



Memorandum

TO: TRANSPORTATION AND
ENVIRONMENT COMMITTEE

FROM: Katy Allen
John Stufflebean

SUBJECT: SEE BELOW

DATE: 07-31-09

Approved

Date

8/6/09

**SUBJECT: CONNECTION FEE STUDY FOR STORM DRAINAGE, SANITARY
SEWER AND SEWAGE TREATMENT PLANT**

RECOMMENDATION

Accept this progress report highlighting activities since June 2008 on the Connection Fee Study for storm drainage, sanitary sewer, and sewage treatment plant.

OUTCOME

Acceptance of this report will allow staff to continue on course with the Connection Fee Study activities. These activities include outreach efforts to communicate the needs to update the connection fees to the Development communities and City Council through 2009.

BACKGROUND

California Government Code § 66113 governs local public agency sewer connection and capacity fees. Although connection fees and capacity charges are separately defined and levied for different purposes, both are often referred to collectively as "connection fees," since they are levied on new connections to public agency service systems. Connection fees are a very typical method that many agencies use to develop capacity expansion.

The City of San José has been collecting sanitary connection fees since the 1950's. Prior to the mid 1950's, sewer construction was financed by the City's general fund. In 1969, City Ordinance No. 14746 established separate connection fees for sanitary sewer and storm drainage to be paid by developers. In 1976, City Ordinance No. 18045 was approved requiring all developers, businesses, and individual property owners who applied for connection to the City's sanitary and storm sewer systems to pay a sewage treatment plant (STP) fee in addition to the sanitary and storm connection fees. Under the Municipal Code, the collected fees must be used

to fund capital improvement programs and future capacity expansion of infrastructure for the respective utilities.

The fees for storm drainage, STP, and sanitary sewer connections were last evaluated in 1980, 1983, and 1990, respectively, and are now far behind what is necessary to support essential system capacity expansion for new development. In addition, the current STP connection fee structure does not include any components related to the South Bay Water Recycling (recycled water) program which was created in the mid 1990s to reduce the maximum treated wastewater flow to the San Francisco Bay.

In June 2008, City Council awarded a contract to Financial Consulting Services (FCS) Group, Inc. to evaluate and develop methodologies for determining equitable connection fees for the aforementioned utilities.

ANALYSIS

A. Established Goals and Continued Technical Evaluation

Through a series of workshops and internal staff meetings, City staff and FCS have evaluated and developed an updated fee calculation methodology for all four connection fees. These revisions will update the connection fees to current 2009 standards. The consultant has performed the following:

- 1) Reviewed the existing City ordinances, resolutions and documentation for each of the fees.
- 2) Conducted a survey of connection and capacity fees charged by other jurisdictions of similar size and capacity. The City of San Jose's connection fees and methodologies used to develop fees were compared to the fees and methodologies of other similar jurisdictions within the state of California and other west coast jurisdictions.
- 3) Analyzed the cash flow needs which entailed projecting financial performance with respect to future capital improvement funding, new connection fee revenues, and other financial sources.
- 4) Evaluated various capital funding strategies necessary to meet proposed capital improvements. This evaluation included the analysis of the 5-year capital improvement program (CIP) for both storm and sanitary and 10-year CIP for treatment plant (the Plant) and recycled water. In addition, sanitary sewer master plan, fixed asset records for storm and the Plant, grant records, reserves, and developer contributions were also analyzed for the purposes of the evaluation.

B. Methodology Evaluation

When establishing a utility connection fee for new development, two cost of service considerations need to be taken into account. The first is the need to recover the portion of the costs of the existing system that have been incurred to provide future capacity (the “Buy-In” fee). The second consideration is the need to collect funds to cover the costs associated with expanding the system to meet the needs of increasing demand brought on by new customers (the “Expansion” fee.) A key tenet in adopting connection fees is “growth pays for growth”. This means that the costs associated with building excess capacity, which are required to serve new customers, are ultimately born by those new users who benefit from this available capacity.

While some utility agencies charge only a “Buy-in” or “Expansion” fee, others may combine them to develop a connection fee based on the full cost of the system build-out. This is sometimes called the hybrid approach. In utilizing the hybrid approach, it is important that costs are not double-counted when combining the original or replacement costs of the existing system with future costs identified in the CIP.

For this study, the consultant evaluated connection fees for storm, sanitary sewer, sewer treatment plant and recycled water in the context of these three methodology approaches: Buy-in, Expansion, and Hybrid. For each utility, a suitable methodology was selected based on each system’s condition and the available data as follows:

- The sanitary sewer connection fee accounts for available capacity within the existing system, as well as accounts for future capital improvements that are planned for the expansion of the system necessary to serve future users.
- The recommended storm drainage connection fee is based on a buy-in fee only. It is anticipated that expansion related costs will be collected in the future as a CIP is developed that can identify the benefit received by future users.
- The STP connection fee accounts for the value of the existing treatment plant assets with the completion of the proposed CIP. This connection fee also accounts for future costs required to expand the recycled water distribution system necessary for future effluent disposal.

C. Preliminary recommended fees

Currently, the connection fees are calculated based on lot size or acreage of the areas to be developed, for both residential units and non-residential properties. For storm and sanitary sewer systems, the residential customers are most commonly charged a fixed fee based on assumed flows and loadings. Non-residential customers for the treatment plant are typically charged based on projected strength measures such as biochemical oxygen demand (BOD), suspended solids (SS) and ammonia (NH₃), as well as flow volume. Both residential and non-residential fees are calculated using the same unit basis. The consultant recommended that the updated fees

be assessed on the basis of "Equivalent Residential Unit" (ERU), which is defined by a specific flow volume and strength characteristic. The following are the preliminary connection fee methodology recommendations for each of the utilities:

1. Sanitary Sewer Collection System

- Existing connection fees for the sanitary sewer collection system are assessed based on customer class (such as residential, commercial or industrial) and lot size, with certain exceptions and special fees for schools. The current sanitary sewer connection fee was developed using the expansion methodology, wherein costs of upgrading or replacing existing pipes were allocated to growth and non-growth. The existing fees were last updated in 1990 and remain at \$447 per lot for a single-family unit or \$1,991 per acre for multi-dwelling units.
- The consultant has recommended a sanitary sewer connection fee methodology that proposes combining the current expansion cost and "buy-in" charges to recover costs that have been spent by the utility in anticipation of future growth. In addition, the consultant recommends replacing the current lot size/acreage fee based of assessment with the Equivalent Residential Unit (ERU) basis, which results in approximately \$1,200 per ERU.

2. Storm Sewer Collection System

- Existing storm drainage fees are also assessed based on customer class and lot size. Lots smaller than 10,000 square feet pay a fixed fee, while larger lots pay a fee by the acre. The fees were last updated in 1980 and remain at \$270 per lot for a single-family unit (\$1,215 per acre for residential units) and \$1,815 per acre for non-residential (first 10 acres).
- Limited funding availability over the past ten years has prevented the development of a storm sewer master plan and has resulted in a minimal capital program. As a result, there is insufficient data with which to analyze the buy-in and expansion costs of the storm sewer system. Consequently, a full review and updating of this connection fee is not possible at this time. However, it is proposed that the current methodology which is based on lot size/acreage be replaced with an ERU basis of calculation. Using records of capital revenues collected since the inception of storm drainage connection and user fees, a level of "ratepayer equity" (the average amount of capital funding each existing customer has paid into the system) was calculated for storm sewer customers. This approach requires new customers to buy into the system at a level commensurate to the equity contributed by existing users. No future capital improvement costs have been included in this calculation due to the unknown nature of how these capital investments will increase capacity necessarily to serve future growth. The proposed connection fee is approximately \$550 per ERU.

3. Sewage Treatment Plant

- Existing STP connection fees for the Plant are assessed based on customer class and lot size, with certain special fees for customers with heavy discharge, and exceptions for schools. The current STP connection fees were developed using the buy-in methodology and were last updated in 1983 at \$780 per single-family dwelling unit and \$438 per multi-family dwelling unit.
- It is recommended that STP connection fee calculation methodology basis be changed from dwelling units to the ERU basis. Based on calculations of existing facilities and capacity, combined with future growth estimates, the recommended base STP connection fee is approximately \$3,500 per ERU. This includes the plant connection fee, recycled water system cost and additional fees imposed for excess chemical discharge for industrial facilities (BOD, TSS, and NH₃)
- Currently, calculation of the STP connection fee does not include any recycled water system costs. However, the primary purpose of the recycled water system is for the disposal of the City's treated wastewater effluent and was initiated in order to achieve the City's San Francisco Bay discharge limits imposed by the Regional Board. Consequently, the consultant has recommended that recycled water costs be recovered through the STP connection fee as an effluent disposal cost. The recommended STP connection fee of \$3,500 per EDU includes a recycled water (effluent disposal) component of \$500, accounting for past and planned capital investments. The recycled water fee component was calculated separately so that the City can establish a mechanism for issuing credit to developers that contribute to the expansion of the recycled water system. It is important to note that the recycled water connection fee cost basis does not include assets that were funded by grants, taxes or developers.

D. Next steps:

The Consultant and City staff will be developing a financial forecasting model for each connection fee to project capital revenues that may be used to fund the proposed CIP (5-year and 20-year planning horizons). City staff will be able to use this model in future years to incorporate updates and changes to the various CIPs and potential changes in capacity projections, enabling it to be used as a tool in the City's budget processes. Once approved by City Council, the model will provide for the incorporation of key City policy decisions related to connection fee reserve structures and levels, as well as funding objectives.

Outreach will be conducted with the development community to present the proposed fees, updated fee calculation methodologies, implementation timeline, and collect their input.

EVALUATION AND FOLLOW-UP

The results of the fee study and recommendations for fee increases will be presented to Council for discussion and approval later this year, after outreach with the development community has been completed.

POLICY ALTERNATIVES

Not applicable (at this time).

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This action does not meet any of the criteria above.

COORDINATION

This report has been coordinated with the City Attorney's Office, the City Manager's Budget Office, and the Finance Department.

FISCAL/POLICY ALIGNMENT

The Mayor's March Budget Message for Fiscal Year 2009-2010 directed staff to identify solutions to continue to deliver essential City services to the community. Updating and aligning the connection fees to reflect the current capacity and growth projections will enable the City to maintain appropriate funding levels for capacity expansion and infrastructure rehabilitation of the storm, sanitary, recycled water, and sewage treatment facilities.

In addition, evaluating and updating the current connection fees are in alignment with the Environmental and Utilities Services CSA outcomes of: Provide Reliable Utility Infrastructure; Healthy Streams, Rivers, Marsh and Bay; and Safe, Reliable and Sufficient Water Supply.

07-31-09

Subject: Connection Fee Study

Page 7

CEQA

Not a project.



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