

SULTAN CITY COUNCIL
AGENDA ITEM COVER SHEET

ITEM NO: Presentation by Financial Consulting Solution Group
DATE: May 10, 2007
SUBJECT: Sewer Rate Study Update
CONTACT PERSON: Public Works Director Dunn

ISSUE:

The issue before the City Council is the progress of the current ongoing sewer rate study from Financial Consulting Solutions Group (FCS).

This is a presentation and update on the Sewer Rate Study from FCS Group, Inc. to the City Council and public to discuss facts and findings with recommended alternatives to this point to meet those financial needs.

Identify key assumptions and issues in the rate study, show the Mayor and Council preliminary results of the rate study and receive feed back from the Council.

BACKGROUND:

The current user fees are adequate to meet the current goals and objectives of the sewer utility. On completion of the 2006 Wastewater Treatment Plant Upgrade Engineering Report, the City realized it would be unable to fund the Wastewater Treatment Plant upgrade the then current General Facility Charge (GFC) and the current rate payers and/or loans available to the City at that time. The City of Sultan contracted with Financial Consulting Solution Group (FCS) to complete a Sewer Rate Study.

Through the public process in November, 2006, concluding with the approval of Ordinance 941-06 on December 14, 2006. The City Council approved increasing the GFC to the maximum amount of \$9,106.00 recommended by the 2004 Katy Isaksen Associates Rate Study. This was the first step to meeting the sewer goals of the City of Sultan.

FCS Group has been working with City Staff to gather the information needed to complete a comprehensive study to identify the funding needed to move forward and will be presenting a method on which to fund the improvements needed to meet the goals set in the 2004 City of Sultan. Comprehensive Plan

SUMMARY:

The May 2006 General Sewer Plan identified the future need to upgrade the existing 1998 Wastewater Treatment Plant when more extensive treatment improvements are required.

2004 Comprehensive Plan 2.11 Utilities Goal:

- Maintain and enhance the development and operation of an effective, efficient wastewater treatment plant and collection system that will meet the needs of Sultan's present and future urban service area.
- Sewer Capacity: Increase wastewater treatment plant and collection line capacity allocations to meet the need of the Sultan future urban area. Increase capacity allocations to reflect increased usage trends caused by Sultan's continued urban intensification and economic development.

Tonight is the first of three public meetings which is part of the September 15, 2006 Contract with FCS Group, Inc. Task Seven (a.)

FISCAL IMPACT:

The meeting tonight is part of the contract the City of Sultan signed with FCS.

RECOMMENDED ACTION:

Consider the information presented tonight giving direction to continue the public process and start the conversation of how to fund the Upgrade of the Wastewater Treatment Plant to meet the goal of maintaining and enhancing the development and operation of an effective, efficient wastewater treatment plant and collection system that will meet the needs of Sultan's present and future urban service area.

COUNCIL ACTION:

DATE: May 10, 2007

ATTACHMENTS:

City of Sultan Rate study Summary.

Contract Task Four – Issue Paper #1: Wastewater Treatment Facility Upgrade Financing Options.

City of Sultan Sewer Utility Rate Study - Growth Scenario Summary

Revenue Requirements	2007	2008	2009	2010	2011	2012	2013
Revenues							
Rate Revenues Under Existing Rates [a]	\$ 901,555	\$ 966,557	\$ 1,090,593	\$ 1,202,869	\$ 1,312,519	\$ 1,509,496	\$ 1,706,472
Non-Rate Revenues	30,842	31,314	25,977	34,752	148,487	100,536	74,531
Total Revenues	\$ 932,397	\$ 997,872	\$ 1,116,570	\$ 1,237,622	\$ 1,461,007	\$ 1,610,032	\$ 1,781,005
Expenses							
Cash O&M Expenses	\$ 679,650	\$ 709,411	\$ 740,812	\$ 773,968	\$ 809,008	\$ 846,069	\$ 885,302
Additional WWTP O&M [b]	-	-	80,000	619,620	893,758	957,816	1,024,923
Rate Funded System Reinvestment	-	-	-	-	-	150,000	200,000
Existing Debt Service	290,909	244,294	242,560	240,825	239,091	237,357	123,640
New Debt Service	-	-	-	1,072,670	1,598,986	1,588,459	1,577,933
Total Debt Service	290,909	244,294	242,560	1,313,495	1,838,077	1,825,816	1,701,573
less: GFC Revenues for Debt Service	(202,162)	(244,294)	(242,560)	(1,313,495)	(1,838,077)	(1,825,816)	(1,701,573)
Debt Service, Net	88,747	-	-	-	-	-	-
Total Expenses	\$ 768,397	\$ 709,411	\$ 820,812	\$ 1,393,589	\$ 1,702,766	\$ 1,953,885	\$ 2,110,225
Net Surplus (Deficiency)	\$ 164,000	\$ 288,460	\$ 295,758	\$ (155,967)	\$ (241,759)	\$ (343,853)	\$ (329,220)
% of Rate Revenue	0.00%	0.00%	0.00%	12.97%	18.42%	22.78%	19.29%
Annual Rate Adjustment	0.00%	5.00%	5.00%	5.00%	5.00%	4.00%	2.00%
Rate Revenues After Rate Increase	\$ 901,555	\$ 1,014,885	\$ 1,202,378	\$ 1,392,471	\$ 1,595,376	\$ 1,908,194	\$ 2,200,341
Additional Taxes from Rate Increase	-	5,819	13,234	22,568	33,759	47,648	48,879
Net Cash Flow After Rate Increase	\$ 164,000	\$ 330,969	\$ 392,432	\$ 8,893	\$ 4,847	\$ 4,217	\$ 27,837
Average Residential Monthly Bill	\$ 52.00	\$ 54.60	\$ 57.33	\$ 60.20	\$ 63.21	\$ 65.73	\$ 67.05
Monthly Difference	52.00	2.60	2.73	2.87	3.01	2.53	1.31

[a] Projected rate revenues include approved rate increases in 2008 and 2009
 [b] 1 FTE added in 2009, 3 added in 2010, 1 additional each year in 2011-2012

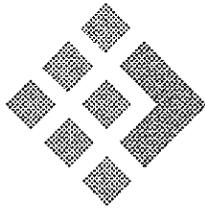
PRELIMINARY FINDINGS

Fund Balances	2007	2008	2009	2010	2011	2012	2013
Operating:							
Beginning Balance	\$ 104,678	\$ 675,678	\$ 503,171	\$ 729,296	\$ 3,954,830	\$ 2,541,628	\$ 1,755,465
Net Cash Flow after Rate Increase	164,000	330,969	392,432	8,893	4,847	4,217	27,837
Ending Balance	\$ 268,678	\$ 1,006,647	\$ 895,603	\$ 738,188	\$ 3,959,677	\$ 2,545,845	\$ 1,783,301
<i>Less: Min. Operating Target (45 days O&M)</i>	\$ 83,792	\$ 87,462	\$ 101,196	\$ 171,812	\$ 209,930	\$ 222,397	\$ 235,507
Balance Available for Capital	\$ 184,886	\$ 919,186	\$ 794,407	\$ 566,376	\$ 3,749,747	\$ 2,323,448	\$ 1,547,794
Plus:							
Other Capital Funding Resources							
Beginning Balance	\$ 562,250	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
General Facilities Charges (GFCs)	-	514,188	-	1,393,886	1,092,720	-	1,005,101
Revenue Bond Proceeds	-	-	-	10,750,000	-	-	-
Public Works Trust Fund Proceeds	-	-	-	10,000,000	-	-	-
Renewal & Replacement Funding	-	-	-	-	-	150,000	200,000
Total Capital Resources	\$ 747,136	\$ 1,433,374	\$ 794,407	\$ 22,710,262	\$ 4,842,467	\$ 2,473,448	\$ 2,752,894
Less:							
Growth Related Improvements/Expansions	\$ -	\$ (514,188)	\$ -	\$ (14,451,905)	\$ (2,332,616)	\$ -	\$ (1,005,101)
Renewal and Replacements	(155,250)	(503,476)	(166,308)	(4,475,340)	(178,153)	(940,380)	(890,595)
Total Capital Projects	\$ (155,250)	\$ (1,017,664)	\$ (166,308)	\$ (18,927,244)	\$ (2,510,769)	\$ (940,380)	\$ (1,895,696)
Ending Balance	\$ 591,886	\$ 415,710	\$ 628,100	\$ 3,783,017	\$ 2,331,698	\$ 1,533,068	\$ 857,198
<i>Less: Min. Cap. Cont. Target 2% of Plant</i>	\$ 342,949	\$ 363,302	\$ 366,628	\$ 745,173	\$ 795,388	\$ 814,196	\$ 852,110
Balance After Policies Funded	\$ 248,937	\$ 52,408	\$ 261,472	\$ 3,037,844	\$ 1,536,310	\$ 718,872	\$ 5,088

Notes: Beginning balance calculated by taking operating fund minimum plus ending balance

City of Sultan Sewer Utility Rate Study - Growth Scenario General Facilities Charge

Existing Cost Basis		Notes
Plant in Service		
Utility Capital Assets	\$ 16,992,177	Original cost of plant-in-service as of 2006
plus: Interest on Non-Contributed Plant	5,070,008	Interest on assets up to a maximum 10-year period
Total Existing Cost Basis	\$ 22,062,185	
Customer Base		
Existing Equivalent Residential Units	1,485	Existing residential customer equivalents as of 2006
Total Customer Base	2,388	From Sultan Wastewater Treatment Plant Upgrade - Engineering Report
Total Charge per ERU, Existing Cost Basis	\$ 9,240	



City of Sultan

Issue Paper #1:

Wastewater Treatment Facility Upgrade

Financing Options

Issue:

The City of Sultan is considering significant upgrades to their Wastewater Treatment Facility to accommodate the substantial population growth that is anticipated in the next 20 years. The costs associated with the upgrades place significant financial risk on the utility and, as a result, its ratepayers. The City would like to identify and evaluate the financing strategies available to them that would minimize risk to the utility's existing customers while enabling the projected growth to occur.

What financing strategies are available to the City, and what are the strengths and weaknesses of each alternative?

Analysis:

Utilities finance major capital improvements through a variety of mechanisms. Large scale improvements often impose financial risk on the utility, and thus its ratepayers. When funding such improvements would impose disproportionate costs or risks on existing customers, alternative strategies can and should be considered to mitigate or transfer such risk to benefited parties.

This document summarizes three conceptual funding approaches targeted at managing and assigning project financial risk. The objective is to identify potentially viable funding approaches which avoid placing undue risk or financial burden on existing utility customers while enabling necessary project development to occur.

Alternative 1: General Facilities Charges

Description: This is a cost-recovery mechanism that imposes an up-front charge as a condition of service. The General Facilities Charge (GFC) is imposed on new development based on capacity required. Capital cost and capacity of the system define the basis of the GFC. In this strategy, project funding remains the City's responsibility, with GFCs as a potential related revenue source.

The most common approach to this strategy incorporates two cost bases into the calculation of the GFC: existing facilities and future capital projects. The "existing" portion of the GFC is determined by the value of the facilities currently in use by the City. New development pays for their fair share of the existing facilities based on the capacity of the system and the demand placed by the new connection. In addition, Cities are permitted to add ten (10) years worth of interest to the cost of the existing system (RCW 35.92.025).

The “future” portion of the GFC is determined by the value of the future capital projects listed in the Capital Improvement Plan (CIP) of the City’s adopted comprehensive plan. Similar to the existing portion of the GFC, new development pays for their fare share of future projects costs based on the capacity served by each project and the demand placed on the system by the new connection. The cost of each project listed in the CIP is allocated to existing and future customers based on the nature of the project (growth-related or repair/replacement) and the capacity served by growth-related projects.

Advantages:

- Allows access to public funding resources
- Provides an equitable charge that adapts to changing costs
- Recovers both past and planned costs in proportion to development requirements
- A common approach, used by a large number of utilities in Washington state

Disadvantages:

- Unreliable revenues dependent on development schedules and execution
- City assumes financial risk; developer is not obligated until ready to develop or connect

At this time, the City has expressed a concern with including the “future” portion of costs in the GFC calculation. However, it is important to note that this is a common and practical strategy available to the City should they choose to reconsider this alternative.

Alternative 2: Developer Reimbursement Contracts (Latecomer Agreements)

Description: Latecomer agreements, authorized under chapter 35.91 RCW, allow construction of utility system improvements by a private landowner(s), with reimbursement by other private landowners who may later connect to the city’s system and benefit from those improvements.

Included within the definition of water and sewer facilities eligible for reimbursement under the statute are “construction of storm, sanitary, or combination sewers, pumping stations, and disposal plants, water mains, hydrants, reservoirs, or appurtenances” within the city or within ten miles from the city limits.

The developer first enters into a recovery contract with the city, then constructs the improvements in accordance with the city’s master utility plans and in conformance with city construction standards. The city inspects and accepts for maintenance the constructed facilities; the facilities are considered

city property, and all costs related to operating and maintaining the facilities are paid for by the city.

Under this funding strategy, the developer fronts the initial costs of the upgrade and receives latecomer payments from future landowners connecting to the system.

Advantages:

- Avoids financial exposure for the city for project construction
- Enables developer to control project schedule
- Requires latecomers to pay toward project costs and reimburse developer
- A relatively common financing strategy used by utilities and municipalities across the state for a variety of capital projects (Appendix A includes a list of utilities)

Disadvantages:

- Precludes access to public funding sources
- 15 year statutory limit on term of agreement
- City still responsible for operation and maintenance costs
- May require developer to comply with public procurement process

To summarize, this strategy involves financing of project costs through developer funding, with the City taking ownership of the facilities once construction is completed and assuming all operating and maintenance costs. The developer is then reimbursed for their upfront investment through latecomer payments from future landowners connecting to the system.

This option may not be allowed in the construction of treatment facilities. The City should obtain a legal opinion regarding the definition of eligible facilities.

Alternative 3: Contractual Development Commitment

Description:

Establishes an agreement between the City and the developer for the developer to acquire or pay for future capacity according to a specified schedule, typically through pre-purchase of GFCs with installment payments.

This strategy contains three major elements:

- **Definition of Cost and Capacity Shares:** Values for the existing facilities and improvement costs are added together to determine the total capacity cost of the improved system. Developers requiring treatment for new connections are required to pay for their proportionate share of the total capacity cost.

- Establish financial commitments and guarantees: The strategy is contingent on the willingness of the developer to guarantee payment of certain costs and payments attributable to their specific area of development. There are three phases to this element:
 - Developer pays for pre-construction project costs to begin the planning process, and an agreement is developed between the City and the developer that outlines the project schedule, payment plan, and a commitment on the City's part to proceed with the project.
 - The City will be the owner of the project in order to provide potential access to public loan programs or tax exempt debt for project financing. The City secures financing and begins construction of the project.
 - In return for treatment capacity adequate for the developer's needs, the developer will guarantee payments to the City sufficient to cover their corresponding share (possibly all) of debt service.
 - The developer would guarantee an annual payment stream linked to payment of project General Facilities Charges
 - The developer will secure the payment stream with an irrevocable letter of credit from a financial institution acceptable to the City. The credit amount will be equal to the total GFC payment obligation for the development under the agreement.

In summary, the method for securing the project financing in this strategy includes an up-front payment toward pre-construction costs, plus a guaranteed payment stream to meet debt expenses. The payment stream is in turn secured by a letter of credit of a quality acceptable to the City.

Advantages:

- Allows access to public funding sources
- Provides guaranteed, scheduled funding and cash flow to utility to help support project debt service
- Protects City from some risks of development delay or reduction
- Can include provisions to support O&M costs

Disadvantages:

- Issues (legal, cost) related to transfer of obligation to divided parties
- Can create "reservoir" of unused capacity and pressure to allow transfer/sale rights

- Less secure payment stream than other options

Conclusion:

The three alternative capital financing strategies identified above should be evaluate by the City in light of their own needs and concerns. The first alternative, a General Facilities Charge, is a relatively common approach used by a large number of utilities in Washington state. The strategy involves a certain degree of financial risk on the City's part, but allows for a flexible and equitable charge that recovers both past and planned costs in proportion to development requirements.

The second alternative, Developer Reimbursement Contracts, is a "Latecomer Agreement" that allows for construction of utility system improvements by a private landowner(s), with reimbursement by other private landowners who may later connect to the city's system and benefit from those improvements. This alternative precludes access to public funding sources, yet involves minimal financial risk to the City. The RCW authorizing this strategy (RCW 35.91) may not include treatment plants under the definition of facilities eligible for funding via latecomer agreement; a legal opinion regarding this alternative is necessary.

The third alternative, a Contractual Development Commitment, establishes an agreement between the City and the developer for the developer to acquire or pay for future capacity according to a specified schedule, typically through pre-purchase of GFCs with installment payments. The developer provides an up-front payment toward pre-construction costs, plus a guaranteed payment stream to meet debt expenses. The payment stream is in turn secured by a letter of credit of a quality acceptable to the City. This strategy allows access to public funding sources and provides guaranteed, scheduled cash flow to the utility to help support project debt service.

Important factors the City should consider include determining an acceptable level of financial risk, assessing the importance of access to public funding resources, and ensuring the desired option meets all legal requirements.

APPENDIX A:

UTILITIES WITH LATECOMER AGREEMENT POLICIES

Cities of:

Port Townsend

Lake Stevens

Redmond

Ridgefield

Yelm

Camas

Monroe

Colville

Friday Harbor

Raymond

Gig Harbor

Carnation

Oak Harbor

Please reference the following website for more information regarding latecomer agreements:

<http://www.mrsc.org/Subjects/PubWorks/latecomers.aspx>