



**DRAFT**

**Development of  
Regional Connection Fees for the  
Water & Wastewater Utilities**

**For**

**Cambria Community Services District**

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## Introduction

### Background

In 1967, the Cambria Community Service District (District) was formed as a special district under California Law to provide the Town of Cambria in San Luis Obispo County wastewater services. Shortly thereafter, the District expanded its services to include potable domestic water, fire, lighting, refuse and parks. The District encompasses approximately 3,200 acres of developed and undeveloped land and serves a population of approximately 6,400. In order to serve its 4,000 customers, the District obtains water from two sources: the San Simeon and Santa Rosa Creek basin aquifers. Both aquifers are regulated by the State of California to prevent excessive drawdown. In addition, the District owns and operates various water wells, chlorination facilities, pumping stations, pipelines, and storage facilities. The District is in process of designing a desalination facility that will help supplement its water supply to achieve build-out capacity as designated in the Buildout Reduction Program (BRP).

On the wastewater side, the District serves its customer's wastewater needs through its 1 million gallon per day (MGD) aeration activation sludge secondary facility. In addition, the District owns and operates various supporting infrastructure such as collection stations and pipelines. As self supporting enterprises, the District must develop water and wastewater rates that provide sufficient levels of revenue to meet all operating and maintenance expenses of the systems. These expenses include debt service requirements, routine annual expenditures, capital improvements, and other specific bond ordinance and revenue requirements.

### Purpose

The purpose of this report is to document the results of a connection fee study. The specific goal of the study was to establish a methodology for deriving connection fees that assists in getting new users to pay their fair share of the costs. The proposed water and wastewater connection fees recognize customer costs of service, contractual agreements, and local policy considerations.

### Scope

The outcome of a detailed study of the connection fees for the District's water and wastewater operations are presented herein. For purposes of this report, the study period has been defined as the fiscal years (FYs) beginning July 1, 2007 and ending June 30, 2013. Unless otherwise noted, references in this report to a specific year are for the District's year ending June 30.

Revenues and revenue requirements for the study period were projected based on a review of historical factors as well as the District's operating and capital budgets and financial policies. As part of the development of a long-term financial management plan for the District, Black & Veatch conducted a study of revenue requirements recognizing projected operation and maintenance expense, establishment and/or maintenance of reserve funds, and capital financing requirements. Capital financing requirements include payments on outstanding revenue bonds and capital improvement expenditures met from annual revenues and available reserve funds. More detailed information regarding the proposed long-term



financial management plan may be found in Black & Veatch's *Development of a Long-Term Financial Management Plan Report, August 2007*.

The connection fee methodology used in calculating the system development charges is premised on the fact that new customers or developers pay for required system capacity, to the extent that service charges do not support the investment for the required capacity. The study considered the total capital investment value less depreciation, less any outstanding utility debt in excess of available debt service reserves and unused construction funds, less any applicable grants or funding from non-utility sources, and divided by the facility service capacity. This method is commonly referred to as the buy-in method.

## **Disclaimer**

In conducting our studies, we reviewed the books, records, agreements, capital improvement programs, and customers, sales and financial projections of the District as we deemed necessary to express our opinion of the District's operating results and projections. While we consider such books, records, documents, and projections to be reliable, Black & Veatch has not verified the accuracy of these documents.

The projections set forth in this report below are intended as "forward-looking statements". In formulating these projections, Black & Veatch has made certain assumptions with respect to conditions, events, and circumstances that may occur in the future. The methodology utilized in performing the analyses follows generally accepted practices for such projections. Such assumptions and methodologies are reasonable and appropriate for the purpose for which they are used. While we believe the assumptions are reasonable and the projection methodology valid, actual results may differ materially from those projected, as influenced by the conditions, events, and circumstances that actually occur. Such factors may include the District's ability to execute the capital improvement program as scheduled and within budget, regional climate and weather conditions affecting the demand for water, and adverse legislative, regulatory or legal decisions (including environmental laws and regulations) affecting the District's ability to manage the system and meet regulatory requirements.



## Water and Wastewater Connection Fees

Many water and wastewater utilities assess connection fees to help offset costs for increased system capacity. Generally levied at the time building permits are required, the connection fees are assessed for increased water use and resultant wastewater flows which result from either (1) changes in use of a structure served by an existing connection to the system, or (2) a new connection to the system. For the purposes of this report, both sources of additional water use and wastewater flow are included in the term “new customer.”

Connection fees are based on the premise that new customers or developers should pay for required water and wastewater system capacity, to the extent that water and wastewater service charges do not support the investment for the required capacity. Similar charges are termed by other utilities as capital recovery fees, system development charges, system capacity charges, impact fees, system equity charges, or other names. These charges represent the current demand requirement of each property and are not transferable to any other property located within the service area.

The cost of providing such capacity in water and wastewater system facilities for new customers can contribute significantly to the need for capital financing and service rates and/or taxes to support the financing. Collection of connection fees to partially or wholly finance new customer capacity requirements can, over time, significantly reduce the amount of financing and the magnitude of rate increases that otherwise might be needed. Ideally, connection fees should generate sufficient revenues to meet future expansion requirements so that existing users are not burdened by the costs of expansion caused by growth in system use by new users.

## Basic Methodologies

Connection fees are traditionally assessed to new development to recover the value of system capacity constructed for new customer service. There is no single established method for the determination of connection fees that is both appropriate for all situations and perfectly equitable to all new customers. There are, however, various approaches which are currently recognized and utilized, some to a greater extent than others, by water and wastewater utilities. These methods can be categorized as follows:

1. **System Buy-In.** Connection fees are designed to derive from the new customer an amount per connection equal to the "equity" in the system attributable to similar existing customers. (Note: The word "equity" refers to that portion of system value for which there is no offsetting debt. It does not imply ownership of, or title to, utility facilities.)
2. **Incremental Cost-Pricing.** Connection fees are designed to derive from the new customer the marginal, or incremental cost of system expansion associated with new customer growth. This method is based on the premise that new connections to the water and wastewater systems should be responsible for those costs which they cause to be incurred for the most recent or next increment of required system capacity, except as such costs are recovered from user fees or other utility charges.



3. Value of Service. Connection fees are based on non-direct cost based considerations such as the fees that other area utilities charge, estimated opportunity or substitute costs, et al. Unlike the system buy-in or incremental cost-pricing methods, this method does not require extensive analyses in valuation and cost determination.

Revenues derived from connection fees are commonly used to offset part or all capital costs to accomplish any of the following objectives:

1. To pay the capital costs of future capacity provided for growth.
2. To provide rate relief to existing system users by recovering that portion of the annual existing and future capacity capital costs associated with growth, including debt service requirements and direct asset purchases from current revenues.
3. To accumulate reserves to finance system improvements and expansions required to meet growth needs.

Since the system buy-in method for developing system development charges requires the selection of a basis for determining plant value, a discussion of asset valuation methods follows.

## Asset Valuation Methods

Various methods are employed to estimate the value of utility facilities required to furnish service to new users. The two principal methods commonly used to value a utility's properties are original cost and reproduction cost.

### **Original Cost**

The principal advantages of the original cost method lie in its relative simplicity and stability, since the recorded costs of tangible property are held constant.

The major criticism levied against original cost valuation pertains to the disregard of changes in the value of money over, which are attributable to inflation and other factors. As evidenced by history, prices have tended to increase rather than to remain constant. Because the value of money varies inversely with changes in price, monetary values in most recent years have exhibited a definite decline; a fact not recognized by the original cost approach. This situation causes further problems when it is realized that most utility systems are developed over time on a piecemeal basis as demanded by service area growth. Consequently, each property addition was paid for with dollars of different purchasing power. When these outlays are added together to obtain a plant value the result can be seriously misleading.

### **Reproduction Cost**

Changes in the value of the dollar over time, at least as considered by the impact of inflation, can be recognized by reproduction cost property valuation. The reproduction cost represents the cost of duplicating the existing utility facilities (or duplicating its function) at current prices. Unlike the original cost approach, the replacement cost method recognizes price level changes that may have occurred since plant construction.

The most accurate reproduction cost valuation would involve a physical inventory and appraisal of plant components in terms of their reproduction costs at the time of valuation. However, with original cost records available, a reasonable approximation of reproduction cost plant value can most easily be



ascertained by trending historical original costs. This approach employs the use of cost indices to express actual capital costs experienced by the utility in terms of current dollars. An obvious advantage of the reproduction cost approach is that it gives consideration to changes in the value of money over time.

### ***Depreciation***

Considerations of the current value of utility facilities may also be materially affected by the effects of age and depreciation. Depreciation takes into account the anticipated losses in plant value caused by wear and tear, decay, inadequacy, and obsolescence. To provide appropriate recognition of the effects of depreciation on existing utility facilities, both the original cost and reproduction cost valuation measures can also be expressed on an original cost less depreciation (OCLD) and a reproduction cost less depreciation (RCLD) basis. These measures are identical to the aforementioned valuation methods, with the exception that accumulated depreciation is computed for each asset account based upon its age or condition, and deducted from the respective total original cost or reproduction cost to determine the OCLD or RCLD measures of plant value.

Recognition of depreciation in establishing value for purposes of connection fee under the system buy-in approach is appropriate in consideration of the fact that, once the new connector has "bought into" the system, he assumes the same status as similar existing customers. This includes assumption of the same responsibilities for future replacement of worn out or obsolete facilities.

## **Connection Fee Determination Methods**

Three methods of developing connection fees which are currently employed by water and wastewater utilities were introduced in a preceding section of this report. These include the system buy-in, incremental cost-pricing, and value-of-service methods, which are further described in the following paragraphs.

### ***System Buy-In Method***

Under this method, connection fees are based upon the "buy-in" concept that new customers, at the time of connection, should pay an amount per connection equal to the equity in the system attributable to existing customers. To recover this equity, connection fees should be designed to recover the cost or current value of applicable service facility capacity associated with each new customer connection. An appropriate basis for calculating a connection fee would include consideration of the total capital investment value less depreciation, less any outstanding utility debt in excess of available debt service reserves and unused construction funds, less any applicable grants or funding from non-utility sources, divided by the facility service capacity.

As previously discussed, there are two principal methods of determining the value of utility system investment: OCLD and RCLD. Unless the City desires to recover only the historical costs of investment, the RCLD value approach is considered to be the most appropriate valuation method because it recognizes the current value of plant investment. It is noted that under the RCLD method, it is necessary to revise connection fees periodically to account for construction cost escalation and depreciation. The system buy-in method typically tends to be best suited for application when there is adequate capacity available in existing facilities to serve new customers.



### **Incremental Cost-Pricing Method**

This method is based on the premise that new system users should be responsible for the value of the latest or next increment of capacity which they cause to be incurred. Accordingly, connection fees would be designed to derive the marginal or incremental cost of system expansion as may be determined by recent construction cost experience or planned future improvements.

In order to determine the true incremental cost of system expansion, it is necessary to conduct a detailed engineering analysis to establish the facilities required to increase the design capacity to a specific level to accommodate additional new customers. Depending upon circumstances, the capacities of existing facilities which are available for new customers and their associated current value (RCLD) may also need to be recognized. The incremental cost of these specific facilities is then divided by the associated capacity provided to determine the incremental unit cost of additional capacity. In deriving connection fees using the incremental cost-pricing method, appropriate reductions in rates should be made to credit any obligation or debt which will eventually be recovered from future users through the payment of ongoing user fees or other utility charges.

Use of this method is generally considered to be most appropriate when a significant portion of the capacity required to serve new customers must be provided by the construction of new facilities.

### **Value-of-Service Method**

The value-of-service method is sometimes employed to develop connection fees for utilities. Though often simpler to employ than the system buy-in or incremental cost-pricing methods, it does not typically recognize the direct cost or value of utility facilities required to provide service for the particular utility facilities involved. Rather, under this method, connection fees are based on considerations such as the rates charged by other communities, the cost of service from available alternative facilities, or other similar measures. Because value of service measures are not typically based on the direct costs or value of facilities of the utility actually providing service, this method is not as readily supportable in adversary proceedings.

## **Legal Requirements in California**

Many states have established specific laws regarding the establishment, calculation, and implementation of connection fees. For most states, the primary objective of these laws is to assure that the charges are established in such a manner that they are fair, equitable, and cost-based.

### **Mitigation Fee Act**

The laws governing the establishment, accounting, and reporting of connection fees in the State of California are found in the “Mitigation Fee Act”. A summary of the relevant statutes required in the calculation of a connection fee is as follows:

*“66013 (a) Notwithstanding any other provision of law, when a local agency imposes fees for water connections or sewer connections, or imposes City charges, those fees or charges shall not exceed the reasonable cost of providing the service for which the fee or charge is imposed, unless a question regarding the amount of the fee or charge imposed*



*in excess of the estimated reasonable cost of providing the services or materials is submitted to, and approved by, a popular vote of two-thirds of those electors voting on the issue.”*

*“66013 ( B)(3) “City charge” shall mean a charge for facilities in existence at the time a charge is imposed or charges for new facilities to be constructed in the future that are of benefit to the person or property being charged.”*

In addition to the specific elements for the determination of proportionate cost sharing under California law, the Mitigation Fee Act also requires the following:

- Funds are maintained in a separate account;
- Annual accounting requirements on fee collections and expenditures;
- A public hearing to adopt or modify the fee; and
- A protest mechanism for the fees.

### **Proposition 218**

In 1996, California voters passed Proposition 218 (“Prop 218”), which required the imposition of certain fees and assessments by municipal governments to require a vote of the public to change or increase the fee or assessment. The applicability of Prop 218 to connection fees is established the Third District Court of Appeals decision in *Richmond v. Shasta Community Services District*, which states that water impact fees are development fees and as such, are not subject to the procedural or substantive requirements of Prop 218. Furthermore, the decision states that local agencies can enact the fee by either ordinance or resolution.

### **Assembly Bill 1600**

The District has broad authority to charge users for capital facilities. The main limitation of that authority is that fees on new developments must have a rationale nexus to the needs created by, and the benefits accruing to that development. In 1988, the California Legislature added sections to the Government Code that codified constitutional and decisional law related to fees imposed on new developments. Assembly Bill (“AB”) 1600 enacted Government Code §66000-66003 related to developer fees. In general, AB 1600 contains three requirements:

- Local agencies must follow a process set forth in the statutes and establish a nexus between a development project and the public improvement being financed with the fee.
- Local agencies must segregate the fee revenues from the General Fund to avoid commingling of funds.
- If a local agency has unspent or uncommitted developer fees for five years or more, then it must make annual findings describing the continuing need for that money, or it must refund the fees.

Since its original passage in 1988, the California Legislature has added and modified various code sections to further clarify and expand the requirements related to developer fees. In particular,



Government Code §66013 contains requirements specific to water and wastewater capacity charges. Specifically, §66013 states that “Notwithstanding any other provision of law, when a local agency imposes fees for water connections or sewer connections, or imposes capacity charges, those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed...”. The fundamental issue of this statutory requirement is that a maximum is set for capacity charges – the estimated reasonable cost of providing the service.

The statutory requirements pertaining to capacity charges in California continue to evolve. In 1998, the California Legislature passed Senate Bill (“SB”) 1760. SB 1760 amends and expands Government Code §66013 to subject capacity charges collected after January 1, 1999 to certain accounting, expenditure, and reporting requirements.

As a special district, the requirements of AB 1600 do not pertain to the development of the District’s connection fees.

## Proposed Methodology

The District has a number of revenue sources that can be used to support its activities. Under the District’s long-range financial plan, it is the District’s policy to fund capital projects through a combination of connection fees, long-term debt, and pay-as-you go monies. As part of this study, the District requested Black & Veatch to apply the buy-in methodology to its assets to derive a new connection fee schedule. In addition, although the District believes that AB 1600 is not applicable to the development of the fees, Black & Veatch believes that as a matter of good cost accounting practice, maintaining the rationale nexus between the fees charged and the cost provides a solid baseline for decision-making.

In order to arrive at the appropriate facilities cost, Black & Veatch reviewed the District’s fixed asset listing. Starting with the original service date and original cost, the estimated replacement cost for each in-service asset was calculated. Cost escalation factors used were obtained from Engineering News Record (ENR), and reflect local conditions in the Los Angeles Area. To arrive at RCLD, the replacement cost was multiplied by the estimated remaining service life percentage. The net replacement cost is then, the RCLD plus any additional asset costs placed into service in FY 05/06. We note that by using an ENR index, the connection fee calculation may be updated yearly if desired to more accurately reflect current construction cost conditions.

Based on data provided by the District and discussion with District staff, Table C-1 summarizes the calculation for the residential connection fee. It is noted that in addition to the system backbone elements, and the expansion projects, the cost of lot reduction, as determined through the Buildout Reduction Program (BRP) is also included in the calculation shown on Table C-1.



**Table C-1  
Development of Residential Connection Fee**

	WATER			WASTEWATER		
	Total	Applicable	Unit	Total	Applicable	Unit
	Cost	DUEs	Cost	Cost	DUEs	Cost
	\$	DUE	\$/DUE	\$	DUE	\$/DUE
Existing Facilities RCLD Basis	10,701,600			8,495,200		
FY 05/06 Work in Progress	6,098,800			961,000		
Proposed Improvements - Existing	1,903,900			1,266,200		
Carry Charges on Existing Facilities	331,700			220,600		
Less Outstanding Debt Principal						
2006 Refunding Loan	1,116,100			3,816,200		
Plus Replacement Funds	624,000			1,968,300		
Net Equity in Existing Facilities	18,212,200			8,874,500		
Desalination Plant & Expansion Projects	15,993,500			2,954,500		
Carrying Charge	2,786,700			514,800		
Total	18,780,200			3,469,300		
Total System						
Backbone	18,212,200	4,739	3,843	8,874,500	4,739	1,873
Desalination Plant & Expansion Projects	18,780,200	841	22,331	3,469,300	841	4,125
Total	36,992,400		26,174	12,343,800		5,998
Expansion Project Debt (P&I)	11,559,300			2,086,000		
Plus Issuance Expenses	231,200			41,700		
Less Bond Reserve	(385,300)			(100,500)		
Total Debt Service - Expansion	11,405,200	841	13,561	2,027,200	841	2,410
BRP Lot Retirement Charge			10,127			
USE (Rounded) - \$/DUE			<b>49,860</b>			<b>14,410</b>