Council Agenda _______
Meeting of April 14, 2009

CITY OF BELMONT
CALIFORNIA

Staff Report

RESOLUTION OF THE CITY COUNCIL OF THE CITY OF BELMONT STATING ITS INTENTION TO REVISE THE CITY'S SEWER CHARGES EFFECTIVE FISCAL YEAR 2009-10

Honorable Mayor and Council Members:

Summary

On March 24, 2009, the City Council discussed and provided direction to City Staff on the proposed Sewer Charge Revisions for Fiscal Year 2009-2010. City Council direction was to review with the Infrastructure Subcommittee and bring back recommendations for "greening" the City Sewer program, to investigate potential cost savings in the program arising from deferral or reduction of the CIP or other cuts in the City Sewer and Storm Drain Programs, to review options to fund the Sewer Enterprise's Capital Improvement Program (CIP) on a pay-as-you-go basis, and to examine the reserves and rates necessary to do so.

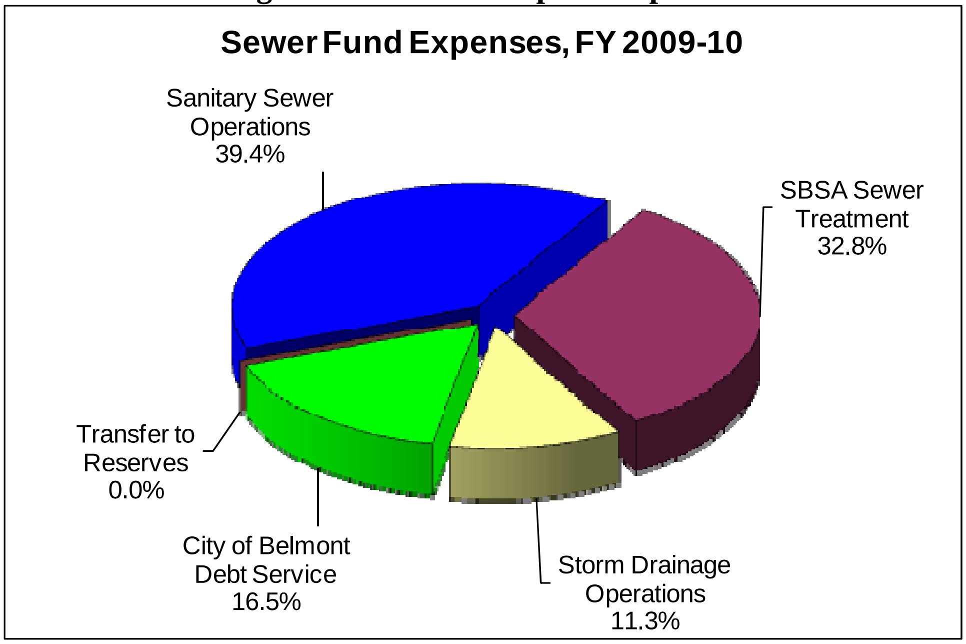
The City of Belmont prepares an annual analysis of the Sewer Enterprise Fund to evaluate the Fund's financial position and to determine whether or not sewer rates need to be revised. The Rate Analysis Report, with addendum showing the proposed revisions, is enclosed for City Council use and consideration. A Proposition 218 hearing is required before the City Council can impose an increase in sewer charges. An authorizing resolution, approved by Council, directs the mailing of Proposition 218 Notices. The authorizing resolution sets rules for tabulating protests, proposes the rates and rate structure, and schedules a public hearing. An action plan showing the proposed schedule for the Proposition 218 process is included as Attachment B.

Background

The City's Sewer Charge revenue is used to fund operations, maintenance, and capital improvements of the City of Belmont's collection system, and also to fund operations and maintenance costs for the South Bayside System Authority's (SBSA) Wastewater Treatment Plant. The City's Sewer Charge is a separate charge from the proposed Sewer Treatment Facility Charge under consideration to fund Capital Improvements to the Wastewater Treatment Plant, as shown in the SBSA's Capital Improvement Program.

Sewer Fund expenses for FY 2009-10 are as shown on the following chart (**Figure 1**). The costs are similar to those that were presented at the March 24, 2009 City Council meeting with some slight adjustments related to funding depreciation and the timing of the next bond sale, which are described in detail in the discussion section below.

Figure 1. Sewer Enterprise Expenses



The SBSA Sewer Treatment portion of the City Sewer Charge provides funding for the operation and maintenance, and some minor capital improvements, to the Wastewater Treatment Plant and appurtenant facilities.

The Sanitary Sewer Operations program provides funds for the operation and maintenance of the City's sanitary sewer collection system. The City maintains 2,450 manholes, 84 miles of sewer main lines and 11 sanitary sewer pump stations. Maintenance staff performs preventive maintenance on sewer main lines, pump stations, annually cleans 50 miles of sewer main lines and video inspects 30 miles of sewer main lines. In addition, staff repairs damaged sewer main lines and manholes and provides 24-hour-a-day response to calls for lateral sewer service. Staff also oversees an annual root foaming contract that chemically treats approximately 50,000 – 60,000 feet of main lines to inhibit root growth.

The Storm Drain Operations Program provides funds to prevent overflows from the storm drain system that cause inflow and infiltration (I&I) into the City Sanitary Sewer System. Storm Drain fees also support the Storm Drain program. City staff maintains 26 miles of storm drain pipe, 586 storm drain manholes and 2 storm pump stations. Each year staff inspects 1,410 storm drain inlets and cleans approximately 700 storm drain inlets.

The City collection system capital improvement program is based on the Sewer Master Plan and Storm Drain Master Plan, both completed in 2007 and reviewed with the City Council in detail at that time. The Master Plans describe the capital needs of the City Sewer and Storm Drain programs, and recommend a program for approximately $40 million dollars each in improvement to the storm and sanitary systems that should be implemented over the next 25 years. The City is currently completing a Capacity Analysis of the sewer system and the proposed budget includes funding to evaluate the City's sewer force mains in upcoming years. These studies will identify future improvement and maintenance needs within the city sewer system.

The proposed projects for the Sewer program extend the life of the system and are developed with the primary goal of preventing Sanitary Sewer Overflows. This includes measures, such as the lining and repair of cracked pipes, to reduce inflow and infiltration of stormwater (I&I) into the system. Emergency response is also highlighted and improvements to the system to improve emergency response during power outages are included in the plan for improvement. These measures protect the environment and also comply with regulatory requirement of the Regional Water Quality Control Board (RWQCB). If the City does not comply with its Sewer System Management Plan, it increases the risk of larger fines and other requirements being imposed in the event there is an overflow. The City Master Plan evaluation looked at the age of the system in each basin, and found that in those basins with the oldest pipes the number of service calls is the highest. This would be a reflection of the fact that older, unmaintained portions of the system are more likely to have cracks or displacements in the pipe or to have root intrusion into the system, resulting in blockage of the flow and the resulting overflow.

The storm drain improvements are developed with the primary goal of preventing inflow and infiltration into the City Sanitary Sewer System due to storm drain deficiencies that result in flooding or excessive infiltration of groundwater into the soil surrounding sewer pipes. Addressing deficiencies in the system also reduces the probability that portions of the system will fail. By improving and maintaining the city infrastructure, the City reduces future deferred maintenance costs and extends the systems life.

The current capital program is a proactive rather than a reactive one. Whether or not to support a proactive program of identifying potential failures in advance and systematically repairing or to go to a program where problems are fixed only as they occur is a policy decision. The recommendation in response to City Council comments from March 24 is to go to a program that is reactive in nature until spring of 2010, when the proactive improvement program would return following the sale of bonds[1].

Discussion

The direction provided by the City Council was to bring back recommendations for "greening" the City Sewer program, to investigate potential cost savings in the program arising from the deferral or reduction of the Capital Improvement Program (CIP) or other cuts in the City Sewer and Storm Drain Programs, to review options to fund the Sewer Enterprise's Capital Improvement Program (CIP) on a pay-as-you-go basis, and to examine the reserves and rates necessary to do so.

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[1] Another factor in the delay of the capital improvement program is a loan of $935,000 from the Sewer Enterprise Fund to pay the first installment of debt service due to the SBSA for Treatment Plant upgrades. It is anticipated that this loan will be repaid in FY 2009-10 from the proceeds of bond financing for the City's share of SBSA capital obligations in anticipation of the enactment of the Sewer Facility Treatment Charge.

After review of the direction from the City Council, a Cost Saving Option, Option 1 that provides cost savings measures through deferral of debt issuance was developed. The Cost Saving Option would provide the lowest rate increase in the first year and is recommended. In addition an alternative, a Hybrid Option, Option 2 that combine cost savings measures through deferral of debt issuance and beginning of a pay-as-you go capital funding program were developed for the City Council consideration. The Hybrid option proposal would provide for a slightly higher rate increase in the first year, but would begin the City on the path to a partial or complete pay-as-you-go capital funding program.

Two other alternatives for immediately implementing a pay-as-you-go option were evaluated, but the resulting much higher initial cost appears problematic, especially under current economic conditions.

Water Conservation and Other Green Measures

The City's rate analysis consultant, HF&H Consultants, LLC (HF&H) investigated development of a rate incentive program that would reward those users who conserve water with lower rate and impose higher charges on those users with above average use. Increasing block rate structures of this kind are a common practice in setting utility rates for water supply. For water purveyors the block rates are supported by increased cost for the water provider to securing higher capacity. The price signal can be so effective that short-term revenue shortfalls can occur as a result of reduced flow. City's specialized counsel advised that such an approach could be difficult to justify for sewer rates, and thereby legally risky, based on legal counsel's interpretation of the California Constitution (Article XIIID, Section 6). Therefore the sewer rates cannot be set for the purpose of causing water conservation.

This increasing block rate structure option and the concerns that were generated during its investigation were reviewed with the Infrastructure Subcommittee on March 30, 2009. One suggestion from the Committee was to review the ideas that are being generated by the Green Advisory Committee and implement those that are applicable during the budget cycle. This approach is recommended, and with the City Council's concurrence will be pursued further.

Staff also recommends that the City implement programs to reduce inflow and infiltration such as ordinances requiring replacement of sewer laterals upon sale of a home or when building permits for construction are obtained. Current major building projects are required to replace the lateral on a case by case basis, as needed. These program that address I&I from privately owned and maintained sewer laterals would further the goal of the City's capital program. These types of programs would also reduce the City's wet weather capacity needs at the Wastewater Treatment plant, and the associated cost for treatment. As these types of programs become more common in other jurisdictions, they generate less controversy. If the City Council desires staff to research and develop such a program, which is recommended, it is suggested that the results of that investigation be presented to the Infrastructure Subcommittee for input before being brought back to the City Council.

Potential Cost Saving Measures

The proposed cost savings, reflected in the proposed rates shown in Attachment A to the Resolution, Option 1, would be the result of going to a reduced capital improvement program that is reactive in nature from the end of FY 2008-09 until spring 2010 when the capital improvement program would re-commence. The proposed rate increase to support such a plan would increase rates 5.0% ($15.12, or a 3.0% increase in the average bill) for the average single family home versus 9.0% ($34.47, a 6.85% increase in the average bill) as shown in the analysis presented to City Council on March 24, 2009.

Under the revised plan, the cost savings would be achieved by delaying certain new construction projects. Projects would continue to be designed, with staff continuing to work on Sewer and Storm related projects currently underway, but limited projects would be awarded until after February 2010. The delay occurs because the currently remaining bond proceeds will be spent before the proposed next $8.5 million in sewer revenue bonds are sold, which is currently planned for February 2010. This differs from the March 24, 2009, proposal, in which these bonds would have been sold earlier, in late 2009, before the remaining bond proceeds are fully expended. The result of delaying the bond sale is a savings of approximately $200,000 in FY 2009-10.

An additional $330,000 in savings is proposed by deferring the funding of depreciation in FY 2009-10. Typically, depreciation is funded each year from rates so that funds are added to reserves for funding maintenance and capital improvements.

The consequence of both of these cost savings, combined with the loan from the capital fund described above, is that capital reserves will be depleted to unusually low levels. The risk that reserves would be inadequate to cover any emergency that might occur would be reviewed during the next budget cycle, and all capital construction would be put on hold if needed.

Figure 2 compares the rate projections presented at the March 24, 2009, City Council meeting with the modified proposal in which the 2009 bond sale is delayed to 2010 and depreciation is not funded in FY 2009-10.

Figure 2. Rate Projections with Continued Debt Funding of CIP

	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Original Report (March 24, 2009 Council Meeting)						
Increase in Rates		**9.0%**	**9.5%**	**9.5%**	**9.5%**	**8.5%**
Cumulative Increase		*9.0%*	*19.4%*	*30.7%*	*43.1%*	*55.3%*
Annual Account Charge	$238.16	$259.59	$284.25	$311.25	$340.82	$369.79
Low-Strength Rate / HCF	$3.12	$3.40	$3.72	$4.07	$4.46	$4.84
High-Strength Rate / HCF	$6.08	$6.63	$7.26	$7.95	$8.71	$9.45
Option 1 - Cost Savings, Continued Debt						
Increase in Rates		**5.0%**	**10.5%**	**10.5%**	**10.5%**	**10.5%**
Cumulative Increase		*5.0%*	*16.0%*	*28.2%*	*41.7%*	*56.5%*
Annual Account Charge	$238.16	$250.07	$276.33	$305.34	$337.40	$372.83
Low-Strength Rate / HCF	$3.12	$3.28	$3.62	$4.00	$4.42	$4.88
High-Strength Rate / HCF	$6.08	$6.38	$7.05	$7.79	$8.61	$9.51

The Option 1 savings reduces the 9.0% rate increase in FY 2009-10 to 5.0%, but increases rates in subsequent years in order to restore funding. With the subsequent 10.5% increases, the City will be in position to sell $8.5 million in sewer revenue bonds in FY 2009-10 and 2012-13 to fund the ongoing capital improvement program. With this modified proposal, the City will continue to fund the capital improvement program almost exclusively from debt.

Pay-As-You-Go Capital Funding

At the City Council's direction, HF&H also evaluated rate increases that would be necessary for the City to fund its capital improvement program from cash on a pay-as-you-go basis rather than from debt, as has been its recent practice. Pay-as-you-go financing is cheaper in the long run because it avoids interest costs, but does not provide cash up front in the amounts needed without significant rate increases.

Figure 3 compares two purely cash-funded scenarios. Under one scenario, which represents one end of the spectrum, a 60.0% increase in rates in FY 2009-10 would allow for an immediate conversion to pay-as-you-go financing, eliminating the need for the proposed bond in FY 2009-10 and subsequent years (assuming current levels of funding continue). Minimal rate increases would be needed through FY 2013-14, when the cumulative rate increases would be 68.0%, compared with 56.5% for the modified program.

Another pay-as-you-go scenario was run in which the transition to full pay-as-you-go financing would occur by FY 2013-14 through a series of four 19.0% annual rate increases, for a cumulative increase of 100.5%. During the transition, there would be a delay in capital improvements until rates increased sufficiently, after which the delayed projects would be funded along with future projects.

These two pay-as-you-go scenarios illustrate that making the transition from a debt-funded to a cash-funded capital improvement program is more expensive over the short term. They also show that earlier, larger increases are less expensive over the long term.

Figure 3. Pay-as-You-Go Rate Projections

	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Pay-as-You-Go (PAYGO) - Immediate Transition						
Increase in Rates		**60.0%**	**0.0%**	**0.0%**	**5.0%**	**0.0%**
Cumulative Increase		*60.0%*	*60.0%*	*60.0%*	*68.0%*	*68.0%*
Annual Account Charge	$238.16	$381.06	$381.06	$381.06	$400.11	$400.11
Low-Strength Rate / HCF	$3.12	$4.99	$4.99	$4.99	$5.24	$5.24
High-Strength Rate / HCF	$6.08	$9.73	$9.73	$9.73	$10.22	$10.22
PAYGO - Gradual Transition						
Increase in Rates		**19.0%**	**19.0%**	**19.0%**	**19.0%**	**0.0%**
Cumulative Increase		*19.0%*	*41.6%*	*68.5%*	*100.5%*	*100.5%*
Annual Account Charge	$238.16	$283.41	$337.26	$401.34	$477.59	$477.59
Low-Strength Rate / HCF	$3.12	$3.71	$4.41	$5.25	$6.25	$6.25
High-Strength Rate / HCF	$6.08	$7.24	$8.62	$10.26	$12.21	$12.21

The results of the analyses shown in **Figures 2** and **3** suggested a hybrid approach that combines both debt and pay-as-you-go financing. With this approach, bonds would be sold in late FY 2009-10 to allow the capital improvement program to continue. A 6.0% rate increase in FY 2009-10 followed by 12% annual increases would reach two-thirds of full funding for the capital improvement program by FY 2013-14 (see **Figure 4**). After two or three more years of 12% rate increases, the rates would be sufficient to fully fund capital improvement program on a pay-as-you-go basis (by approximately FY 2016-17) with no further need for bonds after 2010. During this transition period, capital projects would be delayed in diminishing amounts until full funding is reached.

Figure 4. Hybrid Option – Cost Savings Plus Transition toward Pay-as-You-Go

	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Option 2 - Debt then PAYGO Transition						
Increase in Rates		**6.0%**	**12.0%**	**12.0%**	**12.0%**	**12.0%**
Cumulative Increase		*6.0%*	*18.7%*	*33.0%*	*48.9%*	*66.8%*
Annual Account Charge	$238.16	$252.45	$282.74	$316.67	$354.67	$397.23
Low-Strength Rate / HCF	$3.12	$3.31	$3.71	$4.16	$4.66	$5.22
High-Strength Rate / HCF	$6.08	$6.44	$7.21	$8.08	$9.05	$10.14

Option 2 is reflected in the proposed rates shown in Attachment A to the Resolution, Option 2.

<u>Sub-Committee and Commission Review</u>

On March 4, 2009, the draft rate analysis results were presented to the Infrastructure Subcommittee. The Subcommittee recommended that information be posted on the Hot Topics section of the City's web page if the Rate Analysis and subsequent Notice are approved. A review of restaurant and supermarket water usage was also requested, as water usage had increased significantly for these property types. Although there was an overall increase in flow for the restaurant class, some restaurants experienced flow reductions. The average flow per restaurant parcel went up significantly in part because there was an overall flow increase. The average flow per parcel also increased because three parcels went on standby status, thereby reducing the total number of parcels used to calculate the average. A draft action plan/schedule for the sewer charge increases was reviewed and the Subcommittee recommended the schedule be presented to Council for approval.

Proposed cost savings measures were evaluated and reviewed with the Infrastructure Subcommittee on March 30, 2009, and with the Finance Commission on April 2, 2009. The Infrastructure Subcommittee did not make a formal recommendation, but received the information. The Finance Commission recommends that City Council consider deferring the bond sale so that the first debt payment is in August 2010 and advises staff to review the built-in assumptions on rate and budget forecasting with special emphasis on discretionary spending and statutory increases. The review of discretionary spending and statutory increases is recommended for review during the budget cycle.

The analysis attached to this report defers the first bond sale so the first debt service payment is not due until FY 2010-11, and delays the capital improvement program accordingly. The full extent of that delay will be reviewed with the budget. In addition, review of discretionary spending and statutory increases could be done during the budget review, if recommended by the City Council.

Next Step

The staff report presents a recommendation and an alternative for City Council consideration for approval. A Cost Saving Option, Option 1 that provides cost savings measures through deferral of debt issuance was developed. The Cost Saving Option would provide the lowest rate increase in the first year and is recommended. In addition an alternative, a Hybrid Option, Option 2 that combine cost savings measures through deferral of debt issuance and beginning of a pay-as-you go capital funding program were developed. If the rate analysis is approved and Option 1 or Option 2 is approved the City would mail a notice and begin the public outreach process.

Charges for sewer service are property-related charges subject to Proposition 218. These charges need not be submitted to an election of voters or property owners, but they are subject to a majority protest proceeding. That process is summarized as follows: (i) an agency calculates a budget sufficient to cover the cost of service and determines how to spread that budget as rates across different kinds of customers (e.g., single-family, multi-family, non-residential), (ii) the agency provides 45 days mailed notice of a public hearing on the proposed new rates to every property owner or customer of record who will pay the new rates, (iii) the agency conducts the hearing and accepts written protests from property owners and customers of record, and (iv) the agency tallies the protests; if more than half of the affected property owners and customers of record protest the new rates in writing before the end of the hearing, the agency cannot impose the new rates; otherwise it may impose the rates at any level which does not exceed the rates stated in the notice. Majority protests under these rules are not common except when a very small number of ratepayers are involved. Accordingly, the primary consequences of this process are the delay and cost associated with the noticed hearing and the opportunity for public input on the decision.

Typically, the City conducts rate hearings earlier in the spring. However, the City of Belmont has been considering a new and separate Sewer Treatment Facility Charge to fund the South Bayside System Authority's Capital Improvement Program, and this resulted in the regular Sewer Rate Analysis completion being delayed.

If the City Council authorizes the notice, staff will reconvene to meet with the City Treasurer and City Clerk to review the Notice before it is mailed.

General Plan/Vision Statement
There is no impact from this report. Maintenance of existing City's infrastructure is consistent with the City's goals and policies.

Fiscal Impact
Approval of this action does not establish rates; however, should the City Council implement the rates shown in the Notice, the revenue received is projected to equal the projected revenue for

fiscal year 2009-10 of approximately $5.9 million.

Public Contact

The Council agenda was posted.

Recommendation

It is recommended that Council (i) approve the Rate Analysis Report and addendum for option 1 and the Action Plan attached to this report and (ii) approve the authorizing resolution stating the City's intentions to increase Sewer Rates effective fiscal year 2009-10 and scheduling the public hearing and propose the rate structure.

Alternatives

1. Take no action.
2. (i) approve the Rate Analysis Report and addendum, for option 2 and the Action Plan attached to this report and (ii) approve the authorizing resolution, with a substitute exhibit "A" reflecting option 2.
3. Refer back to staff for further information.

Attachments

A. HF&H Report entitled Sewer Rate Update – FY 2009-10, dated March 19, 2009.

B. HF&H Report Addendum entitled Sewer Rate Update – FY 2009-10, dated April 10, 2009.
  a. Option 1, Cost Saving Option
  b. Option 2, Hybrid Option

C. Action Plan/Schedule

D. Resolution Stating Its Intention to Increase Sewer Charge
  a. Exhibit A, Proposed Rates (Option 1--Cost Saving Option)
  b. Exhibit B, Guidelines for the Submission and Tabulation of Protests

E. Alternative Exhibit A to Resolution (Option 2--Hybrid Capital Financing Option)

Respectfully submitted,

Karen Borrmann, PE	Thomas Fil	Jack R. Crist
City Engineer	Finance Director	City Manager

Staff Contact:
Thomas Fil, Finance Director
(650) 595-7435
tfil@belmont.gov

Karen Borrmann, PE
Assistant Public Works Director/City Engineer
(650) 595-7469
kborrmann@belmont.gov

Brooke Lazzari
Deputy Finance Director
(650) 595-7434
blazzari@belmont.gov