



Memorandum

TO: TRANSPORTATION AND
ENVIRONMENT COMMITTEE

FROM: David Sykes
John Stufflebean

SUBJECT: SEE BELOW

DATE: 01-21-11

Approved

Date

1/27/11

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

RECOMMENDATION

Accept this progress report highlighting activities since August 2009 on the Connection Fee Study for storm drainage, sanitary sewer, and sewage treatment plant fees.

OUTCOME

Acceptance of this report provides the Committee with a status of Connection Fee Study activity to date and will allow staff to continue on course with the outreach efforts to the Development community and City Council regarding the need to update the connection fees.

EXECUTIVE SUMMARY

California Government Code § 66113 governs local public agency sewer connection and capacity fees. Both are often referred to collectively as *connection fees* which are typical methods that many agencies use to develop capacity expansion.

The City's Storm Drainage, Sanitary Sewer and Sewage Treatment Plant (STP) connection fees, which are paid by developers, have not been evaluated since the 1980's and 1990's and are now far behind what is necessary to support essential system capacity expansion for new development.

A joint effort by Department of Public Works and Environmental Services Department to study these fees and their methodologies, started in 2008, resulted in the proposed changes in the calculation methodologies and thus fee amounts. The current fees, in general, are calculated based on the lot size or total areas to be developed for residential units and projected flows and strengths

of flows for non-residential customers. The new STP fee will include a component for recycled water. The proposed fees will be calculated based on waste water flow volume and strength characteristic or storm water runoff and will be based on Equivalent Residential Unit (ERU). The current and its proposed fees are as follows:

Connection Fees	Current Amount	Proposed Amount
Storm drainage	\$270/dwelling unit	\$ 550/ERU
Sanitary sewer	\$447/dwelling unit	\$1,200/ERU
Sewage treatment	\$780/dwelling unit	\$3,500/ERU

These are preliminary amounts. It is estimated that the final fees will be recommended for implementation in late Summer 2011 after the Sanitary Sewer Capacity Master Plan is completed in late Spring 2011.

BACKGROUND

The City of San José has been collecting sanitary sewer and storm drainage connection fees since the 1950's and late 1960's. In addition, in 1976, the City began 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. The collected fees are used to fund capital improvement programs and future capacity expansion of infrastructure for the respective utilities.

The fees for storm drainage, sanitary sewer, and STP connections have not been evaluated for more than 20 years. A survey done in 2006 revealed that the City's connection fees are generally lower than those of many Bay Area cities or agencies. In addition, the current STP connection fee structure does not include any components related to the South Bay Water Recycling Program which was created in the mid 1990's to reduce the discharge of treated wastewater flow to the San Francisco Bay.

In June 2008, 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. In August 2009, FCS submitted a draft report, which included preliminary fee amounts. The draft report was distributed to various stakeholders within the development community. Comments received during the outreach period included recommendations to delay the fee implementation pending completion of the Sanitary Sewer Capacity Master Plan. Completion of the Master Plan would allow the proposed new fees to relate directly to growth areas identified in the Envision San José 2040 General Plan Update.

In August 2009, staff submitted a progress report to the T&E Committee highlighting the activities of the study and the feedback received from the development community. In December 2009, Council approved the First Amendment to extend the agreement with FCS to June 30, 2011, to allow for the completion of the fee study.

ANALYSIS

Methodology

Utility connection fees for new development are established under two primary considerations. The first is the need to recover the portion of the costs of the existing system that have been incurred to provide future capacity, which is referred to as 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.

While some utility agencies charge only a *Buy-in* or *Expansion* fee, it is widely acceptable to combine them to develop a connection fee based on the full cost of the system build-out. This is referred to as the *Hybrid* approach. This ensures that new development activity is funding a fair share of the infrastructure already in place and for the build-out of the sewer system that will treat the additional sewage and drain the storm runoff created.

Preliminary Recommended Fees

Currently, the connection fees for storm sewer and sanitary sewer are calculated based on lot size or acreage of the areas to be developed for both residential and non-residential properties. For STP, non-residential customers are typically charged based on the projected flow volume and the following strength measures: biochemical oxygen demand (BOS), suspended solids (SS), and ammonia (NH₃).

The study recommends that the updated fees be assessed on the basis of *Equivalent Residential Unit (ERU)*, which is defined by the average residential wastewater flow volume and strength characteristic or storm sewer runoff. The proposed methodology develops a unit-cost basis for incremental capacity in the system by spreading the portion of existing facilities costs attributable to growth plus the costs of system expansion serving growth over the projected incremental capacity of the built-out system. This provides a more accurate estimate of the additional demands on the system and a more equitable approach to calculating the connection fees necessary to provide the system capacity to handle the increase.

The following are the preliminary connection fee methodology and amount recommendations for each of the utilities:

1. Storm Sewer Collection System

The existing Storm Drain connection fee is \$270 per dwelling unit and has not been adjusted since 1980.

Limited funding 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.

The study recommends that the current fee methodology, 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 *rate-payer 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.

Future capital improvement costs have not been included in this calculation due to the unknown nature of how these capital investments will increase capacity necessary to serve future growth. New stormwater regulations may limit the amount of runoff generated by new development and, therefore, may result in little additional capacity being necessary. Funding has been approved to complete a master plan for the storm sewer system, which is scheduled to be completed in 2012. Until a comprehensive Storm Sewer Master Plan has been developed, the study proposes an interim connection fee of approximately **\$550 per ERU**.

2. Sanitary Sewer Collection System

The existing Sanitary Sewer connection fee is \$447 per dwelling unit and has not been adjusted since 1990.

The study recommends 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 study recommends replacing the current lot size/acreage fee based assessment with the Equivalent Residential Unit (ERU) basis, which results in approximately **\$1,200 per ERU**. This preliminary recommendation will be refined over the next few months after the master planning effort for the collection system is completed.

3. Sewage Treatment Plant

The existing Sewage Treatment Plant connection fee is \$780 per dwelling unit and has not been adjusted since 1983.

The study recommends that the STP 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 a connection fee for the Plant, the recycled water system, and additional fees imposed for excess chemical discharge for industrial facilities (BOD, SS, and NH₃). This preliminary recommendation will be refined over the next few months as the ongoing master planning effort for the Plant is being completed.

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 requirements imposed by the California Regional Water Quality

Control Board. Consequently, the study 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 ERU 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 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.

Next steps

The guiding principle for developing and 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 borne by those new users who benefit from this available capacity.

In order for the City to better define the potential growth and refine the preliminary sanitary sewer connection fee amounts in connection with available capacity, it has been recommended by the development community and supported by the San José Silicon Valley Chamber of Commerce that the City complete the Master Plan for the sewer collection system, which will be based on the Preferred Land Use Scenario from the Envision San José 2040 General Plan. The Master Plan study is currently in progress and is expected to be completed by April 2011.

Lacking a complete master plan study for the City's storm sewer system was identified as a necessary precursor to updating and implementing the Storm Drainage Connection fee. Staff has since obtained funding to initiate a comprehensive city-wide Storm Sewer Master Plan study with anticipated completion in Fall 2012.

The Consultant and City staff will be developing a financial forecasting model for each connection fee to estimate revenues and capital needs related to both 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. Continued outreach will be conducted with the development community to gain their input, present the proposed fees, fee calculation methodologies and implementation timeline.

EVALUATION AND FOLLOW-UP

The results of the fee study and recommendations for fee increases will be presented to Council for discussion and approval in Summer 2011, 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 and the City Manager's Budget Office.

FISCAL/POLICY ALIGNMENT

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 as well as infrastructure rehabilitation of the storm, sanitary, recycled water, and sewage treatment facilities.

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

CEQA

Not a project. PP10-069, staff report that requires no approvals.

/s/

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/s/

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