of “new” supplies of water are also partially-financed through Facility Capacity Fees; this discussion reflects annual costs to treat and deliver water to the purveyors.) The diversity of funding sources strengthens the Agency’s fiscal position, but masks the “true” cost of water. While the wholesale water rate is \$420/AF, the total cost of water is closer to \$800-\$1,100 per AF, as shown on the following pages. Staff will publish this table as part of the budget each year, to enhance understanding of the “cost of water.”

As discussed in “A Strategic Assessment of the Future of Water Utilities,” “Water utilities should include financial targets in their mission statements and have policies on rates and financial returns that ensure ongoing financial health.” A consolidated understanding of all of the Agency’s costs to treat and distribute water will help establish the appropriate policies and ensure ongoing financial health.

The Agency should continue to monitor how water supplies are funded and, as discussed above, the Agency should consider funding new programs (banking, recycled water, desalination, etc.) through “surcharges” or “components” of water rates, to enhance the visibility of the costs of these programs and more directly links costs to benefits.

Castaic Lake Water Agency
FY 2010/11 Long-Term Financial Plan

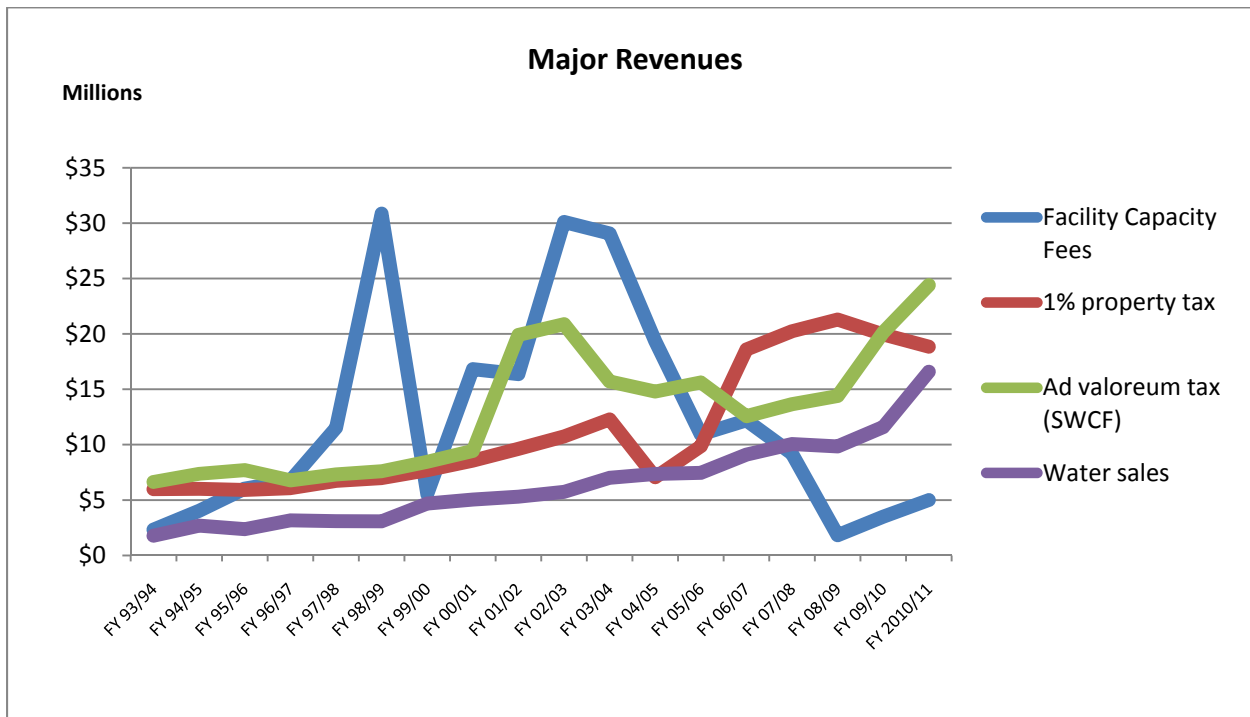
TOTAL COST OF WATER *					
	FY 2006/07	FY 2007/08	FY 2008/09	FY 2009/10	FY 2010/11
	Actual	Actual	Actual	Estimated	Budget
CLWA Operating Budget					
Total	\$ 11,295,584	\$ 11,972,443	\$ 13,105,490	\$ 13,154,800	\$ 16,123,500
Detail on Power Costs					
Electricity - Treatment Plants	441,995	345,307	256,855	300,000	350,000
Electricity - Pumping	817,349	1,198,594	1,089,572	-	-
Electricity - Other	56,672	49,764	43,137	1,100,000	1,200,000
Electricity - Wells	-	-	-	45,000	51,000
	<u>\$ 1,316,016</u>	<u>\$ 1,593,665</u>	<u>\$ 1,389,564</u>	<u>\$ 1,445,000</u>	<u>\$ 1,601,000</u>
Power as a Percentage	11.7%	13.3%	10.6%	11.0%	9.9%
SWP Budget **					
Total	\$ 13,774,790	\$ 16,941,022	\$ 20,490,241	\$ 21,969,400	\$ 23,401,200
Detail on Variable Costs (Power)					
Variable	3,657,626	4,488,388	4,667,948	3,500,000	3,600,000
Off-Aqueduct Power Costs	<u>946,864</u>	<u>1,876,229</u>	<u>4,009,676</u>	<u>5,521,900</u>	<u>4,210,200</u>
	<u>\$ 4,604,490</u>	<u>\$ 6,364,617</u>	<u>\$ 8,677,624</u>	<u>\$ 9,021,900</u>	<u>\$ 7,810,200</u>
Power as a Percentage	33.4%	37.6%	42.4%	41.1%	33.4%
Core Non-SWP Supplies					
BV/RRB	\$ 5,355,350	\$ 5,796,256	\$ 5,949,400	\$ 5,711,600	\$ 5,825,700
Yuba Accord Water	-	-	-	560,000	65,000
	<u>\$ 5,355,350</u>	<u>\$ 5,796,256</u>	<u>\$ 5,949,400</u>	<u>\$ 6,271,600</u>	<u>\$ 5,890,700</u>
TOTAL COST OF WATER	\$ 30,425,724	\$ 34,709,721	\$ 39,545,131	\$ 41,395,800	\$ 45,415,400
TOTAL COST OF POWER	\$ 5,920,506	\$ 7,958,282	\$ 10,067,188	\$ 10,466,900	\$ 9,411,200
Power as a Percentage	19.5%	22.9%	25.5%	25.3%	20.7%
AF Delivered	44,499	44,735	38,276	35,800	40,400
Cost per AF	\$ 683.74	\$ 775.90	\$ 1,033.16	\$ 1,156.31	\$ 1,124.14
* This table reflects all "water"-related costs, and divides by the amount of treated water the Agency delivers to the purveyors.					
** This includes all SWP costs, including "capacity" and "reliability" charges. This amount is included in the total that is divided by the amount of treated water the Agency delivers to purveyors. It may be more accurate to allocate certain "capacity" and "reliability" charges by Table A amount (95,200 AF) and then multiply by the AF delivered to the purveyors.					

DIVERSITY AND SECURITY OF REVENUES (Ongoing)

The Agency has experienced low wholesale water rates throughout its history, generally due to reliance upon one percent property tax revenues to fund debt service, capital improvement projects and capital planning programs for existing users, as well as for rate stabilization. While this keeps water rates low, it results in significant costs being funded by a revenue source over which the Agency has little control. Historically, the wholesale water rate has generated about 15% of the Agency's total revenues. In FY 2009/10, the Board of Directors adopted a new wholesale rate structure designed to fully recover operating costs. Based on this, it is anticipated the wholesale water rate will generate about 23% of the Agency's total revenues.

It may bring enhanced financial stability and also better reflect the true cost of water if the Agency were to shift additional costs to the wholesale water rates. An example could be to include half of capital expenses in wholesale water rates. Capturing more costs in wholesale water rates should help the Agency maintain or improve its credit rating.

Of course, any discussion of rates should take into consideration the balance between revenue needs and ratepayer impacts.



	WWR*	Total Revenue	%
	Revenue		
FY 1997/98	\$ 3,089,358	\$ 33,186,516	9%
FY 1998/99	\$ 3,081,745	\$ 54,379,286	6%
FY 1999/00	\$ 4,679,476	\$ 31,144,740	15%
FY 2000/01	\$ 5,050,974	\$ 50,159,660	10%
FY 2001/02	\$ 5,307,405	\$ 60,549,326	9%
FY 2002/03	\$ 5,738,667	\$ 77,688,500	7%
FY 2003/04	\$ 7,002,983	\$ 70,357,291	10%
FY 2004/05	\$ 7,359,265	\$ 55,668,952	13%
FY 2005/06	\$ 7,462,606	\$ 51,995,786	14%
FY 2006/07	\$ 9,110,221	\$ 66,164,587	14%
FY 2007/08	\$ 9,875,546	\$ 71,372,148	14%
FY 2008/09	\$ 9,717,294	\$ 76,924,159	13%
FY 2009/10	\$ 11,590,400	\$ 61,586,300	19%
FY 2010/11	\$ 16,058,000	\$ 69,534,100	23%

* Wholesale water rate

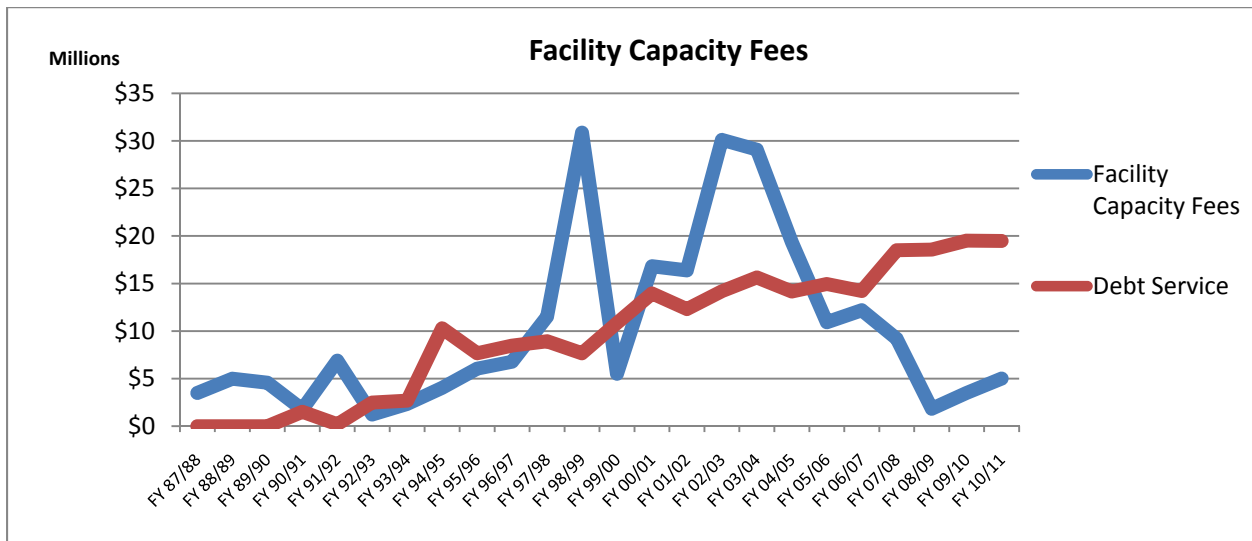
DEBT FINANCING OF CAPITAL IMPROVEMENT PROGRAM (Ongoing)

The Agency's Strategic Plan states that the Agency will utilize reasonable debt financing as an acceptable and appropriate approach to fund long-term facility investments and thus ensure that existing and future users pay their fair share.

The Agency's Debt Management Policy states that the Agency will utilize reasonable debt financing as an acceptable and appropriate approach to fund long-term investments and thus ensure that existing and future users pay their fair share. Long-term investments include the acquisition of land, facilities, public works, improvements and supplies of water; and enhancements or enlargements to existing capacity and facilities for obtaining, importing, transporting and delivering additional quantities of water.

Debt is a way of spreading out the cost of capital improvements over time. In general, public agencies find that debt financing is an appropriate use for one-time projects, generally with a life of 10 years or more.

The majority of the Agency's capital programs are required for future needs. This makes the use of debt appropriate for two reasons: (1) debt financing allows each generation to pay for what it uses and (2) Facility Capacity Fees collected in one year may not be expended until future years. Likewise, in some years, there will not be sufficient Facility Capacity Fees collected to cover that year's debt service.



In 2006, the Agency engaged CDM Consultants to assist with the review and preparation of updated Facility Capacity Fees. In discussions, CDM has stated that it is not unreasonable nor uncommon to include all debt service (principal and interest) in a facility capacity fee calculation. However, it does add risk to an Agency's finances as the revenue stream from development-based activity is not steady. For this reason, some agencies include the interest payments in rate calculations or property taxes, to alleviate some of the risk factor. At this

time, the Agency has sufficient Facility Capacity Fee revenue to continue with the current arrangement; however, this situation should be monitored over time.

Another aspect of the Agency's debt management program is the Agency's relationship with rating agencies and its bond ratings. As discussed in "A Strategic Assessment of the Future of Water Utilities," "Water utilities should . . . examine ways to improve their bond ratings." The Agency may want to consider enhancing its credit rating and marketability of Agency debt to investors to obtain the lowest possible annual debt service.

Debt Financing and Facility Capacity Fees

Appendix B of the FY 2010/11 Budget includes the Agency's COP-funded project forecast, projecting when current COP funds will be exhausted. For the projects that are currently underway, the forecast shows that COP proceeds will be exhausted in early FY 2011/12 and approximately \$70 million will be required to complete those projects. If debt-financed, the annual debt service would be approximately \$4.6 million per year, of which it is estimated that \$2.7 million would be allocated to Facility Capacity Fees and \$1.9 million would be allocated to one percent property tax revenues.

The Agency has typically used debt financing to fund capital improvement projects, but would review its financial situation prior to considering any future debt, to ensure that the Agency can continue to meet reserve and debt coverage requirements. If debt financing is not the best funding source for these projects, the Agency would review grant funding or pay-as-you-go funding. If these sources are not available, the Agency could reduce the scope of or defer the projects.

At this time, Facility Capacity Fee revenues are not sufficient to fund additional debt service. Please see Facility Capacity Fees section for a discussion of this issue.

Debt Financing and One Percent Property Tax Revenues

A more long-term aspect of this issue is the Agency's transition to "build out." Debt service incurred for future users is funded by Facility Capacity Fees and that incurred for existing users is funded by one percent property tax revenues. Through the Agency's history, most of the debt service has been funded by Facility Capacity Fees. The Agency is at a transition point where approximately half of the users are existing users. The debt service funding will transition to existing users. Should one percent property tax revenues not be sufficient to fund increasing debt service, other mechanisms to fund the existing users share would include a component of the wholesale water rate or a parcel charge.

	Current Debt Service	Projected Debt Service for Next Issue
Facility Capacity Fee allocation	80%	58%
One Percent Property Tax allocation	20%	42%

FACILITY CAPACITY FEES (Near-term)

During FY 2008/09, the Agency updated its Facility Capacity Fees, which cover the cost of providing facilities to supply water for new development. That is, Facility Capacity Fees cover those costs that are attributed to future users. The new fees went into effect January 12, 2009. Overall, the fees increased. However, due to the lack of development activity, there has been little revenue associated with the increased fees. Further, even will development increases and revenues increase, the Agency's 10-year forecast projects that Facility Capacity Fee revenues are not sufficient for full funding of reserve requirements or for the issuance of new Certificates of Participation. Reserve funding will be covered by one percent property tax revenues until revenues increase. The issuance of new Certificates of Participation will be deferred until revenues are sufficient to support debt service.

Facility Capacity Fee revenues are always difficult to estimate due to the unpredictable timing of receipts. Collection of this revenue depends heavily on development activity which, in turn, depends on real estate demands, the regional economic situation, land use planning activity, coordination with other projects and other difficult-to-estimate activity. This revenue stream will always demonstrate a "boom or bust" pattern and will always be difficult estimate.

During 2010, the 2008 Data Document will be updated and new Facility Capacity Fees will be recommended for approval to be effective in January 2011. *The new fees must be designed to generate sufficient revenues to fund reserves and the issuance of Certificates of Participation, and be sufficient to cover the volatility of the revenue stream.*

WATER CONSERVATION (Near-term)

The Agency continues to promote conservation and strives to achieve the goal of 10% annual water conservation as identified in the Agency's Urban Water Management Plans. The Agency will aggressively strive to achieve 20% conservation by the year 2020.

During FY 2008/09, the Board of Directors adopted a Water Use Efficiency Strategic Plan (Plan) for the Santa Clarita Valley. The Plan identifies a comprehensive long-term conservation effort for the Valley that meets the regions goal of achieving a ten percent water conservation savings through the adoption of policies and programs designed to promote a long-term water-use ethic. The FY 2010/11 Budget includes \$980,000 in the General Fund/Operating Budget for key initiatives.

The 2009 Strategic Planning retreat identified a need to further review increased investment in a conservation-related capital improvement program, as well as the need to identify a funding source for that program.

Staff will continue to monitor the progress of the Water Use Efficiency Plan. As the plan is implemented and conservation is measured, there may be a need to explore additional conservation efforts. Depending on this review, there may be a need to develop a funding strategy for future conservation efforts.

BUENA VISTA/ROSEDALE RIO BRAVO WATER PROGRAM FUNDING (Near-term)

In 2007, the Agency entered into a 30-year agreement for 11,000 AFY of water known as the Buena Vista/Rosedale-Rio Bravo (BV/RRB) water. This is 100% reliable Kern River water. At the time it was acquired, it was intended to supplement the Agency's SWP supplies, which are committed to users in the Agency's existing service area, by providing water for parties seeking to annex to the service area. The Agency began funding the program with one percent property tax revenues and assumed that annexing parties would reimburse one percent property tax revenues for their share. Since that time, due to the Wanger federal court decision regarding protection of the Delta smelt under the Endangered Species Act, the Agency stopped processing annexations and plans to use the BV/RRB water within the existing service area. Because of this, the Agency should review its funding of this program. It is currently funded by one percent property tax revenues, but the Agency may want to consider including the existing users' share in wholesale water rates and including future users' share in Facility Capacity Fees. If this approach is used, the allocation of costs will change over time, as the Agency approaches build-out. That is, the Agency may reach a point where all of the benefits are received by existing users, and all of the costs will be paid by existing users.

RELIABILITY PROGRAMS (Near-term)

The Agency should review its reliability (banking) programs and determine appropriate funding sources. The Agency currently participates in two short-term programs and one long-term banking program. The two short-term banking programs are the Semitropic banking programs and the long-term program is the Rosedale Rio Bravo program. The funding mechanism for the Semitropic banking programs is a high priority for immediate review.

Semitropic Banking and Exchange Program

In FY 2002/03 and FY 2003/04, the Agency stored water in the Semitropic Water Banking and Exchange Program (Semitropic). The water must be withdrawn by FY 2012/13 and FY 2013/14. The one-time participation fees were paid from bond proceeds. The annual maintenance fees are nominal and are funded by one percent property tax revenues (approximately \$112,000 per year).

During 2009, the Agency withdrew 4,950 AF from the program at an estimated cost of \$595,300, or \$120/AF. Significant costs will be incurred to withdraw the remaining water. In today's dollars, the cost to withdraw the remaining 46,000 AF would be over \$5.5 million.

The Agency should continue to develop funding mechanisms for withdrawal. During FY 2008/09, the Board of Directors approved an increase of \$20/AF to the wholesale water rate and passed the extraction costs through to the purveyors. As withdrawal programs arise, the Agency should review its options and develop the appropriate funding source.

OPERATIONS AND MAINTENANCE (Mid-term)

The Agency's infrastructure is expanding and will continue to expand. The number and complexity of Agency facilities have grown in recent years and will continue to do so. Each major CIP project that becomes operational adds new complexity and costs to the Agency's overall system. As this additional infrastructure is implemented, the Agency will require additional staff resources and will incur additional costs to operate and maintain the infrastructure. This is one of the key issues identified by Ed Means of Redoak Consulting, a Division of Malcolm Pirnie, during his August 2007 presentation to the Board. Recent Agency budgets have added some resources to address the new infrastructure, but this issue should be studied further. The Agency should develop a method to fully understand the impact of the CIP on operating costs. That is, when a project is added to the CIP, its cost is not just the cost of the capital improvement program, but includes the ongoing costs to operate and maintain that project.

A more long-term aspect of this issue is to prepare for the time when the Agency system has been "built out." At this time, the Agency has a fairly new infrastructure with low maintenance costs. The Agency should prepare for increasing maintenance costs and ongoing repair and replacement.

The Agency currently funds operating and maintenance costs through the wholesale water rate, and repair and replacement with one percent property tax revenues. Is this arrangement sufficient for the future? Or should the Agency consider a repair and replacement component to the wholesale water rate?

As discussed in "A Strategic Assessment of the Future of Water Utilities," "Water utilities should formally document infrastructure and rate needs and communicate their needs to stakeholders."

STATE WATER CONTRACT FUND (Mid-term)

The Agency funds the State Water Project (SWP) contract commitment through the ad valorem tax rate. Due to legal restrictions on water exports, the Agency is facing reduced SWP reliability and increased SWP costs. As various parties look to a Delta fix (Bay Delta Conservation Plan [BDCP] and the Delta Habitat Conservation and Conveyance Program [DHCCP]), costs are anticipated to increase significantly. The Agency is incurring significant increases in the Agency-set tax rate, due to increasing costs and due to decreased assessed valuations. It is likely that the tax rate will continue to increase even when assessed valuations increase due to the BDCP and DHCCP.

The Agency will continue to monitor SWP expenditures and strive to provide consistent changes in ad valorem tax rates.

IMPACT OF HEALTH CARE REFORM (Mid-term)

During 2010, federal health care reform legislation was enacted. It is likely this legislation will increase the Agency's health care costs. At this time, the program is too new for an analysis, but the Agency should continue to monitor this program.

STRUCTURE OF WHOLESALE WATER RATE (Long-term)

In August 2009, the Board adopted a rate structure for calendar years 2010, 2011 and 2012 that is designed to recover operating costs. The rates that have been established are as follows: \$420/AF effective January 1, 2010, \$478/AF effective January 1, 2011 and \$507/AF effective January 1, 2012. Beginning in July 2010 and thereafter, a portion of the wholesale water rate totaling \$20/AF is designated for operating reserves.

In the future, the Board of Directors may consider including additional components to the wholesale water rate.

The Agency currently uses a "postage stamp" rate – that is, one unit rate for every acre foot of water. This is derived by dividing total operating expenses by estimated acre feet of water to be sold. While the majority of costs are fixed, all revenues are variable. In the future, the Agency may want to consider different means of establishing a wholesale water rate, depending on the desired objectives. An example could be to include half of capital expenses in wholesale water rates.

As discussed in "A Strategic Assessment of the Future of Water Utilities," "Water utilities should consider better matching their high fixed costs as a fixed component of rates to reduce sales volume risk."

Other ideas for wholesale water rate design include:

- ◆ Shift costs from the variable rates to more stable, fixed charges, such as standby charges, system access or readiness-to-serve charges.
- ◆ Use a Rate Stabilization Fund designed to capture excess revenues in high water sales years, to be available for low water sales years. An example target funding level could be equivalent to the financial loss resulting from two years of above average rainfall.
- ◆ Create a General Fund/Operating Budget reserve fund.
- ◆ Divide the rate into a series of components, such as:
 - Readiness-to-serve
 - Water supply (could include O&M)
 - Capacity
 - Customer service or administrative
 - Water supply reliability
 - Security
 - Water Quality

RECYCLED WATER (Long-term)

The Agency's draft Recycled Water Master plans calls for a target capacity of 17,400 AFY of recycled water. In order to achieve this, recycled water will have to be deployed in areas that are currently developed. To connect existing users to a recycled water system is expensive. But if this financial constraint is not addressed, the Agency may not be able to achieve the goal of 17,400 AFY.

In regards to operating costs, the draft Recycled Water Master plan states that "... to encourage its use, recycled water should be available at a lower rate to users than potable water." Based on this, the Agency adopted a rate in 2002 that set the rate at 80% of the retail rates for potable water. At this time, the Valencia Water Company pays \$408/AF for recycled water as compared to \$420/AF for potable water.

These funding mechanisms may need further review.

Fiscal Year	AF Sold	Rate/AF	Revenue
FY 2003/04	259	\$ 316	\$ 83,774
FY 2004/05	418	\$ 331	\$ 138,432
FY 2005/06	406	\$ 328	\$ 133,364
FY 2006/07	380	\$ 327	\$ 124,263
FY 2007/08	437	\$ 366	\$ 159,987
FY 2008/09	296	\$ 386	\$ 114,116
FY 2009/10	330	\$ 408	\$ 134,600
FY 2010/11	300	\$ 464	\$ 139,200

ENERGY COSTS (Long-term)

As discussed by Ed Means during his August 2007 presentation to the Board, upcoming financial constraints include energy volatility. The total cost of water table included earlier in this plan shows that over 20% of the total cost of water is for energy. The Agency should be aware of the significance of these costs and review energy saving techniques where appropriate.

As discussed in "A Strategic Assessment of the Future of Water Utilities:"

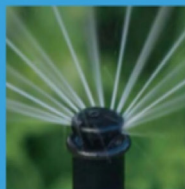
- ◆ "The price of energy will trend higher, and with increased instability. It will be difficult for water agencies to predict energy prices accurately and to pass the additional costs through to consumers effectively."
- ◆ "Energy shortages may occur with increased frequency. Water systems will need increased capability to switch to alternate supplies during more frequent shortages."
- ◆ "Energy use is, and will remain, a large component of the cost of water. Higher costs will increase the need to focus on energy efficiency."
- ◆ "Consideration should be placed on energy costs as a pass-through cost in rates."

SECURITY (Long-term)

The Environmental Protection Agency (EPA) states that improving the security of our nation's drinking water and wastewater infrastructures has become a top priority since the events of 9/11. The EPA requires water agencies to engage in a number of security programs. In 2003, the Agency prepared an EPA-mandated risk assessment, or a Vulnerability Assessment. As a result, the Agency is implementing security improvements using a phased approach. As new facilities are constructed, the security system will become more complex and more challenging to operate, which will result in increased operating and maintenance costs. At this time, the Agency spends an extremely small portion of its operating and capital improvement budgets on security measures. It is likely that the financial impact of security will increase over time. This will increase operating and capital improvement program costs.

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Spanish Language Outreach – Bus Shelter
As part of the Agency’s Spanish public outreach, a bus shelter ad with water saving tips was posted in a predominately Spanish-speaking part of the Santa Clarita Valley.