

Changing Perspectives on Outside Water-Rate Surcharges: *Understanding New Criteria*

By: Greg Clumpner, Director, Utility Rate Group

Municipal water agencies throughout California sometimes impose a surcharge on customers “outside” their normal service area in order to recover the additional costs of serving customers farther from the core service area – and possibly for other reasons. And outside customers could actually choose to use another agency to provide their service or even develop their own water system.



Generally, outside surcharges have been applied without a specific cost-of-service analysis, and are often set at 25-percent of the charges paid by inside customers. However, recent court rulings have changed this by requiring a clear cost basis, and many cities are now attempting, for the first time, to demonstrate this cost basis.

WHAT IS THE BASIS FOR OUTSIDE SURCHARGES?

Outside surcharges may have been originally developed using arguments that are no longer valid. Municipal water utilities that want to provide adequate justification for their

surcharges, particularly when attempting to increase them, should consider the following:

Surcharges based on original system investments: If the original water system was purchased from a private water company using General Fund or property tax revenue from inside customers, inside customers may see the surcharge as a valid recovery of their investment in the water enterprise. However, this may be problematic if the water system was originally purchased (say 80 years ago) and is now essentially fully depreciated.

Surcharges applied to both fixed and volumetric charges: Many surcharges are applied to both fixed and volumetric charges. However, if the purpose is to recover infrastructure costs, those costs are most appropriately collected through fixed charges; volumetric surcharges may not be appropriate if they are recovering purchased water and pumping (energy) costs.

Customer class characteristics should be considered: Customer classes generally consider factors such as consumption levels and peaking demands. Outside customers with different consumption patterns than inside customers might statistically be a separate class and, therefore, it may be better to eliminate the surcharge and treat them as a separate class, since any cost differences would then be directly calculated into their rates.

Surcharges that recover public safety costs: Public safety services primarily protect city residents and businesses, and outside customers may receive little or no direct benefits from these costs if they are included in the outside surcharges. Such costs may be difficult to defend.

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Update on Development Impact Fees and ADUs

By: Tim Seufert, Managing Director

This past spring, the California Senate policy committees decided to put a pause on fee caps as proposed in Senate Bill (SB)13 and SB 4. These two bills would have capped fees on Accessory Dwelling Units (ADUs) and other types of housing. Development impact fees are calculated based on estimated and reasonable costs and development projections. In addition, such fees already meet stringent

constitutional and statutory controls that require developer fees to bear a reasonable relationship to the impact of the new development, and limit school fees to \$3.69 per square foot or up to only half of construction costs.

These fees are an important tool for local governments to provide basic infrastructure and quality of life investments in a community that supports new development. For example, impact fees can pay for firefighting, facilities, vehicles and equipment to maintain service levels and protect the lives and property within new structures, including ADUs. Recreation and park districts are dependent

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on impact fees to establish new parks as neighborhoods grow. Park fees were implemented during the post war boom to ensure that all California neighborhoods would have access to parks and open space. Some park districts report being dependent on Quimby and park development fees for up to three quarters of all their revenue.



The Senate policy committees decided that if additional controls are necessary, a more appropriate solution would be a comprehensive look at the Mitigation Fee Act, which governs developer fees. Current law, enacted by AB 879 (Grayson, 2017) directs the Department of Housing and Community Development to study developer fees and provide recommendations by June 30th, 2019. The fee caps were removed from both bills until the study is released with recommendations.

SB 13 (Wieckowski) previously would have prohibited any impact fees on ADUs smaller than 750 square feet and significantly limited fees for larger ADUs. When it comes to utility connection fees, ADUs already receive preferential treatment relative to other development. Under a deal struck in SB 1069 (Wieckowski, 2016), local governments may only impose connection fees on a subset of ADUs and limits those fees to the proportionate burden caused by the ADU. SB 13 would have undone this deal, after only three years, by entirely prohibiting connection fees on any ADUs.

SB 4 (McGuire) previously would have prohibited impact fees on “neighborhood multifamily developments” – up to a four-unit apartment in urban areas or up to a duplex in non-urban areas. The bill would have expressly stated that this prohibition did not apply to fees for water, sewer, or utility services.

SPECIAL TAXES: IS 2/3 OR 50% VOTER APPROVAL NEEDED?

By: Tim Seufert, Managing Director

The California Constitution requires that special taxes receive 2/3 voter approval for implementation, and this has been the general understanding for decades. Specifically, Proposition 218 requires that special taxes proposed by a council or board receive 2/3 approval for implementation.

More recently, however, a court case, the *California Cannabis Coalition v. City of Upland*, was decided: The results of that case essentially seemed to open the door to approval of

special taxes at the 50% level if they were proposed by citizen initiative, not by the local governing agency.

The San Francisco City Attorney subsequently issued an opinion that the two-thirds rule could be avoided in this way, if a special tax was proposed by a citizen initiative. Three special taxes were then proposed by initiative (two city-related, with one for the school district) and approved at a simple majority, not at 2/3.

The Oakland USD followed San Francisco and is implementing a



parcel tax that achieved just over 50%, yet it was proposed as a measure requiring 2/3 or higher approval. The three San Francisco revenue measures approved in 2018 are now in litigation. Those cases will provide guidance for all local governments over the next year or two.

UPCOMING CONFERENCES:

California Special District Association General Manager Summit (CSDA):

June 23 – 25, HYATT REGENCY, Newport Beach
Tim Seufert will speak on revenues along with Michael Colantuono of Colantuono, Highsmith, Whatley, PC

Floodplain Management Association Annual Conference (FMA):

September 3 – 6, THE SHERATON MARINA, San Diego

California Special District Association Annual Conference (CSDA):

September 25 – 28, ANAHEIM MARRIOTT, Anaheim
Sara Mares will speak on how to finance new projects with CFDs and Assessment Districts. *Stop by the NBS Booth and meet our team!*

California Stormwater Quality Association Annual Conference (CASQA):

October 7 – 9, MONTEREY CONFERENCE CENTER, Monterey

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NBS is Growing!

NBS added 6 new team members so far this year:

Sandra Burkhart, Derek Keene, Leslie Cremer, Amanda Welker, Alice Bou and Jeremy Jung.

Sandra is a Senior Consultant with profound industry knowledge from many years of leadership in government agencies, banking, and the energy industry.

Derek, Leslie, Amanda and Alice are each Financial Analysts. Derek has extensive experience in operations management and finance. Leslie brings a wealth of experience in accounting, analysis and financial management. Amanda's background is in municipal budget planning and analysis. Alice has two decades of financial, accounting and risk management experience.

Jeremy is a GIS/Data Analyst and will produce products specific to public engagement services and revenue studies. He comes to us with significant GIS experience.

These professionals will add to NBS' ability to *help communities fund tomorrow.*





32605 Temecula Parkway, Suite 100
Temecula, CA 92592

Questions to Consider When Evaluating Outside Water-Rate Surcharges

While the methodology for calculating outside surcharges is still an evolving practice, some of the key questions that should be answered include:

1. Is it transparently documented how the surcharge was calculated?
2. Do they demonstrate their cost basis?
3. Should outside customers be treated as a separate customer class rather using a surcharge?
4. Should outside customers expect reasonable answers to questions such as:
 - *What's the total revenue collected from outside customers through surcharges, and what's the cost basis for those charges?*
 - *What specific benefits are provided to outside customers (additional pump stations, storage, etc.)?*



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WATER-RATE SURCHARGES | *Continued from cover*

Surcharges that reimburse governmental facility costs: Some cities allocate a share of general governmental facilities to their water utility. Yet if there is no apparent cost incurred, benefit provided, or reasonable basis for allocating governmental facility costs to outside water customers, the surcharge begins to look more like a subsidy to the General Fund.

Visit online at nbsgov.com for the full article. This article was also published in *Journal - American Water Works Association Volume 111, Issue 1 Pages: i-iv, 2-93, January 2019*