

Montara Water & Sanitary District



Water Capacity Charge Workshop

July 6, 2017



BARTLE WELLS ASSOCIATES
INDEPENDENT PUBLIC FINANCE ADVISORS



Montara Water
and Sanitary District

Presentation Overview

- **Water Capacity Charge Update**
 - *Brief Review of Background and Draft Recommendations*
- **Principles & Issues**
- **Questions & Concerns**
- **Alternative Approaches**



Goal: Review draft recommendations, address questions, identify potential alternatives

Water Capacity Charge Update



Background

- ▶ **Water capacity charges have not been recalculated since 2011**
- ▶ **Since 2011, the water system has undergone a number of changes**
 - District completed a number of capital improvements to improve system reliability
 - Identified new sources of water supply
 - District customers successfully reduced water use in response to drought
 - Acquired the Pillar Ridge water system and customer base
 - New growth limit set at 1% by Local Coastal Program (LCP)
 - District's Public Works Plan approved by the Coastal Commission in 2013



Current Capacity Charges

- ▶ Current fees based on *Water Capacity Charge Study, April 2011* by BWA
- ▶ In 2011, SRT updated the Water System Master Plan and associated Capital Improvement Program (CIP)
- ▶ CIP allocated costs to existing customers and growth
 - Identified cost of improvements benefitting approximately the next 621 equivalent connections
 - Project costs excluded cost recovery for facilities funded by GO Bonds
 - Projects costs allocated to growth = \$8.81 million
- ▶ Capacity Charge = $\$8.81\text{M} / 621 = \$14,187$ per new 5/8" meter or equivalent
 - Connection fees adjusted annually based on Engineering News-Record Construction Cost Index (SF Bay Area)
 - Current Capacity Charge for a 5/8" x 3/4" Meter = \$15,729
- ▶ Revenues deposited into separate fund & used exclusively for eligible projects



Legal Requirements

- ▶ Development impact fees are governed by California Government Code Section 66000 *et. seq.*, (AB1600, enacted 1987 and amended 4 times including addition of Section 66013 in 1990)
- ▶ Section 66013 governs water & sewer capacity charges
 - Charge “shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed” (Unless obtain 2/3 voter approval)
 - Capacity charge can recover costs for:
 - “public facilities in existence at the time a charge is imposed”
 - “new facilities to be acquired or constructed in the future that are of proportional benefit to the person or property being charged”
 - “supply or capacity contracts for rights or entitlements, real property interests, and entitlements or other rights involving capital expenses”
- ▶ Code does not detail any specific method for fee calculation; a variety of methods may be used to determine an appropriate charge

Master Plan Update

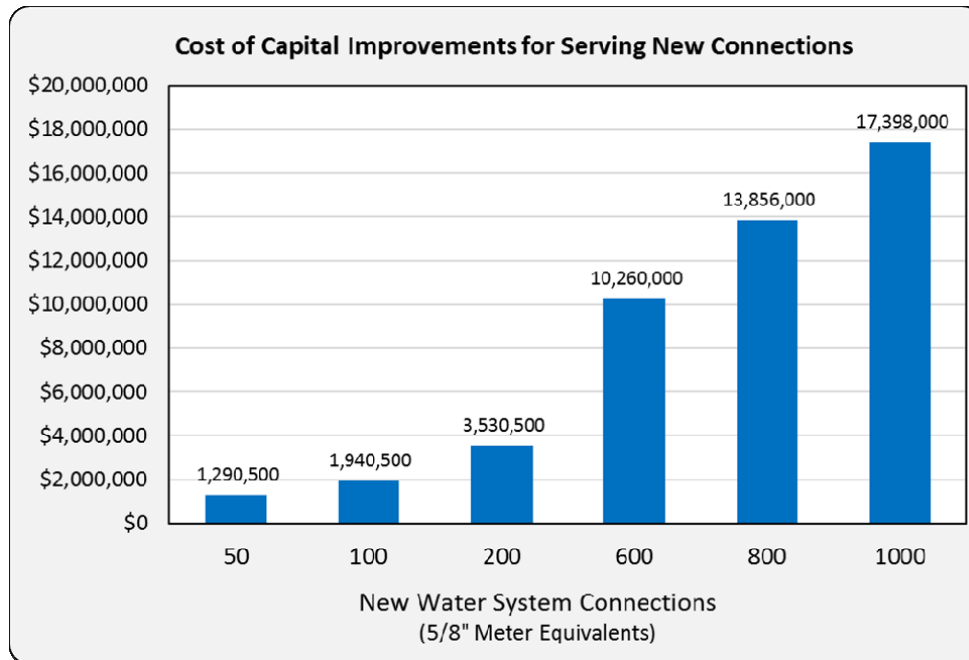
- ▶ **SRT developed 2017 Water System Master Plan Update**
 - Separate CIPs developed for a) existing customers and b) new customers
- ▶ **New Customer CIP identifies projects allocated to growth**
 - Projects needed to meet capacity needs of new development
- ▶ **SRT updated water system hydraulic model as part of process**
 - Hydraulic model used to identify system capacity deficiencies
- ▶ **SRT used hydraulic model to identify capital improvements needed to serve future increments of growth**

Capital Improvements for Growth

Water System Capital Improvements Required for Serving Different Levels of Growth			
Growth Scenario	New Connections (5/8" Meter Equivalents)	Estimated Population Growth	Estimated Cost of Improvements to Serve New Connections
Scenario 1	50	3%	\$1,290,500
Scenario 2	100	6%	\$1,940,500
Scenario 3	200	12%	\$3,530,500
Scenario 4	600	35%	\$10,260,000
Scenario 5	800	47%	\$13,856,000
Scenario 6	1000	59%	\$17,398,000

Source: SRT Consultants, April 24, 2017.

Capital Improvements for Growth



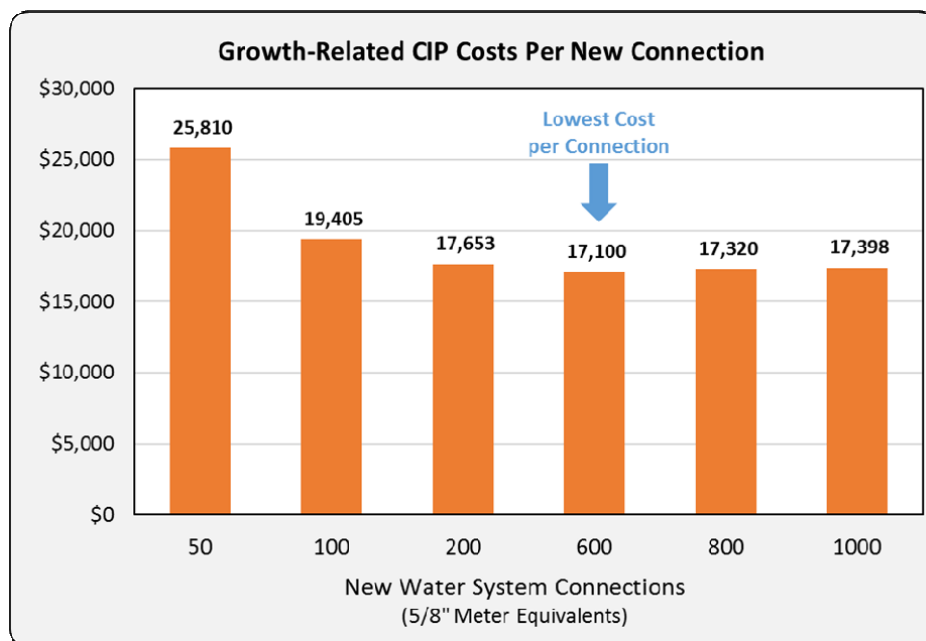
Capacity Charge Update

- ▶ **Incremental Cost Approach**
 - Costs of improvements needed to serve growth / corresponding # of new connections
 - Similar methodology to 2011 fee calculation, simple & straightforward approach
 - Forward looking approach, growth pays its own way
- ▶ **Excludes cost recovery for any facilities previously funded by District's General Obligation Bonds to ensure no double-counting**
- ▶ **Excludes cost recovery for capital improvements and assets funded by prior or existing ratepayers**
 - Even though some of these improvements may provide benefit to new connections, such as via improved system reliability
- ▶ **Recovers costs based on the incremental demand placed on the water system by new connections**
 - Same charge applies whether the connection is from new construction, redevelopment, or well-conversions

Incremental Cost per Connection

Growth-Related CIP Cost per New Connection			
Growth Scenario	Estimated Cost of Improvements to Serve New Connections	New Connections (5/8" Meter Equivalents)	Cost per New Connection (5/8" Meter Equivalent)
Scenario 1	\$1,290,500	50	\$25,810
Scenario 2	\$1,940,500	100	\$19,405
Scenario 3	\$3,530,500	200	\$17,653
Scenario 4	\$10,260,000	600	\$17,100
Scenario 5	\$13,856,000	800	\$17,320
Scenario 6	\$17,398,000	1000	\$17,398

Incremental Cost per Connection



Capacity Charge per Meter Size

Updated Water Capacity Charges		
Meter Size	Ratio to 5/8 x 3/4"	Capacity Charge
5/8 x 3/4-inch	1.00	\$17,100
3/4-inch	1.10	18,810
1-inch	1.40	23,939
1-1/2 inch	1.80	30,783
2-inch	2.90	49,589
3-inch	11.00	188,095
4-inch	14.00	239,395

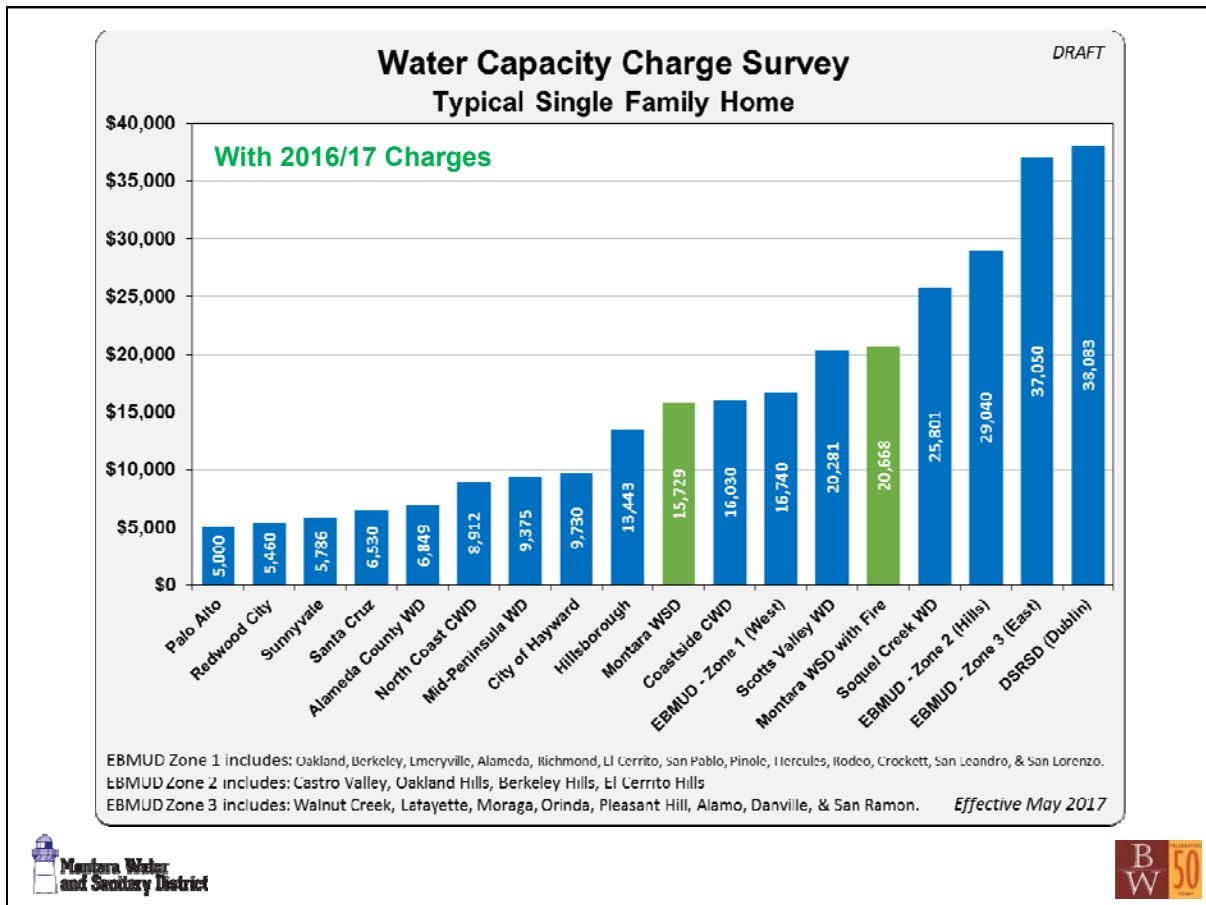
Charges for connections for meters larger than 4-inch will be determined by the General Manager based on estimated water demand.

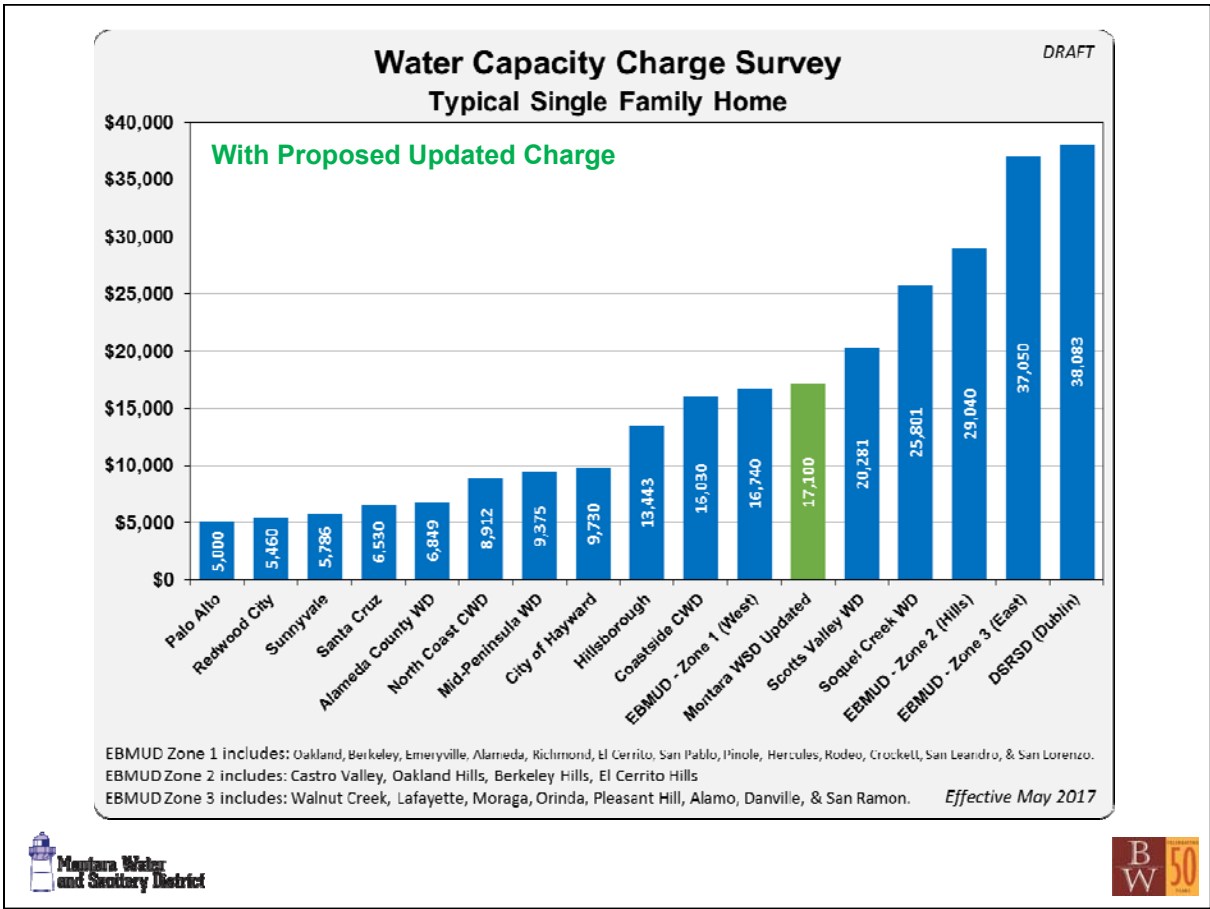
Current vs. Updated Charges

Comparison of Current & Updated Water Capacity Charges				
Meter Size	Current	Updated	Increase \$	Increase %
5/8 x 3/4-inch*	\$16,262	\$17,100	\$838	5.2%
3/4-inch	17,889	18,810	921	5.1%
1-inch	22,766	23,939	1,173	5.2%
1-1/2 inch	29,275	30,783	1,508	5.2%
2-inch	47,159	49,589	2,430	5.2%
3-inch	178,879	188,095	9,216	5.2%
4-inch	227,666	239,395	11,729	5.2%

Updated Charges

- ▶ Updated charges based on cost of infrastructure improvements needed to serve new demands
 - Updated charges would apply consistently to new connections based on demand; same charges apply to new construction, redevelopment, or well-conversions
- ▶ New customers can connect before the growth-related improvements are constructed
 - This does not negate the need for the capacity charge
 - Improvements would still subsequently need to be completed to increase capacity and reliability to adequately serve new water demands
- ▶ Current and updated charges are in upper-middle range compared to other Bay Area agencies





Multi-Year Fee Payment Program

- ▶ Program adopted to help existing homes served by private wells
- ▶ Eligible costs include all fees due to District as part of connection process
 - Mainline extensions not eligible; must be paid in full, up front
- ▶ Multi-year payment program:
 - Term of repayment: Up to 10 years (customer's choice)
 - Interest rate: 2%, waived for conversions through Dec 31, 2017
 - Customer can opt to any amount up to 100% of eligible fees
 - Customer can pay the balance without penalty anytime
- ▶ Fees are collected on the property tax rolls subject to an Agreement between District and each participant
- ▶ Balance due upon a) property sale, b) title transfer (excluding transfer for financing)



Issues & Alternatives



Principles & Issues

- ▶ **Growth should pay its own way**
 - Growth shouldn't subsidize ratepayers
 - And ratepayers shouldn't subsidize growth
- ▶ **Capacity charges vs. rates, balance between revenue sources**
 - Lower capacity charges = more funding requirement from rates, and vice versa
- ▶ **Different perspectives on what is fair and equitable**
 - Primary principal is that the charges should correspond to the cost of improvements providing capacity for new development
- ▶ **Charges should exclude cost-recovery for facilities funded by GO Bonds to avoid double-counting**
- ▶ **Capacity charge should be proportional to new demand placed on the system**
 - Well conversions and development of vacant land both place new demand on system
 - Capacity charge should be consistent, regardless of source of new demand



Questions & Concerns

► Are draft capacity charge recommendations legal?

- Yes, confirmed and documented by District's legal counsel
- Concern expressed that recommended charge may not be legal because new facilities required to serve growth may also provide some benefit for existing customers
 - Capacity charges are a different situation than the SAM expansion assessments invalidated by Superior Court
 - SAM assessments deemed invalid because capacity improvements would have benefitted existing users whose properties were excluded from the assessments, thereby getting a "free ride" paid by the assessed properties
 - In this case there is no "free ride" since existing customers do not need capacity provided by expansion projects, existing customers already funded their own capacity needs
- There would be no need for new customer expansion projects if there was no increase in water demand, projects are required exclusively to serve new demand
- Capacity charges are paid in conjunction with voluntary decision to develop property; are inherently different than voted assessments



Questions & Concerns

► Do capital improvements needed to serve growth also benefit existing customers? If so, should new connections only have to pay a portion of costs for "new customer" improvements with ratepayer funding the rest?

- E.g. A pipeline upsizing to meet capacity needs for growth also includes replacement of an older pipeline (should costs be split between ratepayers and new connection?)
- Answer: No, upsizing triggered by new demand, pipelines being upsized have lots of useful life and would not be replaced using current limited ratepayer funds
- Expansion projects are needed exclusively to serve new demand

Questions & Concerns

- ▶ **Should capacity charges be reduced to give new connections credit for the improved economies of scale they provide?**
 - Revenues from new ratepayers exceed the marginal cost of providing service (some costs are fixed costs that do not increase with more customers)
 - New connections are the biggest beneficiaries of economies of scale as they are joining a greater number of existing ratepayers
 - Giving a fee credit to new connections shifts burden to ratepayers
 - Economies of scale should benefit everyone proportionately...not just new connections
- ▶ **Can well owners be given a break and allowed to pay a reduced fee?**
 - Not recommended, unless there is some defensible, cost-based rationale
 - Capacity charges applied in proportion to new demand placed on the water system
 - Demand from well conversions is no different than demand from new construction
 - Capacity charge should be consistent, regardless of source of new demand

Questions & Concerns

- ▶ **Should properties that pay GO Bonds not have to pay capacity charges?**
 - No, GO Bonds funded acquisition and initial critical improvements to a deficient water system that did not receive prudent reinvestment & maintenance from prior owners
 - Substantial additional improvements required to serve existing customers and growth
- ▶ **Did existing customers have to double pay for the water system?**
 - Prior/existing customers funded rate of return profit to Citizens/CalAm in lieu of a buy-in for facilities
 - Property owners, including existing customers, also paid for water system acquisition via GO bonds
- ▶ **Would a lower charge lead to lots of additional connections?**
 - Not likely, capacity charge is only a small share of costs for developing a new home
 - Might provide a little additional incentive well owners to connect, but other cost barriers exist and District has already adopted a multi-year fee payment program

General Fee Methodologies

► Buy-In Cost Approach (Not Recommended)

- For systems largely built out AND without need for significant improvements for growth
- Capacity charge based on cost of buying in for a share of capacity in existing facilities
- Some facilities already funded by GO Bonds
- Approach excludes cost recovery for improvements needed to serve growth

► Average Cost Approach (Not Recommended)

- Total cost / total capacity
- Cost of existing facilities + upgrades / future service capacity with upgrades
- Results in a lower fee than under the recommended incremental approach
- Requires existing customers to shoulder a share of improvements for growth
- *Existing ratepayers have already helped pay for system twice (as prior customers and via GO Bond payments issued for system acquisition)*

General Fee Methodologies

► Incremental Cost Approach (Recommended)

- Forward looking: recovers cost for upgrades needed to serve next increment of growth
- Similar methodology to 2011 fee calculation, simple & straightforward approach
- Vetted by legal counsel
- Excludes cost recovery for any facilities previously funded by GO Bonds
- Excludes cost recovery for improvements & assets funded by existing ratepayers

► Buy-In + Incremental Cost Approach (Not Recommended)

- New connections fund 100% of future facilities needed to serve growth + reimburse existing customers for share of improvements funded by ratepayers that benefit growth
- Cost of facilities identified for reimbursement should be adjusted to account for any debt financing (add in interest paid, subtract outstanding principal)
- Equity issues regarding how to allocate costs for improvements and assets funded by existing ratepayers vs required for serving growth
- Results in the highest fee

Schedule



Schedule

- ▶ **Jan-19** Adopted multi-year capacity charge payment program for well conversions
- ▶ **Mar-16** Water Capacity Charge introduction
 - *Received public comments and subsequent letter*
- ▶ **May-4** Water Master Plan Update & Capacity Charge Update
 - *Received public comments*
 - *Legal counsel responded to legal issues raised in letter*
 - *Board direction to set up a workshop*
- ▶ **Jul-6** Capacity Charge Workshop
 - *Review proposed Capacity Charges*
 - *Address questions, discuss issues & alternatives*
 - *Provide Board direction*



Questions / Discussion

