STAFF REPORT

CITY COUNCIL of the CITY of SAUSALITO

AGENDA TITLE

Discussion and Direction Regarding Sanitary Sewer Fee Study Summary of Draft Findings dated March 16, 2009

RECOMMENDED MOTION

Direct Staff to Notice Sewer Customers Regarding Public Rate Hearing and Prepare Relevant Documents in Conformance with State Law (Proposition 218) with a Target Date for Adoption of New Rates on or before June 23, 2009

SUMMARY:

The City of Sausalito owns and operates sewers conveying wastewater to the Sausalito Marin-City Sanitary District (SMCSD) for treatment and discharge to the Bay. The rates charged by the City for that service are based on a financial plan prepared in 2003, with rates enacted through 2008. The rates are collected citywide from parcel owners billed by the County Assessor's Office on Property Tax Rolls. SMCSD charges are separate, but also on same property tax bill).

The City retained CDM to prepare a Sanitary Sewer Fee Study for the City of Sausalito. The overall goal was to identify equitable sewer charges for the 3,000 accounts in support of sustainable utility services. The attached Summary of Draft Findings takes into account the facts that:

- City sewers are operating under an USEPA Administrative Order due to recent spills.
- Sewer system management is regulated by State Water Discharge Requirements (WDRs) mandating pipeline cleaning and repair.
- SMCSD fees are likely to continue to be increased as well.

The updated fees must be compliant with state law, and must be sufficient to fund programs mandated by these new state regulations and with USEPA orders. As such, the Department of Public Works has provided CDM with an updated capital improvement program based on the results of both EPA Order gathered and routine capital improvement planning, as well as a significant expansion in the historical level of sewer maintenance and repair. Preliminary financial plan findings made by CDM on the basis of Staff projections and including a range of alternatives were discussed with the City's Sustainability Commission on February 5, 2009 and Finance Committee on Monday March 16, 2009. The draft study conclusions include:

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The Department of Public Works has recommended that the O&M expenditures be increased steadily from $880,000 this year (FY 2008-09) to $1.6 million per year in five years (FY 2013-14). In addition, rolling stock purchases of $445,000 are needed immediately.

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Based on proposed project costs of $7.6 million in the "Priority Sewer Project Estimate of Probable Conceptual Costs," annual project expenditures should be increased from the $444,000 to at least $1.1 million per year to reduce the backlog of critical facility rehabilitation projects. At this rate, roughly half of the projects will be completed by the end of FY 2013-14.

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Sewer system operating revenues from rates and charges must be sufficient to cover all operating expenses. As such, the sewer fee revenues must be increased by at least 45 percent for the FY 2009-10 operations and maintenance (O&M) costs.

The current City fees of $215 per year have been unchanged for two years. In order to place a fee in the FY 2009-10 property tax rolls, the City must enact updated rates by mid-June for submission to the Assessor's office by mid-July.

ISSUES

Scheduling issues are summarized in the attachment and above – in order to implement any rate change, proper notice, required hearings, and Council action to adopt new rates must be complete by early July in order to make the next set of property tax bills. Coordination with SMCSD rates has been identified as an issue – while the SMCSD has recently adopted a 30% increase, it seems likely based on their environmental compliance circumstances that additional increases to Sausalito rate-payers will be forthcoming over the next few years. "Lifeline" issues for fixed income and disadvantaged rate-payers is a concern – Staff has identified conceptual alternatives for accommodating such an element into proposed rates and can work with CDM to finalize such details if so directed.

In conformance with the California Code of Regulations, TITLE 14. NATURAL RESOURCES, DIVISION 6. RESOURCES AGENCY. CHAPTER 3. GUIDELINES FOR IMPLEMENTATION OF THE CALIFORNIA ENVIRONMENTAL QUALITY ACT, ARTICLE 18. STATUTORY EXEMPTIONS, § 15273. Rates, Tolls, Fares, and Charges, (a): "CEQA does not apply to the establishment, modification, structuring, restructuring, or approval of rates, tolls, fares, and other charges by public agencies which the public agency finds are for the purpose of:

(1) Meeting operating expenses, including employee wage rates and fringe benefits,
(2) Purchasing or leasing supplies, equipment, or materials,
(3)Meeting financial reserve needs and requirements,
(4) Obtaining funds for capital projects, necessary to maintain service within existing service areas, or

(5) Obtaining funds necessary to maintain such intra-city transfers as are authorized by city charter.

...

(c) The public agency shall incorporate written findings in the record of any proceeding in which an exemption under this section is claimed setting forth with specificity the basis for the claim of exemption."

FISCAL IMPACT

No additional fiscal impacts other than those discussed in the summary are anticipated.

STAFF RECOMMENDATION

Direct Staff to Notice Sewer Customers Regarding Public Rate Hearing and Prepare Relevant Documents in Conformance with State Law (Proposition 218) with a Target Date for Adoption of New Rates on or before June 23, 2009

ATTACHMENTS

City of Sausalito, Sanitary Sewer Fee Study Summary of Draft Findings, March 16, 2009

PREPARED BY:

Jonathon Goldman
Director of Public Works

REVIEWED BY:

Mary Anne Wagner, Esq.
City Attorney

SUBMITTED BY:

Adam W. Politzer
City Manager

CDM

City of Sausalito
Sanitary Sewer Fee Study Summary of Draft Findings
March 16, 2009

The City of Sausalito owns and operates sewers conveying wastewater to the Sausalito Marine-City Sanitary District (SMCSD) for treatment and discharge to bay waters. This summary describes the preliminary results of a Sanitary Sewer Fee Study for the City of Sausalito. The overall goal of the study is to identify equitable sewer charges for the 3,000 accounts in support of sustainable utility services. The last financial plan was prepared in 2003, with rates enacted through 2008.

The City sewers are operating under an USEPA Administrative Order due to recent spills. Sewer system management is regulated by State Water Discharge Requirements (WDRs) mandating pipeline cleaning and repair. The updated fees must be compliant with state law, and must be sufficient to fund programs mandated by these new state regulations and with USEPA orders. As such, the Department of Public Works is planning a significant expansion in the historical level of sewer maintenance and repair.

The City bills property owners through their parcel tax bills for the sewer system costs. The charges from SMCSD also appear on these bills, but as a separate line item. The current City fees of $215 per year have been unchanged for two years. In order to place a fee in the FY 2009-10 property tax rolls, the City must enact updated rates by mid-June for submission to the Assessor's office by mid-July.

Summary of Findings and Recommendations

The preliminary financial plan findings were discussed with the City's Sustainability Commission on February 5, 2009. The draft study conclusions include:

- The Department of Public Works has recommended that the O&M expenditures be increased steadily from $880,000 this year (FY 2008-09) to $1.6 million per year in five years (FY 2013-14). In addition, rolling stock purchases of $445,000 are needed immediately.

- Based on proposed project costs of $7.6 million in the "Priority Sewer Project Estimate of Probable Conceptual Costs," annual project expenditures should be increased from the $444,000 to at least $1.1 million per year to reduce the backlog of critical facility rehabilitation projects. At this rate, roughly half of the projects will be completed by the end of FY 2013-14.

- Sewer system operating revenues from rates and charges must be sufficient to cover all operating expenses. As such, the sewer fee revenues must be increased by at least **45 percent for the FY 2009-10 operations and maintenance (O&M) costs.**

6D
5

- Annual capital project expenditures of approximately $1 million per year will deplete the sewer fund within three years, so a State Revolving Fund (SRF) loan of at least $3.3 million is recommended. In order to receive this loan, **a 16 percent rate increase is needed in FY 2011-12 and 4 percent in the following year** to satisfy a SRF loan service coverage ratio of 1.10. Finally, an **11 percent rate increase is needed in FY 2013-14** for adequate reserves and revenue goals within the sewer enterprise fund.

- Under this plan at the end of FY 2013-14, $3.2 million of the $7.6 million in projects identified in the "Priority Sewer Project Estimate of Probable Conceptual Costs" will not have been funded or started. As such, additional SRF loan or grants will be required along, with more rate increases starting in FY 2014-15. If all projects must be completed by FY 2014-15, the recommended rates must be increased further, funding from SRF loans and grants received, and City staffing increased for project contract administration, inspection and management.

- California Article XIII C & D requires that sewer utility rates be fair and equitable, and that the rate-based revenues from each customer class be proportional to the City's cost of service to that class. Based on our analysis, to achieve cost of service equity the single-family dwelling parcel charges must be increased by 25 percent (on top of the revenue requirements), and multi-family and non-residential fees reduced.

- The result of the projected rate-based revenue requirements and cost of service equity adjustment will increases single-family dwelling resident parcel rates from the current $215 per year to $391 effective July 1, 2009, an 82 percent increase. In order to reduce the level of this rate shock, we recommend that the increase be spread over two years, or $355 effective July 1, 2009 and $429 effective July 1, 2010. In the following three years, the increases to revenues described above will further boost the fee to $523.

- To increase the cost of service equity for the 207 non-residential discharges in the City, a commercial customer rate structure refinement is also proposed. The refinement will also improve the billing administration and stabilize the annual bills to those customers, much like the residential customer classes. The refinement sets the largest portion of the fee to each non-residential parcel to their allocated capacity in the sewer system. This capacity is based on historical sewage discharge of each of the 207 accounts.

Rate Study Objectives

In developing fees for the City, five municipal utility financial planning objectives are the basis of the proposed fees. The five objectives are:

- **Revenue Sufficiency.** Rate-based revenues effective in funding the costs of services.

6D
6

- **Practical.** Easy and feasible for the City to implement and administer.
- **Equitable.** Fair in apportioning the costs of service among the different customer classes.
- **Acceptable to the Community.** Understandable and designed to foster public acceptance.
- **Compliant with Applicable Regulations.** Meets the calculation requirements of regulatory agencies and applicable City and State laws.

The first objective requires that user charges be designed such that the revenues will produce the cash required to sustain the utility by meeting debt service requirements and maintaining adequate reserves. The second objective requires that the new rates do not create an administrative burden to calculate. The third objective requires that the user charges result in each customer paying that portion of the revenue requirements (the City's costs) for which they are responsible. The fourth objective requires that the utility's customers can easily understand the user charges. The fifth objective requires that applicable laws, regulations and court case findings be correctly applied to the proposed user charge structure.

Rate-based Revenue Requirements

The City operates the wastewater service utility in a self-supporting enterprise fund from user charges. Annual rate-based revenue requirements to cover the wastewater utility costs are projected from operating and maintenance (O&M) expenses, project capital expenditures, debt service for financing capital improvements (if any), less interest and other operating and non-operating revenues. At a minimum, the rate-based revenues must cover all operating expenses and provide sufficient net operating revenues for any debt service coverage ratio covenants.

O&M expenditures are escalating from $880,000 this year (FY 2008-09) to $1.6 million per year in five years (FY 2013-14). In addition, project expenditures are climbing from the current $444,000 to $1.1 million per year for the projected future. This year the net operating revenues before project expenditures or depreciation is essentially zero, and within two years will be negative $500,000 per year. However, operating revenues must be minimally sufficient to cover operating expenses. As such, the sewer fee revenues must be increased by at least 45 percent immediately for FY 2009-10 O&M costs.

The Sewer Enterprise fund has $3 million in cash reserves, with $2 million available for project expenditures. With at least $5 million in project funding requirements over the next five years, the City should seek a low interest rate loan from the State Revolving Fund (SRF). In order to receive a SRF loan of $3.3 million, In order to receive this loan, a 16 percent rate increase is needed in FY 2011-12 and 4 percent in the following year to satisfy a SRF loan

service coverage ratio of 1.10. Finally, an 11 percent rate increase is needed in FY 2013-14 for adequate reserves and revenue goals within the sewer enterprise fund.

Projected Revenues, Expenditures and Fund Balances

The projected changes in revenues, expenses, and reserves resulting from this increase in revenues are shown in **Figure ES-1** below; the sources and uses of funds table supporting the figure is provided at the end of this memo.

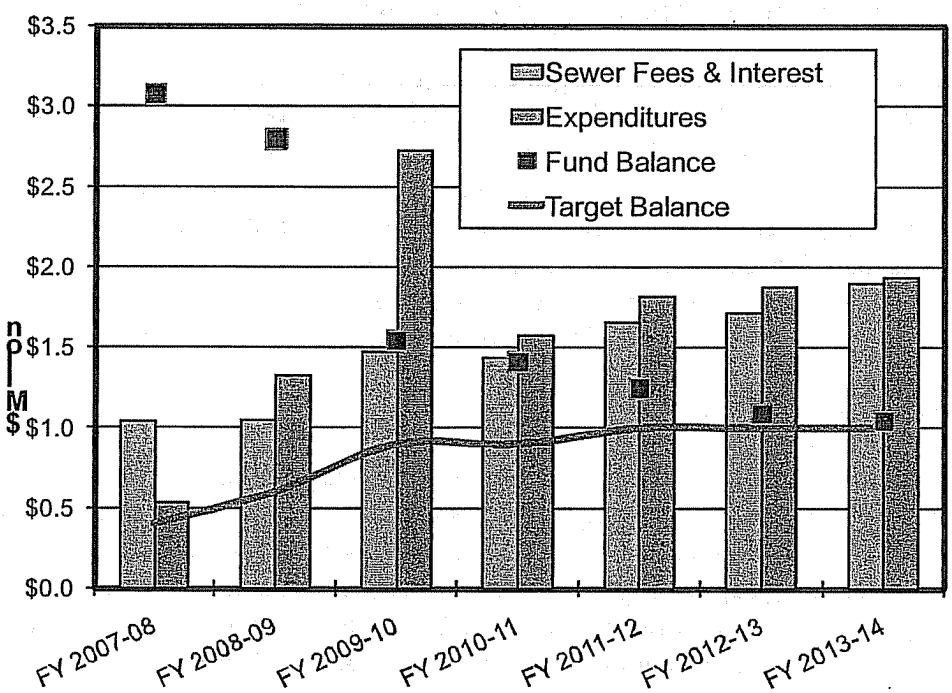

Figure ES-1. Projected Revenues and Expenditures

Alternative Schedule of Rate Increases

While the projected increase is severe, no viable alternative was identified, although two alternatives to the proposed rates were evaluated. Specifically:

- **Alternative 1: Uniform Rate Increases.** Since the 94 percent rate increase in the first year may cause rate shock to some residential customers, the effect of spreading the 45 percent portion of the increase for revenue requirements over several years was considered. The result was a 19 percent increase for revenues over the next three years, followed by a 10.5 percent increase in the last five years. The results are:

6D
8

- Due to the slower initial pace of rate increases, the total increase over five years would be 106 percent rather than the 94 percent described above.

- In the first 2 years net operating revenues would be negative, and in violation of State revenue plan guidelines and the WDRs. It is possible the SRF loan would not be available until the net operating revenue was positive, which may result in the City losing the current opportunity to receive some of the Federal stimulus package infrastructure funds being distributed to States through the SRF programs.

- **Alternative 2: Historical Rate Increases.** The total projected increase in annual revenues over the next five years is 94 percent. In contrast, over the last five years the increase in revenues was 54 percent. If the historical annual 9 percent rate of sewer service charge increases were continued, the City would be unable to qualify for the proposed SRF loan, and would have to use existing cash for the proposed capital project expenditures. These expenditures would be limited to $500,000 only in FY 2009-10, and $7 million in required sewer system rehabilitation projects would not be completed.

Customer Cost of Service Equity and Billing Practices

California Article XIII C & D (Proposition 218) requires that sewer utility rates be fair and equitable, that the rate-based-revenues from each customer class be proportional to the City's cost of service to that class, and that the customers be informed of any changes in their rates. Based on our analysis, the current City practice of fixed residential charges is consistent with state and nationwide standards, and can remain unchanged. Moreover, the practice of billing the charges on the annual County Assessor's Office tax rolls is also consistent with normal practice, is administratively convenient, and should be continued.

However, the single-family dwelling parcel charges are currently lower than is equitable, in comparison with the other classes. To achieve cost of service equity, these charges must be increased by 25 percent, on top of the revenue requirement-based changes. In contrast, Multi-family fees must be reduced slightly, and non-residential revenues are 9 percent higher that equitable under the current rates.

The result of the projected rate-based revenue requirements and cost of service equity adjustment will increases single-family dwelling resident parcel rates from the current $215 per year to $391 effective July 1, 2009, an 82 percent increase. In order to reduce the level of this rate shock, we recommend that the increase be spread over two years, or $355 effective July 1, 2009 and $429 effective July 1, 2010.

Commercial Account Sewer Service Rate Structure Update

The current billing method for commercial wastewater customers consists of a fixed annual customer service fee of $167 per parcel and a variable rate of $2.03 per hundred cubic feet (Hcf) of prior year water demand. We propose that the charges be updated based on their historical maximum water demands, rather than the current allocation based on the prior year's actual water use.

Proposed Rates and Alternative Commercial Charge

Based on the draft assumptions, findings and conclusions, the proposed rates for the next five years are shown below in Table ES-1. The proposed rates use the refined non-residential rate structure using historical maximum water usage values for each account to determine the allocated capacity charges.

Description	No. of Accounts	Current FY 2008-09	Projected FY 2009-10	FY 2010-11	FY 2011-12	FY 2011-12	FY 2012-13
Change in Rate-based Revenues			45%	0%	16%	4%	11%
Rates for Residential Dischargers ($/year-dwelling unit, with changes for equity)							
Single-family Dwelling	1,258	$215	$355	$429	$453	$471	$523
Single Family Attached	832	$167	$260	$260	$301	$313	$348
Multi-family Residential	1,960	$167	$193	$193	$224	$233	$259
Commercial Rates for Non-Residential Dischargers (Based on Historic Maximum Water Use)							
Account Charge ($/yr-parcel)	207	$167	$242	$242	$281	$292	$324
Water Use Rate ($/Ccf, b)		$2.03	$1.94	$1.94	$2.25	$2.34	$2.60

Table ES-1. Proposed Rates

Survey of Local Sewer Service Charges

A survey of single-family dwelling charges was prepared, comparing the combined costs of collection and treatment both current and proposed for Sausalito residents with other local communities. While these surveys are popular, they are rarely informative, as the local fees will vary widely due to the following issues:

- Local terrain (both hills and earth types);
- Housing density (length of pipe between sewer connections);

6D
10

- Other funding sources (many special districts receive property taxes to offset fees);
- Level of service provided (frequency of pipe cleaning, speed of emergency response);
- Level of on-going capital program spending;
- Efficiency, competence and experience of staff;
- Fund reserves accumulated for capital projects.

		Equivalent Monthly Charge for Single-family Dwellings			Equivalent Annual Charge for Single-family Dwellings		
Agency (Regional Treatment Authority)	Effective Date	Treatment	Conveyance	Total	Treatment	Conveyance	Total
Tiberon/Belvedere	Unknown			$95			$1,139
2010 Sausalito (SMCSD)	Jul-10	**$50**	**$30**	**$80**	**$600**	**$355**	**$955**
Marin City (SMCSD)	SMCSD Increase			$66			$791
Current Sausalito (SMCSD)	Aug-08	**$32**	**$18**	**$50**	**$388**	**$215**	**$603**
City of Larkspur	Jul-09			$46			$552
Ross Valley (Sanitary District No. 1 of Marin County (CMSA, a)	Jul-08			$40			$480
San Rafael SD (CMSA)	Jul-07			$40			$474
Marin City (SMCSD)	Jul-08			$37			$439
Marin SD #2 (Corte Madera, CMSA)	Jul-08			$36			$436
Mill Valley (SASM)	Aug-07			$25			$297

a. The District receives ~30 percent of its revenues from property tax appropriations.
SMCSD is increasing its treatment rates from $388 to $600 per single family dwelling in 2010.

Table ES-2. Rate Survey

Remaining Steps for Sewer Service Fee Enactment

Parcel can be charged for sewer services only after new fees are enacted by City Council. The enactment of the new multi-year rate structure would fulfill this requirement. The remaining process culminating in the enactment of sewer service charges by the City Council is:

1. The Council must authorize City Staff to mail a public rate hearing notification of proposed fees to all sewer customers, in compliance with state law (aka Proposition 218), and must make available for the customers their proposed bills and this report;

2. The Council must hold a public hearing on the proposed fees at least 45 days after the notification and, absent significant protest, conduct the first reading of proposed rates;

6D
11

3. The Council must enact the proposed rates at a following City Council meeting, but no later than the last Council Meeting of June 2009.

4. The County Assessor's Office must receive by mid-July 2009 a list of sewer service charges to individual parcels, based on the rate structure approved by the City Council.