CITY OF BEVERLY HILLS

PUBLIC WORKS SERVICES DEPARTMENT

MEMORANDUM

TO: PUBLIC WORKS COMMISSION

FROM: Trish Rhay, Assistant Director, Public Works Services

DATE: December 11, 2014

SUBJECT: Water Capacity Fee Update

ATTACHMENT: December 2, 2014, City Council Agenda Report

At its meeting of December 2, 2014, the City Council authorized staff to proceed with the development of Water Capacity Fees.

As recommended by the Public Works Commission and the Public Works Liaison Committee, the City Council approved a hybrid fee structure to be applied to new and redeveloped residential and/or commercial projects.

Staff will provide an overview of the City Council's deliberation on this matter.

AGENDA REPORT

Meeting Date: December 2, 2014

Item Number: F-3

To: Honorable Mayor & City Council

From: Trish Rhay, Assistant Director, Public Works Services - Utilities
Daniel E. Cartagena, Senior Management Analyst
Michelle Tse, Senior Management Analyst

Subject: WATER CAPACITY FEES

Attachments: None

RECOMMENDATION

Staff seeks City Council approval on the establishment of the water capacity fee structure and the application of the fees on future residential and commercial developments.

If the City Council is in support of the proposed framework for the water capacity fee structure, staff will bring forward a similar framework for wastewater capacity fees for City Council consideration at a future meeting.

INTRODUCTION

At its August 13, 2014 meeting, the Public Works Commission ("Commission") unanimously supported the establishment of both water and wastewater capacity fees in the Beverly Hills Water service area, which includes a portion of West Hollywood. The Public Works Liaison Committee ("Liaison Committee") members, Councilmembers Brien and Mirisch, are also in support of the water capacity fee framework. The proposed water capacity fee structure will be assessed on both new construction and substantial remodels and additions for residential, commercial, and mixed-use projects. This report will describe the framework and impact of capacity fees to offset the anticipated increase in water demand on the existing water system. A Liaison meeting was held on November 25, 2014 and their recommendation will be presented to the City Council during the December 2, 2014 Formal Session. The wastewater capacity fee recommendation will be brought forward for City Council consideration at a future meeting.

DISCUSSION

In the last few years, the City has experienced an increase in construction in both residential and commercial sectors following the 2008 economic downturn. The trend with construction projects is that the properties being built are considerably larger in size. This growing trend prompted the Commission to inquire as to the financial and physical conditions of the existing water infrastructure to meet the anticipated water demand increase due to these larger properties. The

concern expressed was that the growing pace of construction activity may accelerate the need to increase the water system's supply and capacity.

By way of background, Beverly Hills rate payers have been investing in the existing water system since the early 1900's. With the exception of the water treatment plant (currently debt funded) the entire system has been paid for by past and present customers. Current water rates are not adequate to support projects to expand and maintain the water system to meet future needs. As part of the analysis, the Commission discussed the fairness of levying the cost of expanding the water system to existing customers. To address the fairness and equality issue, the Commission recommends that water capacity fees be applied to new and substantial remodel and development projects. These funds would then be used to expand the City's water system in order to meet increased demand.

Capacity fees are one-time capital charges that ensure rate equity between past, present and future customers. These fees are imposed on customers that request new or expanded connections to the City's water system. Such fees are not uncommon and are permitted by law. There are, however, provisions that limit how the capacity fees can be structured. Water capacity fees can be imposed so long as the charges do not exceed the estimated cost for providing such a service.

The basic statutory standards governing water capacity fees are embodied in Government Code Sections 66013, 66016, 66022 and 66023. Government Code Section 66013, in particular, contains requirements specific to pricing water connection fees:

> *Notwithstanding any other provision of law, when a local agency imposes fees for water connection or sewer connection, 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, unless a question regarding the amount the fee or charge 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."*

Section 66013 also includes the following general requirements:

- Local agencies must follow a process set forth in the law, making certain determinations regarding the purpose and use of the fee; they must establish a nexus or relationship between a development project and the public improvement being financed with the fee.

- The connection fee revenue must be segregated from the General Fund in order to avoid commingling of connection fees and the General Fund.

Public Works Commission and Public Works Liaison Committee Review

The water capacity fee framework has been discussed and vetted by the Commission and the Liaison Committee and both support the establishment of water capacity fees. The Liaison Committee is recommending the water capacity fee apply to both new construction and substantial remodels for commercial, mixed-use, multi-residential and single family properties. During these discussions, it was pointed out that the standard approach for assessing capacity fees is typically based on the water meter size needed to support new development. However, the Liaison committee felt the standard meter size assessments missed smaller scale development that may be expanding their usage but not significant enough to trigger a water meter upgrade. A brief discussion also took place in September with the City Council during setting of the fiscal year 2014/15 water rates.

The following sections discuss the capacity fee framework, which consists of a hybrid fee structure approach. The proposed hybrid method allows a fee assessment on construction projects regardless of whether the scope of construction work triggers an increase to the meter size.

Proposed Hybrid Capacity Fee Structure

The first step in the capacity fee calculation is to determine the total cost associated with providing capacity for future development. There are two factors that need to be considered when determining the investment new customers should pay:

1. Water distribution system – asset value
2. Additional water supply development – future investment

These factors set the total revenue target any new capacity fee would need to recover from development within the City's system. The following sections elaborate on the factors and figures taken into consideration in the development of the capacity fee structure.

Water Distribution System - Asset Value

Since rate payer investments made since the early 1900's have created a water system that would support existing and future customers, the capacity fee should factor in new customers "paying back" existing customers for past investments made that allow and support new development. This section details the value of these past investments.

By way of background, the existing water system consists of the following major components:

- 10 reservoirs for a total storage capacity of close to 40 million gallons
- 4 groundwater wells
- 2 service connections to Metropolitan Water District (MWD)
- 171 miles of pipeline
- 11,000 water meters

Table 2 below provides the estimated value of the existing Water System.

Table 2 – Estimated City Water System Value

Asset Value		$124.4 Million
Capital Improvement Program (CIP)	[+]	$ 6.1 Million
Debt	[-]	$ 37.7 Million
TOTAL		$ 92.8 Million

The asset value in the table above is based on current book value of all water assets within the City of Beverly Hills water system. The City will need to add new wells and treatment capacity for new users; therefore these assets in the current water system are excluded in the system value. The Capital Improvement Program ("CIP") value represents a 2.5 year average of the current 5-year CIP. This CIP value is based on the City's current 5-year CIP. This value will be scaled in each consecutive year so new customers will pay the appropriate share of these costs. The debt balance represents the remaining principal bond payments for the Water Treatment facility. All rate payers will pay for this debt on their base bills.

Water Supply Development - Future Investment

Public Works Services is currently working with the Commission to complete the 10 year Water Enterprise Plan. This plan will formalize the project and investment portfolio needed to sustain the City's long term water supply. The preliminary estimated investment of approximately $30 million over the next 10 years will be required to meet the City's increased water production needs.

Currently, the estimated $30 million capital investment is currently not factored in the existing water rates.

Calculation of Fees

The next step in the process is to convert the above investments into the proportional fee related to any given development size and impacts. This is done by converting each investment type into a unit type usage rate. Table 1 below shows these conversions.

Table 1- Total Cost per Gallons Per Day (GPD)

Investment Type	Total Investment	System Volume (gpd)*	Cost / gpd*
Water Distribution System	$92,817,860	9,030,575	$10.28
Water Supply Development	$30,000,000	3,000,000	$10.00
Sum of Water Distribution and Water Supply Development			$20.28

*Gpd = gallons per day

The resulting cost/gpd of $20.28 can then be used to assess the cost of the projected water usage for project development. The average water use for a single family residence is approximately 925.7 gallons per day. To calculate the single family residence connection cost, the cost/gpd (i.e. $20.28) multiplied by the average number of gallons per day for a single family residence (i.e. 925.7 gallons) equates to $18,773. There are several assumptions in this calculation:

Assumptions:

1. The $18,773 figure accounts for both indoor and outdoor water use on the property.
2. Half of the usage is for personal indoor use. To find the average cost for a single family residence indoor use, 50% of $18,773 would be $9,387.
3. The average single family residence size is 5,000 sq. ft. To calculate the average cost per square footage of single family residence, it would be $9,387 / 5,000 sq. ft. = $1.88

Based on this analysis, $1.88 sq. ft. is the average cost per square feet of single family residence; this figure will be used to calculate the capacity fee using the net increase of square footage. Example 3a below will highlight how this figure is used to calculate the capacity fee for residential projects.

In summary, the proposed capacity fee framework is designed to achieve the following objectives:

- Assess the water capacity fee on new and substantial residential, commercial, and mixed-use projects that have expanded water usage but may not necessarily trigger a meter size upgrade.
- The first 1,000 sq. ft. net increase of floor space for residential projects (in which the project scope does not trigger a meter size upgrade) would be exempt from the capacity fee assessment.
- Commercial development and redevelopment projects would be assessed a capacity fee rate different than residential projects. The calculation would be based on building use type, similar to the pre-existing wastewater fees.

Application of the Fee

As stated earlier, the hybrid approach will assess fees for both residential and commercial redevelopment projects regardless of whether the development triggers a meter change or not. Table 2 below illustrates which calculation would apply to any given commercial and residential development.

Table 2 – Hybrid Capacity Fee Framework

	Meter Rate Calculation Approach	Sq. Ft. Rate Calculation Approach
New Development	Yes	No
Substantial Remodel Requiring Meter Change	Yes	No
Substantial Remodel Not Requiring Meter Change	No	Yes

Following are examples for each specific type of assessment that may occur under the proposed hybrid capacity fee framework and highlights how the capacity fee framework will be applied in both residential and commercial project settings.

Example 1: New Development – Residential and Commercial Projects
For both new residential and commercial projects that need to be connected to the City's water system for the first time, the capacity fee would be calculated as a flat rate fee based on meter size. Given the current layout of the City, there are very few, if any, areas that do not have water meter connections already in place.

Table 3 provides the breakdown of the water capacity fee assessments based on the various water meter size.

Table 3 - Water Capacity Fee Based on Meter Size

Meter Size	Capacity Multiplier	Capacity Fee
1"	1	$ 14,912
1.5"	2	$ 29,824
2"	3.2	$ 47,719
3"	6	$ 89,473
4"	10	$149,121
6"	20	$298,243

For example, if a 6-unit condo development of 100,000 sq. ft. is built on a vacant lot with no current meter but installs a 2" water meter, the capacity fee assessment would be $47,719 as outlined in Table 3 above.

Example 2: Redevelopment Requiring Meter Upgrade – Residential and Commercial Projects
Residential and commercial projects that trigger the need for a larger meter size would be assessed the cost difference of the meter upgrade from the current smaller to new larger meter. However, if a property remodel does not trigger a meter change-out, the capacity fee would be calculated based on the net increase of square footage in floor area.

For example, if a single-family residential redevelopment project required a water meter upgrade from a 1" to a 1.5" water meter, then the capacity fee would be assessed as follows:

1.5" new larger meter size:	$ 29,824
Less 1" current smaller meter size:	$ 14,912
Assessed Capacity Fee:	*$ 14,912*

Example 3a: Redevelopment Without Meter Upgrade – Residential Projects
If a residential redevelopment project does not require a meter change-out, the capacity fee would be calculated based on the net increase of square footage in floor area.

For example, if a 4,000 sq. ft. single family residence was torn down to build a 6,000 sq. ft. single family home, the water capacity fee would be calculated based on the net increase of square footage in floor area. In this case, the 2,000 sq. ft. increase in the property size would result in a capacity fee assessment of $4,000, calculated as follows:

2,000 sq. ft. property size next increase x $1.88/sq. ft. = $3,760 capacity fee assessment

However, any net increase of square footage up to 1,000 sq. ft. would be exempt from the capacity fee assessments. This exemption is included in the framework calculation to address rounding factors within the calculations. Smaller residential projects may be significant enough to warrant a capacity fee assessment. As such, any net increase of square footage in excess of the 1,000 sq. ft. would be assessed the full capacity fee.

Example 3b: Redevelopment Without Meter Upgrade – Commercial Projects
Capacity fees for commercial projects that do not trigger a water meter upgrade will be calculated using the pre-existing water uses utilizing wastewater fees. Table 4 provides an overview of the pre-existing rates based on building usage type.

Table 4 – Water Capacity Fees for Non-Residential Use

Customer Class	Beverly Hills Estimated Water GPD (gal/day)	Service Unit	Water Connection Fees
Auditorium/Community Center	4.4	Per seat	$ 90
Bank	167	Per 1,000 sq. ft.	$ 3,380
Gymnasium	278	Per 1,000 sq. ft.	$ 5,633
Health Spa	667	Per 1,000 sq. ft.	$13,519
Hotel, per room	144	Per room	$ 2,929
Medical Office	278	Per 1,000 sq. ft.	$ 5,633
Office Building	167	Per 1,000 sq. ft.	$ 3,380
Shopping Center	167	Per 1,000 sq. ft.	$ 3,380
Coffee House	333	Per 1,000 sq. ft.	$ 6,759
Restaurant – Full Service	33	Per seat	$ 676
Retail Store	89	Per 1,000 sq. ft.	$ 1,803
School – Private	222	Per 1,000 sq. ft.	$ 4,506
Supermarket	167	Per 1,000 sq. ft.	$ 3,380

If the project increases the existing size of the business for the same use, then the net increase of square footage will be calculated based on the business type use.

For example, if a hotel expands its size by adding 6 more rooms, then the capacity fee would be calculated as follows: $2,929 per room x 6 rooms = $17,574.

The capacity fee calculation will also take into consideration a change in building use. For example, if a 750 sq. ft. commercial building was redeveloped from retail use to a hair salon, the capacity fees will be calculated using the net square footage increase with the new building use type rate.

Health spa connection fee: 750 sq. ft. x $13,519 per 1,000 sq. ft.		$10,139.25
Retail store connection fee: 750 sq. ft. x $1,803 per 1,000 sq. ft.	[-]	$ 1,352.25
Capacity fee assessment:		*$ 8,787*

It is possible to have instances in which commercial development projects may initially trigger a capacity fee based on a meter size upgrade and subsequent future development projects may trigger additional capacity fee assessments. For commercial projects that have previously paid for the capacity fee based on a meter upgrade, development projects for the same building can appeal the re-assessment for capacity fees. The rationale is that capacity fees based on meter change upgrades already pay for the anticipated increase in demand. As such, the assessment of additional capacity fees is not necessary.

Proposed Capacity Fee Collection Method

The City would collect the capacity fee through the bi-monthly utility billing process. Staff would, on a regular basis, compile a listing of all development projects in both Beverly Hills and the portion of West Hollywood serviced by the City to assess the capacity fees. The fees would be added to a property's utility billing statement. The two advantages to this payment method are: 1) would provide an existing accountholder the option to pay the fee in installments or a one-time payment; and 2) provide a more manageable method of collection the fee in West Hollywood.

As previously mentioned, there will also be an appeals process in place to address instances in which commercial development projects may trigger subsequent capacity fee assessments after having paid for the capacity fee assessed based on a water meter upgrade.

FISCAL IMPACT

The proposed capacity fees would fund future capital infrastructure projects to expand and maintain the City's existing system. The City's Water utility service is funded by the Water Enterprise Fund. The Water Enterprise Fund is solely dependent on user rates, charges and fees to fund operations, maintenance and long-term debt obligations. The establishment of the Water Capacity Fee is seen as a method to minimize future rates increases due to buy-in benefits resulting from future growth.

George Chavez
Approved By