

**CITY OF WILLITS**  
**WATER RATE STUDY**

**JUNE 1997**

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Attn: Gordon Logan  
City Manager

Bartle Wells Associates is pleased to present our water rate study for the City of Willits water enterprise. The report presents our recommendations on adjustments to the City's water rates to cover operating and capital expenses and on financing necessary capital improvements.

We found that no overall in water revenues is needed in 1997/98. However, there are some inequities in the current rates, which should be corrected. We also believe that the City will need to increase water rates in 1998/99, to yield additional revenue of \$100,000 or 7.7 percent. The report calculates rates for the next five years, on two bases: cash financing of capital improvements and the use of debt for the largest capital improvement-replacement of the main transmission line. We believe that the City should consider borrowing about \$1.5 million to finance the balance of the main transmission line. A portion of the line is included in the 1997/98 budget.

The recommended rates will reduce the monthly bill for the customer with a 5/8-inch meter and average water use by \$0.93 or 2.7 percent. The impact on customers with larger meters varies.

We have enjoyed working with the City on this interesting and challenging assignment. We appreciate the cooperation we have receive from City staff. We look forward to working with the City in implementing the recommendations.

Very truly yours,

BARTLE WELLS ASSOCIATES

Lora J. Stovall, CIPFA  
Principal

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## SUMMARY AND RECOMMENDATIONS

- The City of Willits water enterprise provides water service to about 2,150 customers in and adjacent to the City. Over 80 percent of the customers are single family residential customers, most of which have basic 5/8 x 3/4-inch water meters. The number of water customers and level of water sales have been very stable over the past several years. Revenues and expenses have also been stable.
- Proposition 218, approved by California voters last November, establishes both substantive and procedural requirements on “fees imposed as an incident of property ownership.” There is considerable difference of opinion among attorneys about whether these requirements apply to water and sewer user fees. If they do apply, the proposition requires that charges be based on the cost of serving each customer. The rate structure recommended in this report should satisfy this requirement.
- Proposition 218 appears to prohibit in lieu payments from enterprise funds to a City’s general fund. Willits’ water and wastewater enterprises have historically paid such fees, but they are not included in the proposed 1997/98 budget. Overhead costs can be allocated to the enterprise funds, as the City does. The overhead cost allocation appears to assign an appropriate share of costs to the water enterprise.
- The water system needs a number of capital improvements over the next few years. The most urgent project is replacement of the main transmission line, the only supply line bringing water to the City. The cost of this project is estimated at \$1.65 million. The report shows the costs and timing of projects if they are financed with cash or if debt is used for the main transmission line.
- Water sales revenue has been about \$1.3 million for the past two years, and this level of revenue should be sufficient for the coming fiscal year. Timber sales in 1997/98 are expected to generate net revenue of over \$600,000 which can be used for capital improvements. In 1998/99, the water enterprise will need revenues from user charges of \$1.4 million, an increase of \$100,000 (7.7 percent) from the current revenue. The projected revenue requirement increases to \$1.5 million in 2000/01.
- The City should consider the use of borrowing for the main transmission line, to accelerate its construction. Financing this project with cash would require a surcharge of \$500,000 per year for two years. Using about \$1.5 million of debt would reduce the impact on water rates and allow current and future water customers who use the line to help pay for it.
- The City’s current water rates consist of a monthly meter charge based on meter size and customer type and a quantity charge based on water consumption. The monthly meter charge includes a water allowance. Water consumption above that allowance is billed at the quantity rate.

- Analysis of the City's current water rates demonstrates some discrepancies, such as:
  - Residential customers pay in effect a higher meter charge than nonresidential customers with the same size meter;
  - The net meter charge, after deducting the value of the water allowance, varies substantially between meter sizes;
  - Larger meters generally pay smaller net meter charges;
  - The 6-inch meter basically pays no meter charge, due to the value of the water allowance.
  - Single family residential customers generally pay a higher average water cost than nonresidential customers.
  
- The recommended rates correct these discrepancies are designed to meet the following basic conditions:
  - To produce enough revenues to pay the total cost of the water system;
  - To achieve equity among customers;
  - To be simple in form, adaptable to changing conditions, easy to administer, and easy for the user to understand.
  
- The rate approach used in the report consists of a meter charge based on meter capacity and a quantity charge based on water use, as follows:
  - Meter charges should be set to generate 50 percent of annual user charge revenue;
  - All customers with the same size meter should pay the same meter charge;
  - Meter charges should be based on the ratio of the meter's capacity to the capacity of the basic 5/8-inch meter, to reflect the relative demand of the water system;
  - No water allowance should be included with the meter charge; and
  - All water should be billed at the quantity rate.
  
- The recommended rates for 1997/98 for customers with 5/8-inch meters are as follows:
  - A meter charge of \$18.60 per month, compared to the current charge of \$21 (which includes the first 300 cubic feet of water.)
  - A quantity charge of \$1.76 per hundred cubic feet of water, compared to a current quantity charge of \$2.40 per hcf for water used over 300 cubic feet.
  - A total bill for the average customer of \$34.26 per month, which is \$0.93 less than the current bill of \$35.20.

Meter charges for larger meters would be higher.

- The recommended rates for 1998/99 would increase by about 8 percent.
  
- The recommended rates have a significant impact on residential customers with large meters. This is due to basing the meter charge on the meter capacity. The City has about 35 single family residential customers with meters of 1-inch or larger. These are

large meters for typical residential customers, and the average usage for the customers does not appear to justify the meter size. The City may wish to consider allowing these customers to change their meters to a smaller size at a moderate cost if the customer's water usage does not require the larger meter.

## **INTRODUCTION AND BACKGROUND**

The City of Willits provides water service to customers in and adjacent to the City. The system is operated as an enterprise, with expenses paid from water revenues.

Bartle Wells Associates, independent public finance advisors, was retained to review the City's current water rates and rate structure for several purposes:

- To review the financial health of the water enterprise and evaluate the sufficiency of revenue produced by the current rates;
- To ascertain compliance with Proposition 218, which imposes certain procedural and substantive requirements on fees related to property ownership, which may include water and sewer fees;
- To examine and update the City's water connection charge.

This report presents Bartle Wells Associates' findings and recommendations.



## **PROPOSITION 218**

On November 5, 1996, California voters approved Proposition 218, "The Right to Vote on Taxes Act," an initiative amendment to the California constitution. The amendment establishes both substantive and procedural requirements on "fees imposed as an incident of property ownership." There is considerable difference in opinion among attorneys about whether service charges for water and sewer are subject to these provisions. A summary of some of the arguments on this point are included in the appendix to this report. These questions will ultimately be settled by the courts, and the answers may not be available for a number of years. In the meantime, Willits and many other local governments in California will have to reach their own conclusions on the practical impact of the proposition.

### **Substantive Requirements**

Proposition 218 imposes the following five substantive requirements for property related fees and charges. If the courts determine that it does apply to water and wastewater fees and service charges, the charges would have to meet these requirements.

1. Revenues from the charge must not exceed the funds required to provide the service.
2. Revenues from the charge must not be used for any other purpose other than that for which it was imposed.
3. The amount of the charge imposed upon any parcel or person as an incident of property ownership must not exceed the proportional cost of the service attributable to the parcel.
4. No charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question.
5. No charge may be imposed for general governmental services... In any legal action contesting the validity of a fee or charge, the burden shall be on the agency to demonstrate compliance with these requirements.

These requirements basically make a "cost of service" approach to rates a requirement of the California constitution. The first three requirements also apply under current (i.e. pre-Proposition 218) law, to avoid charges being characterized as taxes.

One issue of particular concern to many cities is that of general fund transfers. The drafters of Proposition 218 hold that such transfers are revenues in excess of the cost of providing a service and/or revenues being applied to a purpose other than that for which the fee was charged. Clearly, transfers which reimburse the general fund for overhead costs are a cost of service of the utility. However, in lieu transfers to compensate the city for the taxes and franchise fees that a private utility would pay are likely to be prohibited if the proposition is determined to apply to water and wastewater fees.

Calculation of the cost of service should include all the City's costs, including administration, capital outlay, operating and maintenance, conservation programs, maintaining a reasonable reserve, and accumulating funds for capital improvements and replacement. The cost should also include the costs of complying with both the procedural and substantive requirements of Proposition 218. Under current law, a municipal utility is also allowed to earn a profit or rate of return. Proposition 218 likely reverses that law.

Requirement 3 will prohibit preferential rates, such as lifeline or senior citizen rates, on property related services. Differences in rates between residential and commercial customers must be based on differences in the cost of service to such customer categories. Rates designed to encourage water conservation such as ascending block rates may be prohibited, unless it can be demonstrated that there are higher costs of service associated with higher water use.

### **Procedural Rules**

Under Proposition 218, in order to impose new or increased fees and charges, the City must:

- Identify the parcels which would be subject to the charge;
- Calculate the amount of the fee to be imposed on each parcel;
- Provide written notice by mail to the record owner of each affected parcel of the amount of the fee, basis of the fee, reason for the fee, and the time and place of a public hearing on the proposed fee or charge.

The City must conduct a public hearing not less than 45 days after mailing the notice. If the agency receives written protests against the proposed fee or charge at the public hearing from a majority of the owners of the identified parcels (one parcel, one vote), the fee or charge may not be imposed. It will be very difficult in most cases for property owners to assemble protests by owners of a majority of the parcels.

### **Effective Date**

In addition to the uncertainty about the proposition's application to fees and charges, there is also confusion about the effective date of its provisions. The proposition requires that all fees and charges comply with its requirements by July 1, 1997. However, the effective date is confusing with respect to existing fees and charges. The information presented to the voters indicates that all existing fees that continue in effect after July 1, 1997 must comply with Proposition 218. The Legislative Analyst states that by July 1, 1997, local governments would be required to reduce or repeal existing property related fees that do not meet the proposition's restrictions on the amount of fees or use of revenues. Some attorneys believe that agencies do not have to submit existing fees to Proposition 218's procedural requirements, so long as the fees are not being increased, but existing fees must comply with the proposition's substantive requirements.

### **Impact on Willits' Water Enterprise**

The rate analysis in this report evaluates the costs of serving the City's water customers and the rates paid by those customers, and recommends adjustments to correct inequities. The recommendations will result in rates which are proportional to the cost of service for each customer category.

The water enterprise has historically paid an in lieu franchise fee to the general fund, as have the City's other enterprises. These fees are probably prohibited by Proposition 218, and the City has not included these fees in the proposed 1997/98 budget. The water enterprise also pays an allocation of overhead costs, which it should continue to pay. The overhead costs allocated to the water enterprise include the costs of City administrative personnel, such as city manager, fiscal officer, city attorney, and city council, all of which provide necessary services to the water enterprise. The allocation is calculated annually and assigns an appropriate share of these costs to the water enterprise.

The City has no special rate categories, such as senior citizen or low income, which would likely be prohibited by Proposition 218. Such categories should not be considered due to their uncertain legality.

Complying with the procedural rules of the proposition will be difficult for a number of reasons:

- Written notice must be provided to the record owner of each parcel. The City sends water bills to the account holder, who may not be the owner.
- The amount, basis, and reason for the fee must be included in the notice. The amount of a customer's water bill depends on his meter size and water usage. The notice will probably have to include the proposed rate schedule and the impact on representative customers.

The proposition provides no way for the city council to override a protest, such as to correct urgent health and safety problems. It also includes no restrictions on the City's ability to reconsider increases in fees following a majority protest. If the City believes that fee increases are necessary, in spite of a successful protest, the council can apparently immediately call for notice a new public hearing on the increased fees.

# WILLITS WATER ENTERPRISE

## Water Customers

The City of Willits water enterprise serves about 2,150 water connections. Table 1 shows the number of customers by meter size from 1991 through 1996. The table shows the number of customers as of December of each year. The number varies slightly from month to month, as the occupancy of individual homes and businesses changes, and new accounts are opened and closed.

The number of customers has been very stable over that time period. The largest category of customers is single family residential connections with 5/8-inch meters. This categories has increased by an average of 12 connections per year. Nonresidential 5/8 meters have increased less than one per year. While most single family residential customers have 5/8-inch meters, there are a few with meter sizes up to 2-inches.

Table 2 shows water accounts by customer type. As shown, 81 percent of the customers are single family residential connections.

## Water Sales

Table 3 summarizes water consumption for 1992/93 through the first nine months of 1996/97 in hundred cubic feet (hcf). One hcf equal 748 gallons. Water consumption has also been very stable. Total water consumption was about 370,000 in 1994/95 and 373,000 in 1995/96. Based on an analysis of water use by month over the past five years, Bartle Wells Associates projects that annual water use for 1996/97 will be about 388,000 hcf, a slight increase from the past two years.

## Financial Data

**Revenues and expenses:** Table 4 summarizes the water enterprise's statement of revenues and expenses from 1994/95 through the recommended budget for 1997/98. User charges constitute over 90 percent of water revenues. The second category of revenues is interest earnings. The expenses are very stable for the years shown, with the recommended budget for 1997/98 equal to the actual expenses for 1994/95. The revenue and expense statement does not include capital expenditures or principal on debt. The water enterprise financial statements are included as an appendix to this report.

**Outstanding debt:** The City has outstanding certificates of participation which were issued in 1994. The COPs refunded prior debt which financed the purchase of the water system. Table 5 is the payment schedule for the COPs. The City's annual payments are about \$350,000. In the Installment Purchase Agreement supporting the COPs, the City committed to maintain a certain level of annual revenues over and above the expenses for operating and maintenance and debt service. This rate or coverage covenant requires the City to establish and maintain rates and charges for water service which are sufficient to yield:

- net revenues of at least 115 percent of annual debt service; and

- net revenues excluding interest income, connection fees and harvest revenues of at least 100 percent of annual debt service.

Net revenues are defined as total revenues of the water system less budgeted operating and maintenance expenses. Revenues means all income and money derived from ownership and operation of the water system, including the sale of timber, gravel extraction, lease of grazing rights, interest on investment, and proceeds of standby or water availability charges levied by the City, as well as transfers from the rate stabilization fund. Table 6 calculates the City's coverage since 1994/95. The City has consistently met its coverage covenant and, based on the recommended budget, should do so in 1997/98.

A coverage covenant protects the bondholders, who are the City's lenders. It requires the City to maintain sufficient revenue to properly operate and maintain the water system, pay its debt, and provide funds for unexpected expenses and capital improvements. Funds remaining after payment of operating and maintenance and debt service can be applied by the City for any legal purpose.

The Installment Purchase Agreement also establishes conditions under which the City can enter into additional contracts and bonds secured by water revenues on a parity with the outstanding COPs. These provisions, called the additional bonds test, are also designed to protect the security of the bondholders by requiring the City to increase revenues sufficient to provide adequate security for outstanding and additional debt. The additional bonds test basically requires the City to demonstrate net revenues of at least 115 percent of debt service on outstanding and additional debt.

The City also received a loan and grant from the State of California Department of Water Resources for the construction of Centennial Dam. The loan, in the amount of \$3,510,000 has interest at 4.1439 percent and is payable in semiannual installments of \$102,742.24 each April 1 and October 1 through October 1, 2019. The loan is secured by a pledge of water revenues which is subordinate to the pledge of the COPs.

**Fixed and variable expenses:** Table 7 analyzes the proposed water enterprise budget for 1997/98, in terms of fixed and variable costs. Fixed expenses are those expenses that the water enterprise must pay regardless of the amount of water sold; variable expenses are those that vary depending on the amount of water. As shown in Table 7, most of the expenses, over 90 percent, are fixed, which is true of most utilities. Generally only expenses for power and chemicals, and some other supplies, vary with the amount of water produced and sold.

### **Capital Improvement Requirements**

Table 8 summarizes capital improvements required over the next ten years, developed by City staff. The City has made significant improvements to the water system since its acquisition, including construction of Centennial Dam and construction of a new water treatment plant. However, additional improvements are needed to other parts of the system, are described below.

- **Main transmission line:** The main line which brings water into the City is in very poor condition and replacement is critical. It is the only supply line, and if it goes down the City cannot deliver any water to its customers. Because of its importance, this line should be replaced as soon as possible. Construction of the project is estimated to cost \$1.5 million, with an additional \$150,000 for design and engineering. Construction will take about one year.
- **Water plant:** Although the water plant is only eight years old, it is already at capacity in the months of July and August. The City should begin to plan for the addition of a third clarifier filter unit. The estimated cost of this project is \$175,000 for equipment and \$50,000 for building and installation.
- **Emergency generator:** The water plant currently has no backup power source if there is an interruption in service from PG&E. A new generator would provide a source of emergency power at a cost of about \$60,000.
- **Pump stations:** The City has four pump stations in the system, which need duplexing and new controls, at a cost of about \$125,000.
- **Water line replacement:** Many of the City's water lines, in addition to the main transmission line, are forty to fifty years old and are seriously corroded. The cost of line replacement is estimated at \$1.3 million.
- **Water meter replacement:** Many of the City's water meters are old and becoming inaccurate. They also lack customer shutoff valves. Replacement of the meters will reduce service costs and staff overtime, and provide more accurate readings. Replacement of 1,500 meters at \$350 each requires a total of \$525,000 for this project.
- **Emergency water pump:** The City has no capacity to pump potable water in an emergency without PG&E power. In the past, the water system has used fire department pumps for this purpose, but the water system should have a diesel powered, high capacity potable water pump for long term use. The estimated cost of the pump is \$35,000.
- **Fire hydrant replacement:** There are approximately 50 red barrel type fire hydrants throughout the City which are so seriously aged that their performance in the event of need is questionable. Replacement of 50 hydrants at \$2,000 each require a total of \$100,000.

Table 8 shows the capital improvements and their costs, and includes two options for timing of the projects. Option 1 assumes cash financing of all projects, and Option 2 assumes the use of debt for the main transmission line. The two financing options are used in the following projections of future revenue and expenses.

With all cash financing, based on the assumptions discussed in the next section on the cash flow projections, the City would complete \$2.4 million of projects within the next five years. These include the main transmission line, water plant expansion, emergency generator and water pump, and some meter replacements. The main transmission line would be constructed over three years, as funds are available. The water line and meter replacement programs would also be phased over a number of years as funds are available.

Using debt to finance the main transmission line would accelerate the capital improvements by allowing completion of that line in 1998/99. Other projects could also be accelerated, such as the meter replacement program, based on the availability of funds and about \$2.8 million of projects within the next five years. Other water utilities have found that meter replacement programs have a rapid payback, as new meters more accurately measure water consumption and result in higher water revenues.

### **Cash Flow Projections**

Tables 9 and 10 are cash flow projections for the water enterprise, which calculate the revenue requirement for 1997/98 and future years. Table 9 finances all projects with cash, while Table 10 uses debt for most of the costs of the main transmission line. The projections are based on the following assumptions:

- **Beginning balance:** The estimated available cash balance of the water fund is expected to be about \$650,000, as of July 1, 1997.
- **User charges:** For 1998/99 and beyond, Bartle Wells Associates has calculated the amount of user charge revenue needed to meet operating and maintenance expense, debt service and coverage, and capital improvements as shown in Table 8.
- **Interest:** Interest is calculated at 5 percent on the average of the beginning and ending balances.
- **Other revenues:** Revenues from other sources are projected at \$25,000 per year.
- **Timber sales:** Timber sales revenues per the budget are included in 1997/98. Net timber sales revenues of \$500,000 are assumed in 2001/02, and are assumed to be applied to capital expenses.
- **Operating expenses:** Operating expenses are projected to increase from the current level at 3.5 percent per year.
- **Debt service:** The tables include actual debt service on the outstanding COPs and the state loan. Table 10, which uses debt to finance the main transmission line, includes new parity debt service, subject to the coverage requirement of the outstanding COPs.
- **Closing balance:** The projections are designed to generally maintain a balance of not less than \$500,000. More specifically, the City should maintain an operating reserve

of at least 20 percent of annual O&M expenses, which would be \$250,000, plus a capital reserve of at least \$250,000.

**Revenue requirement:** The user charges shown in Tables 9 and 10 is the revenue required to meet the City's current obligations for operating expenses and debt service and to undertake the necessary capital improvements. The revenue requirement for the next five fiscal years with cash and debt financing is as follows:

<b>Fiscal Year</b>	<b>Cash Financing</b>	<b>Debt Financing</b>
1997/98.....	\$1,296,600	\$1,296,600
1998/99.....	1,400,000	1,400,000
1999/00.....	1,900,000	1,400,000
2000/01.....	1,900,000	1,500,000
2001/02.....	1,500,000	1,500,000

The current rates will generate sufficient revenue for 1997/98, with the anticipated timber sales revenue providing funds for capital improvements. A rate increase will be needed in 1998/99 to increase water sales revenue by \$100,000 (7.7 percent). Financing the capital improvements on a cash basis would require a surcharge for two years, to generate \$900,000 over that time period.

These are of course projections, based on the assumptions discussed above. Actual expenses and revenue requirements will vary from the assumptions and will need to be reviewed at two to three year intervals.



## **WATER RATES**

### **Current Water Rates**

Table 11 summarizes the City's current water rates. The rates consist of a monthly meter charge, based on meter size and customer type, and a quantity rate based on water consumption. The monthly meter charge includes a water allowance, as shown in Table 11. Water consumption above that allowance is billed at the quantity rate.

The water allowance for all single family residential customers is 3 hcf per month, regardless of meter size. Nonresidential meters of 1-inch or larger have higher water allowances.

Table 11 also calculates the net meter charge, after deducting the value of the water allowance, and the ratio of the meter charge to the basic 5/8-inch meter. This analysis points out some discrepancies in the current water rates, such as:

- Residential customers pay in effect a higher meter charge than nonresidential customers with the same size meter;
- The net meter charge varies substantially between meter sizes;
- Larger meters generally pay smaller net meter charges;
- The 6-inch meter basically pays no meter charge, due to the value of the water allowance.

Table 11 also calculates the ratio of the net meter charge for each category to the basic 5/8x3/4-inch meter. This further demonstrates the inconsistencies in the current rates.

Table 12 calculates the average water bill at the current rates for each meter size, based on average monthly water consumption, and also calculates the effective cost of water per hcf. The average bill for the basic residential customer with a 5/8-inch meter is \$35.20; with the average 9 hcf monthly usage, this is equivalent to \$3.95 per hcf of water consumption. Again, this analysis demonstrates some discrepancies in the relative costs per customer:

- The effective cost per hcf, based on average usage, ranges from a low of \$2.40 for the 6-inch meter to a high of \$9.77 per hcf for the 4-inch meter;
- The customers with 3- and 4-inch meters, on average, use less water than the allowances included in their basic meter charge, which increases their average water cost;
- Single family residential customers generally pay a higher average water cost than nonresidential customers.

These discrepancies should be corrected, to ensure that the City's water rates meet the cost of service requirement of Proposition 218.

## **Revenue by Customer Class**

Table 13 calculates the water consumption and water revenue for each customer class under the City's current water rates. The basic 5/8x3/4-inch meter uses 54.5 percent of water and pays 61.5 percent of revenue. This is a reasonable relationship. The revenue from this meter class should be slightly higher than its water consumption, to reflect the costs associated with demand on the water system from a large number of meters. The costs related to water demand are discussed further in the following section on water rate structures.

Comparison of usage and revenue in Table 13 demonstrates other discrepancies between water revenue and usage. The most significant variations are the underpayment by 2-inch nonresidential meters and 6-inch meters, and the overpayment by 3-inch and 4-inch meters. The ratios also demonstrate the relatively higher costs of residential customers than nonresidential customers with meters of the same size.

## **Cost of Service Rates**

Utility rates today are commonly based on the cost of service concept, which states basically that the rates charged to various customers should reflect the costs of providing utility service to those customers. As discussed earlier in this report, if Proposition 218 is determined to apply to water rates, it would require a cost of service approach to rates. Cost of service rates means that the costs of utility service are distributed to customer classes based on their usage characteristics and requirements for service. Rates must meet certain basic conditions:

- The rates should produce enough revenue to pay for the total costs of the system.
- The rates should try to achieve equity to all customers throughout the entire range of use.
- The rates should be simple in form and, therefore, adaptable to changing economic conditions, easy to administer, and easy for the user to understand.

There are a variety of approaches to cost of service ratemaking. The rate approach used in this report is based on a meter or demand charge based on meter capacity and a quantity charge based on water use. It is a commonly-used approach which is simple to understand and administer and allocates costs to customer classes based on demand and usage.

## **Meter Charges**

The meter charge portion of the water bill is a fixed charge, payable on a regular basis. Any customer connected to the water system must pay the meter charge for each billing period, whether or not they use any water. The meter charge recognizes the fact that the water utility incurs fixed costs in connection with the ability or readiness to serve each and every connection. These fixed costs are not dependent upon the volume of consumption or the magnitude or time of the demand for water. They continue even when a customer does not use water.

A meter charge is a form of demand charge. Demand charges are made to cover those costs which are not related to actual water use but relate to the demand that a customer can place on the water system. The amount of the meter charge varies substantially between agencies.

Most water agencies' rates include a fixed meter charge. Black and Veatch's 1995 survey of water rates in 421 California cities served by 313 water purveyors identified fewer than 10 with volume charges only. About another 45 cities have rate structures that do not combine a base or meter charge with volume charges for water. This category includes miscellaneous rate structures, such as flat rates and rates based on footage or structure size. Many of these rates apply in central California areas in which water is not metered.

A water utility's costs can be divided into fixed and variable costs. In general, the majority of a water utility's costs are fixed, as demonstrated in Table 7. These include personnel costs, overhead, and debt service, all of which are usually significant portions of the annual budget. Variable costs are those that vary based on the amount of water delivered, and include costs associated with source of supply, pumping, chemicals, and similar items.

From a strictly financial point of view, fixed charges are beneficial. The more costs that are recovered through fixed charges, the more secure the utility's revenue stream. The level of revenue is predictable and not subject to fluctuation as water sales fluctuate. Many California agencies learned this lesson during the recent drought periods, as water sales dropped sharply, in response to voluntary or mandatory rationing programs. The utilities' expenses did not drop proportionately, and rate increases were needed.

On the other hand, high fixed charges reduce the amount of control the customer has over his water bill. The bill remains relatively stable regardless of water use. In California today, water utilities generally encourage water conservation. State law specifically authorizes public water agencies to adopt and enforce water conservation programs within their service areas and to adopt water rate structures that promote water conservation. This requires both that the total bill vary based on the amount of water a customer uses, and that the bill inform the customer of his water usage. These requirements encourage a lower fixed meter charge and a higher element of the total water cost based on the volume charges.

In 1992, the California Public Utilities Commission, which regulates investor-owned water utilities, adopted guidelines on the amount of annual revenue which should be generated by the meter charge. According to the CPUC guidelines, systems with over 2,000 connections should generate 50 percent of their annual revenue from meter charges. The percentage increases for smaller water systems.

The size of a customer's meter represents his potential level of demand on the water system. A significant percentage of the costs of any water system is related to its requirement to be able to deliver water to any customer instantaneously at any time and up to the flow capacity of that customer's meter.

Meter charges for different sizes of meters should be based on the relative flow capacity of different-sized meters. The meter capacity measures the demand that each customer can place on the water system at any time. Customers with the same size meters should pay the same meter charge, regardless of type of customer. Table 14 shows flow rates and capacities for meters by size, and their ratios to the 5/8-inch meter.

### **Recommended Water Rates**

Based on the analysis in this study, Bartle Wells Associates recommends the City adopt water rates based on the following structure:

- Meter charges should be set to generate 50 percent of revenue;
- All customers with the same size meter should pay the same meter charge;
- Meter charges should be based on capacity ratio to the 5/8-inch meter;
- No water allowance should be included with the meter charge;
- All water should be billed at the quantity rate.

Table 15 presents the recommended water rates for 1997/98 and projected rates for the following four fiscal years. The water rates include a meter charge based on the above recommendations and a quantity charge. The rates are designed to generate the revenue requirements developed in Table 10. The table also includes a surcharge for cash financing on all the capital projects.

The 1997/98 recommendations restructure rates to correct the inequities discussed and to meet the requirements of Proposition 218 that charges be proportional to the cost of service. The meter charge based on meter capacity reflects the potential demand from each customer and the quantity charge is based on each customer's water consumption.

### **Impact of Recommended Rates**

The recommended rates are designed to maintain water sales revenue in 1997/98 and to increase the revenue by about 8 percent in 1998/99. Table 16 demonstrates the impact of the recommended rates on typical customers. The impact of the rate restructuring varies, with the largest percentage increase on residential customers with large meters. The largest dollar increase would be on the 6-inch meters, which have the lowest water cost under the current rates.

The City has about 35 single family residential customers with meters of 1-inch and larger. The recommended rates have a significant impact on these customers, due to basing the meter charge on the meter capacity. These are large meters for typical residential customers, and the average usage for these customers does not appear to justify the meter size. Based on City water sales data, the average usage by single family residential customers is as follows:

Meter Size	Average Water Use (hcf)
5/8x3/4.....	9
3/4.....	14
1.....	19
1-1/2 .....	30
2.....	23

The City may wish to consider allowing these customers to change their meters to a smaller size at a moderate cost if the customer's individual water usage does not require the larger meter.

### Revenue From Recommended Rates

Table 17 calculates the revenue from the recommended 1997/98 and 1998/99 rates, based on current average water usage. The table demonstrates that the revenue is split about evenly between the meter charge and the quantity charge, and that the revenue would satisfy the revenue requirements developed earlier in this report.

## CONNECTION FEES

Connection fees are charges to new customers to recover the capital costs of facilities that are needed to serve such growth. These costs include future projects which must be constructed to serve new growth, as well as the costs of excess capacity in facilities constructed in advance for future use by new users. The fees must be reasonable and non-arbitrary, and based on facility capital costs, user loads, and system capacity. A variety of methods may be used to determine appropriate connection charges.

Local agencies imposing fees as a condition of development, including water connection fees, must comply with the provisions of California Government Code beginning with Section 66000. Section 66001 of the statute requires a local agency establishing, increasing, or imposing a fee as a condition of a development project to do the following:

- Identify the purpose of the fee.
- Identify the use to which the fee is to be put. If the use is financing public facilities, the facilities must be specified, which may be by reference to a capital improvement plan.
- Determine how there is a reasonable relationship between the fee's use and the type of development project for which it is imposed.
- Determine how there is a reasonable relationship between the need for the public facility and the type of development project on which the fee is imposed.
- Determine how there is a reasonable relationship between the amount of the fee and the cost of the public facility or portion of the public facility attributable to the development on which the fee is imposed.

Section §66013 deals specifically with water and sewer connection fees, and provides that such fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed, unless the fees are submitted to the electorate and approved by two-thirds of the votes cast.

The government code also specifies how the proceeds of such fees must be deposited, invested, accounted for, and expended.

### **Current Connection Fees**

The City requires new connections to pay the actual cost of parts and labor in connection with connecting to the water system, plus a capital improvement fee of \$1,525 per residential unit inside City limits or \$3,025 per residential unit outside City limits. Motels, hotels, campgrounds and other similar uses are charged \$1,025 per room or space. Fees for commercial are based on meter size, and range from \$1,525 for a 5/8-inch meter to \$28,025 for a 6-inch meter.

### **Accounting for Connection Fee Funds**

The government code requires that fees collected in connection with the approval of a development project must be deposited in a separate fund or account to avoid

commingling and that they be expended only for the purposes for which they were collected. Any interest income earned by moneys in the capital facilities account must also be deposited in that account and be expended only for the purpose for which the fee was originally collected.

Within 180 days of the last day of each fiscal year, the local agency must make the following information available for the fiscal year:

- A brief description of the type of fee in the account;
- The amount of the fee;
- The beginning and ending balance of the account;
- The amount of the fees collected and interest earned;
- An identification of each public improvement on which fees were expended and the amount of the expenditures on each improvement, including the total percentage of the cost of the public improvement that was funded with fees;
- An identification of an approximate date by which the construction of the public improvement will commence if the local agency determines that sufficient funds have been collected to complete financing on an incomplete public improvement and the public improvement remains incomplete;
- A description of each interfund transfer or loan made from the account or fund including the public improvement on which the transferred or loaned fees will be expended, and, in the case of an interfund loan, the date on which the loan will be repaid, and the rate of interest that the account or fund will receive on the loan; and
- The amount of refunds made from the account.

For the fifth fiscal year following the first deposit into the connection charge account, and every five years thereafter, the city must make all of the following findings with respect to that portion of the account remaining unexpended, whether or not such amount has been committed to projects:

- Identify the purpose to which the fee is to be put;
- Demonstrate a reasonable relationship between the fee and the purpose for which it is charged;
- Identify all sources and amounts of funding anticipated to complete financing in incomplete improvements when the fee was established;
- Designate the approximate dates on which the funding is expected to be deposited into the appropriate account or fund.

If these findings are not made, the moneys in the account must be refunded.

When sufficient funds have been collected to complete the financing on incomplete public improvements identified when the fee was established and the public improvements remain incomplete, the City must identify, within 180 days of the determination that sufficient funds have been collected, approximately when the construction of the public improvement will begin, or the City must refund unexpended fees and accrued interest to

the then current record owners of the development project on a prorated basis. The City may refund the unexpended revenues by direct payment, by providing a temporary suspension of fees, or by any other reasonable means. If the administrative costs of refunding unexpended revenues exceed the amount to be refunded, the City, after holding a public hearing, may determine that the revenues shall be allocated to some other purpose for which development fees are collected and which serves the project on which the fee was originally imposed.

### **Basis of Connection Fees**

A connection fee should be based on estimates of the capacity in the water system to serve new development and the capital costs related to serving new development.

**Capacity for new development:** In order to connect new customers to the water system, the facilities must have capacity to serve that new development. The capacity of existing facilities must be estimated, as well as the additional capacity which will come from new facilities.

**Capital costs for new development:** Several categories of capital costs may be related to serving new development:

- **Capital improvement requirements:** The capital improvements requirements identified in Table 8 probably include capacity for new development as well as replacement and upgrades required to serve current customers. Each of the projects should be analyzed to allocate an appropriate share of costs to expansion.
- **Expansion-related debt service:** The City's water debt was used to purchase the system and construct a reservoir. These facilities, particularly the reservoir, probably include capacity for new development. Again, the costs of these projects can be reviewed to determine an appropriate allocation of costs, and therefore debt service, to expansion.
- **Buy-in to existing facilities:** A portion of the existing water system facilities may include capacity for new users as well as current customers. This can be evaluated by reviewing the water system fixed assets and estimating those with capacity to serve new development. This calculation should not include any facilities financed with debt, if a share of debt service has been allocated as discussed above.

At the present time, the City does not have this information available. The City should take the following steps to develop the information to serve as the basis of a connection fee:

- Develop a capital improvement program (CIP), such as that shown in Table 8, as a part of the annual budget.
- Divide the CIP projects and costs between those for expansion and those for repair or rehabilitation and upgrade. This can be done by City staff on a reasonable basis. For



example, some of the water lines may be replaced with larger lines to add capacity. If a line is increased from 6 to 8 inches, the costs can be proportioned based on that increase in capacity.

- If necessary, develop a master plan to identify improvements needed over twenty or more years. The City may need the assistance of a consulting engineer to develop a master plan. The master plan should identify the projects needed for expansion and those needed for replacement or upgrade.
- Connection fee revenues should be deposited in a special fund and can be used by capital purposes only.

Bartle Wells Associates will work with City staff to develop the necessary information and recommend an appropriate connection fee.

### **Adjustment of Connection Fee**

In addition to developing a new connection fee based on the information discussed above, the connection fee can also be adjusted based on the change in construction costs. A common measure of public works construction costs is the Engineering News Record Construction Cost Index. This index has been calculated and published by Engineering News Record magazine since 1908. The index is calculated for 20 cities around the United States, as well as the 20-cities average. Specific indexes are developed for San Francisco and Los Angeles.

Each year, the City should review its connection fee and consider adjusting it based on the change in the San Francisco CCI. For example, if the City's existing connection fee of \$1,525 was adopted in 1992, the San Francisco CCI at that time was 3296. The March 1997 San Francisco CCI was 3651, which is an increase of 11 percent. Based on the CCI, the connection fee should be increased to \$1,700. This approach will ensure that the connection fee reflects the changing value of the facilities necessary to serve new development.

## **TABLES**

Table 1  
City of Willits Water Enterprise  
Number of Customers, at December

Meter Size (inches)	Customer Type	1991	1992	1993	1994	1995	1996	Change 1991-96
5/8 x 3/4	SFR	1,623	1,616	1,666	1,676	1,667	1,682	59
5/8 x 3/4	Others	208	213	209	213	217	216	8
3/4	SFR	29	28	28	25	25	25	-4
3/4	Others	26	22	22	21	20	18	-8
1	SFR	29	29	32	28	27	26	-3
1	Others	63	65	65	64	64	66	3
1-1/2	SFR	8	8	8	7	7	7	-1
1-1/2	Others	34	31	31	36	30	31	-3
2	SFR	4	4	3	3	3	3	-1
2	Others	44	43	44	35	41	43	-1
3	All	3	3	3	4	4	4	1
4	All	2	2	2	2	2	2	0
6	All	1	1	1	1	1	1	0
8	All	1	0	0	0	0	0	-1
Fire		26	26	28	28	27	29	3
Total		2,101	2,091	2,142	2,143	2,135	2,153	52
Change			-10	51	1	-8	18	52

Table 2  
City of Willits Water Enterprise  
Accounts by Customer Type

Type	December 1996	Percent of Total
Single family residential .....	1,744	81.0%
Multi family residential .....	93	4.3%
Mobile home parks .....	9	0.4%
Small business .....	145	6.7%
Larger business .....	26	1.2%
Motels .....	13	0.6%
Restaurants and bars .....	25	1.2%
Laundromat .....	3	0.1%
Grocery .....	8	0.4%
Hospital .....	6	0.3%
Institutional .....	56	2.6%
Industrial .....	25	1.2%
Total .....	2,153	100.0%

Table 3  
 City of Willits Water Enterprise  
 Water Consumption History

Meter Size (inches)	Annual Consumption (hcf)				1996/97					
	1992/93	% total	1993/94	% total	1994/95	% total	1995/96	% total	Through 3/97	% total
5/8 x 3/4	191,270	54.7%	214,787	55.1%	206,205	55.6%	203,051	54.5%	176,381	58.3%
3/4	4,066	1.2%	4,146	1.1%	4,469	1.2%	4,278	1.1%	2,606	0.9%
3/4	8,019	2.3%	6,988	1.8%	6,837	1.8%	6,838	1.8%	5,116	1.7%
1	5,283	1.5%	5,714	1.5%	6,545	1.8%	5,929	1.6%	5,232	1.7%
1	31,190	8.9%	30,912	7.9%	31,320	8.4%	38,448	10.3%	25,450	8.4%
1-1/2	1,221	0.3%	12,261	3.1%	2,558	0.7%	2,552	0.7%	1,791	0.6%
1-1/2	23,523	6.7%	24,749	6.3%	23,269	6.3%	23,592	6.3%	18,980	6.3%
2	1,225	0.4%	964	0.2%	836	0.2%	814	0.2%	764	0.3%
2	69,815	20.0%	75,885	19.5%	70,982	19.1%	72,681	19.5%	54,242	17.9%
3	2,798	0.8%	1,814	0.5%	4,889	1.3%	2,909	0.8%	2,598	0.9%
4	1,303	0.4%	1,167	0.3%	2,300	0.6%	1,243	0.3%	1,903	0.6%
6	10,209	2.9%	10,566	2.7%	10,464	2.8%	10,423	2.8%	7,387	2.4%
<b>Total</b>	<b>349,922</b>	<b>100.0%</b>	<b>389,953</b>	<b>100.0%</b>	<b>370,674</b>	<b>100.0%</b>	<b>372,758</b>	<b>100.0%</b>	<b>302,450</b>	<b>100.0%</b>

Table 4  
City of Willits Water Enterprise  
Revenues and Expenses

	1994/95	1995/96	Estimated 1996/97	Recom Budget 1997/98
<b>REVENUES</b>				
User Charges	\$1,164,500	\$1,308,200	\$1,296,600	\$1,296,600
Penalties	4,700	4,700	5,200	5,200
Renewals	1,500	1,600	1,300	1,300
Installation charges	3,000	3,700	1,200	1,200
Hook-up fees	7,500	21,000	7,900	7,900
Other fees & charges	2,300	5,800	8,650	8,650
Interest	108,800	96,700	70,000	69,800
Timber sales				846,000
Miscellaneous	<u>900</u>	<u>1,800</u>	<u>0</u>	<u>50</u>
Total revenues	1,293,200	1,443,500	1,390,850	2,236,700
<b>EXPENSES</b>				
<b>Administration</b>				
Salaries & benefits	17,800	18,500	31,700	29,900
Fees & permits	10,200	5,600	6,800	7,300
Supplies and services	7,600	9,100	8,800	10,300
Professional services & contracts	5,800	9,400	2,000	5,500
Taxes & assessments	800	800	800	900
Depreciation & amortization	309,700	320,400	323,700	334,400
Overhead & administration	160,200	169,000	173,700	167,800
Public utility fees	<u>69,900</u>	<u>78,500</u>	<u>77,200</u>	<u>0</u>
Subtotal administration	582,000	611,300	624,700	556,100
<b>Water maintenance*</b>				
Salaries & benefits	81,600	101,800	119,200	101,800
Supplies & services	13,600	11,300	20,800	35,700
Professional services & contracts	3,400	3,200	6,900	11,000
Special departmental expense	24,500	32,700	12,900	12,000
ISF equipment charges	<u>21,800</u>	<u>18,400</u>	<u>22,000</u>	<u>18,500</u>
Subtotal water maintenance	144,900	167,400	181,800	179,000
<b>Plant operations</b>				
Salaries & benefits	121,200	103,800	106,800	103,500
Supplies & services	11,200	4,400	4,100	7,000
Professional services & contracts	16,000	6,900	8,300	282,500
Special departmental expense	25,200	29,700	22,800	30,000
Utilities	70,900	70,500	65,000	67,500
ISF equipment charges	<u>7,300</u>	<u>8,700</u>	<u>7,300</u>	<u>4,000</u>
Subtotal plant operations	251,800	224,000	214,300	494,500
<b>Water engineering</b>				
Salaries & benefits	20,000	19,500	0	0
Professional services & contracts			<u>5,900</u>	<u>23,000</u>
Subtotal water engineering	20,000	19,500	5,900	23,000
Contingencies appropriation	0	0	1,600	15,000
Debt service interest	<u>340,200</u>	<u>332,400</u>	<u>305,000</u>	<u>318,100</u>
Total expenses	1,338,900	1,354,600	1,333,300	1,585,700
Net income	(45,700)	88,900	57,550	651,000
Less depreciation & amort.	309,700	320,400	323,700	334,400
Total cash expenses	\$1,029,200	\$1,034,200	\$1,009,600	\$1,251,300

\*Includes watershed maintenance and meter reading.

Table 5  
City of Willits Water Enterprise  
Debt Service Schedule  
Water Refunding Certificates of Participation

Fiscal Year	Interest	Principal	Total Debt Service
1994/95 .....	\$237,368	\$225,000	\$462,368
1995/96 .....	205,168	150,000	355,168
1996/97 .....	200,474	155,000	355,474
1997/98 .....	195,155	160,000	355,155
1998/99 .....	189,303	165,000	354,303
1999/00 .....	182,978	170,000	352,978
2000/01 .....	176,105	180,000	356,105
2001/02 .....	168,515	190,000	358,515
2002/03 .....	160,284	195,000	355,284
2003/04 .....	151,481	205,000	356,481
2004/05 .....	142,195	210,000	352,195
2005/06 .....	132,245	220,000	352,245
2006/07 .....	121,385	230,000	351,385
2007/08 .....	109,750	240,000	349,750
2008/09 .....	97,375	250,000	347,375
2009/10 .....	84,250	270,000	354,250
2010/11 .....	70,500	280,000	350,500
2011/12 .....	56,125	295,000	351,125
2012/13 .....	41,000	310,000	351,000
2013/14 .....	25,125	325,000	350,125
2014/15 .....	8,500	340,000	348,500
	\$2,755,279	\$4,765,000	\$7,520,279

Table 6  
City of Willits Water Enterprise  
Debt Service Coverage

	1994/95	1995/96	Estimated 1996/97	Recom Budget 1997/98
<b>REVENUES</b>				
User Charges	\$1,164,500	\$1,308,200	\$1,296,600	\$1,296,600
Penalties	4,700	4,700	5,200	5,200
Renewals	1,500	1,600	1,300	1,300
Installation charges	3,000	3,700	1,200	1,200
Hook-up fees	7,500	21,000	7,900	7,900
Other fees & charges	2,300	5,800	8,700	8,700
Interest	108,800	96,700	70,000	69,800
Net timber sales				628,000
Miscellaneous	900	1,800	0	0
Total revenues	1,293,200	1,443,500	1,390,900	2,018,700
<b>EXPENSES</b>				
<b>Operation and Maintenance</b>				
Administration	272,300	290,900	301,000	221,700
Water maintenance	144,900	167,400	181,800	179,000
Plant operations	251,800	224,000	214,300	276,500
Water engineering	20,000	19,500	5,900	23,000
Contingency				15,000
Total operation & maintenance	689,000	701,800	703,000	715,200
Net revenues	604,200	741,700	687,900	1,303,500
Debt Service, COPs*	360,000	355,200	355,500	355,200
Available for other purposes	244,200	386,500	332,400	948,300
Payments on water loan	205,500	205,500	205,500	205,500
Balance available	38,700	181,000	126,900	742,800
<b>COP coverage requirements</b>				
Total net revenue > 1.15 debt service	1.68	2.09	1.94	3.67
Net revenue, excluding interest and timber sales > 1.0 debt service	1.38	1.82	1.74	1.71

\*1994/95 COP payment estimated by Bartle Wells Associates.

Table 7  
City of Willits Water Enterprise  
1997/98 Budgeted Expenses

	1997/98 Prelim Budget	Fixed	Variable
<b>Administration</b>			
Salaries & benefits	\$29,900	\$29,900	
Fees & permits	7,300	7,300	
Supplies and services	10,300	10,300	
Professional services & contracts	5,500	5,500	
Taxes & assessments	900	900	
Depreciation & amortization	334,400	334,400	
Overhead & administration	167,800	167,800	
Public utility fees	0		
Subtotal administration	556,100		
<b>Water maintenance</b>			
Salaries & benefits	101,800	101,800	
Supplies & services	35,700	17,850	\$17,850
Professional services & contracts	11,000	5,500	5,500
Special departmental expense <sup>1</sup>	12,000	6,000	6,000
ISF equipment charges	18,500	18,500	
Subtotal water maintenance	179,000		
<b>Plant operations</b>			
Salaries & benefits	103,500	103,500	
Supplies & services	7,000	3,500	3,500
Professional services & contracts <sup>2</sup>	64,500	64,500	
Special departmental expense <sup>3</sup>	30,000		30,000
Utilities	67,500		67,500
ISF equipment charges	4,000	4,000	
Subtotal plant operations	276,500		
<b>Water engineering</b>			
Professional services & contracts	23,000	23,000	
Subtotal water engineering	23,000		
<b>Contingencies appropriation</b>	15,000	15,000	
<b>Debt service</b>	318,100	318,100	
Total expenses	1,367,700	1,237,350	130,350
Percent of total expenses.		90.5%	9.5%

1 - Safety supplies, rock/asphalt/gravel

2 - Excluding costs related to timber harvest.

3 - Chemical & lab supplies, rock/gravel/asphalt



**Table 8**  
**City of Willits Water Enterprise**  
**Capital Improvement Requirements**

	Budget	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
<b>Option 1: Cash for all Projects</b>											
Main transmission line	\$1,650,000			\$500,000	\$330,000						
Water plant expansion	225,000			225,000							
Emergency generator	10,000										
Pump stations	125,000										
Water line replacement	1,300,000						100,000				
Water meter replacement	525,000			50,000	75,000	100,000	200,000				
Emergency water pump	35,000					100,000	200,000				
Fire hydrant replacement	100,000				30,000	30,000	25,000				
<b>Totals</b>	<b>3,970,000</b>	<b>\$420,000</b>	<b>\$585,000</b>	<b>\$550,000</b>	<b>\$660,000</b>	<b>\$230,000</b>	<b>\$525,000</b>	<b>\$200,000</b>	<b>\$100,000</b>	<b>\$100,000</b>	<b>\$600,000</b>
<b>5-year total</b>	<b>2,445,000</b>										
<b>Option 2: Debt for Main Transmission Line</b>											
Main transmission line	1,650,000										
Water plant expansion	225,000			225,000							
Emergency generator	10,000										
Pump stations	125,000										
Water line replacement	1,300,000										
Water meter replacement	525,000			50,000	50,000	50,000	50,000				
Emergency water pump	35,000			100,000	100,000	100,000	75,000				
Fire hydrant replacement	100,000				25,000	25,000	35,000				
<b>Totals</b>	<b>\$3,970,000</b>	<b>\$420,000</b>	<b>\$1,465,000</b>	<b>\$375,000</b>	<b>\$175,000</b>	<b>\$325,000</b>	<b>\$310,000</b>	<b>\$150,000</b>	<b>\$150,000</b>	<b>\$150,000</b>	<b>\$450,000</b>
<b>5-year total</b>	<b>\$2,760,000</b>										

Table 9  
City of Willits Water Enterprise  
Revenue and Expense Projection  
Option 1: Cash for all Projects

	Actual 1995/96	Estimated 1996/97	Budget 1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Beginning balance			\$650,000	\$972,800	\$537,500	\$602,300	\$529,400	\$955,100	\$571,600	\$574,400	\$647,200
<b>REVENUES</b>											
User charges	\$1,308,200	\$1,296,600	\$1,296,600	\$1,400,000	\$1,900,000	\$1,900,000	\$1,500,000	\$1,500,000	\$1,600,000	\$1,600,000	\$1,600,000
Interest	96,700	70,000	69,800	24,300	13,400	15,100	13,200	23,900	14,300	14,400	16,200
Other revenues	38,600	24,300	24,300	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000
Timber sales (net)			628,000				500,000				
Total revenues	1,443,500	1,390,900	2,018,700	1,449,300	1,938,400	1,940,100	2,038,200	1,548,900	1,639,300	1,639,400	1,641,200
Total sources of funds	1,443,500	1,390,900	2,668,700	2,422,100	2,475,900	2,542,400	2,567,600	2,504,000	2,210,900	2,213,800	2,288,400
<b>EXPENSES</b>											
Operating expenses											
Administration	290,900	301,000	221,700	229,500	237,500	245,800	254,400	263,300	272,500	282,000	291,900
Water maintenance	167,400	181,800	179,000	185,300	191,800	198,500	205,400	212,600	220,000	227,700	235,700
Plant operations	224,000	214,300	276,500	286,200	296,200	306,600	317,300	328,400	339,900	351,800	364,100
Water engineering	19,500	5,900	23,000	23,800	24,600	25,500	26,400	27,300	28,300	29,300	30,300
Contingency			15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000
Total operation & maint	701,800	703,000	715,200	739,800	765,100	791,400	818,500	846,600	875,700	905,800	937,000
Net revenues	741,700	687,900	1,303,500	709,500	1,173,300	1,148,700	1,219,700	702,300	763,600	733,600	704,200
Capital expenses											
Debt Service, COP's	355,200	355,500	355,200	354,300	353,000	356,100	358,500	355,300	355,300	355,300	355,300
Water loan payments	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500
Capital improvements			420,000	585,000	550,000	660,000	230,000	525,000	200,000	100,000	100,000
Total capital expenses	560,700	561,000	980,700	1,144,800	1,108,500	1,221,600	794,000	1,085,800	760,800	660,800	660,800
Annual sources less uses	181,000	126,900	322,800	(435,300)	64,800	(72,900)	425,700	(383,500)	2,800	72,800	43,400
Closing balance			972,800	537,500	602,300	529,400	955,100	571,600	574,400	647,200	690,600
COP coverage tests											
Net revenue > 1.15 debt svc	2.09	1.94	3.67	2.00	3.32	3.23	3.40	1.98	2.15	2.06	1.98
Net revenue - (interest + timber sales) > 1.0 debt svc	1.82	1.74	1.71	1.93	3.29	3.18	1.97	1.91	2.11	2.02	1.94

Assumptions:  
Escalator 3.5%  
New debt (type) none  
Terms of debt: na  
Interest rate na  
term (years) na  
Interest earnings rate 5.0%

Table 10  
City of Willits Water Enterprise  
Cash Flow Projection  
Option 2: Debt for Main Transmission Line

Assumptions:	
Escalator	3.5%
New debt (type)	bank loan
Terms of debt:	interest rate
	term (years)
Interest earnings rate	20
	5.0%

	Actual 1995/96	Budget 1996/97	Budget 1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Beginning balance			\$650,000	\$972,800	\$1,050,900	\$687,900	\$583,800	\$803,100	\$613,200	\$547,800	\$550,800
REVENUES											
User charges	\$1,308,200	\$1,296,600	\$1,296,600	\$1,400,000	\$1,400,000	\$1,500,000	\$1,500,000	\$1,600,000	\$1,600,000	\$1,700,000	\$1,700,000
Interest	96,700	70,000	69,800	50,600	43,500	31,800	34,700	35,400	29,000	27,500	26,800
Other revenues	38,600	24,300	24,300	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000
Timber sales (net)			628,000				500,000				
Total revenues	1,443,500	1,390,900	2,018,700	1,475,600	1,468,500	1,556,800	2,059,700	1,660,400	1,654,000	1,752,500	1,751,800
Proceeds of debt				1,500,000							
Total sources of funds	1,443,500	1,390,900	2,688,700	2,448,400	2,519,400	2,244,700	2,643,500	2,463,500	2,267,200	2,300,300	2,302,600
EXPENSES											
Operating expenses											
Administration	290,900	301,000	221,700	229,500	237,500	245,800	254,400	263,300	272,500	282,000	291,900
Water maintenance	167,400	181,800	179,000	185,300	191,800	198,500	205,400	212,600	220,000	227,700	235,700
Plant operations	224,000	214,300	276,500	286,200	296,200	306,800	317,300	328,400	339,900	351,800	364,100
Water engineering	19,500	5,900	23,000	23,800	24,600	25,500	26,400	27,300	28,300	29,300	30,300
Contingency			15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000
Total operation & maint	701,800	703,000	715,200	739,800	765,100	791,400	818,500	846,600	875,700	905,800	937,000
Net revenues	741,700	687,900	1,303,500	735,800	703,400	765,400	1,241,200	813,800	778,300	846,700	814,800
Capital expenses											
Debt Service, COPs	355,200	355,500	355,200	354,300	353,000	356,100	358,500	355,300	355,300	355,300	355,300
New debt service				132,900	132,900	132,900	132,900	132,900	132,900	132,900	132,900
Water loan payments	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500	205,500
Capital improvements			420,000	1,465,000	375,000	175,000	325,000	310,000	150,000	150,000	150,000
Total capital expenses	560,700	561,000	980,700	2,157,700	1,066,400	869,500	1,021,900	1,003,700	843,700	843,700	843,700
Annual sources less uses	181,000	126,900	322,800	78,100	(363,000)	(104,100)	219,300	(189,900)	(65,400)	3,000	(28,900)
Closing balance			972,800	1,050,900	687,900	583,800	803,100	613,200	547,800	550,800	521,900
COP coverage tests											
Net revenue > 1.15 debt svc	2.09	1.94	3.67	1.51	1.45	1.57	2.53	1.67	1.59	1.73	1.67
Net revenue - (interest + timber sales) > 1.0 debt svc	1.82	1.74	1.71	1.41	1.36	1.50	1.44	1.59	1.53	1.68	1.61

Table 11  
City of Willits Water Enterprise  
Water Rates

Meter Size (inches)	Customer Type	Monthly Meter Charge	Water Included (hcf)	Water Included (value)	Net Monthly Meter Charge	Ratio to 5/8" Meter
5/8 x 3/4	All	\$21	3	\$7.20	\$13.80	1.00
3/4	SFR	21	3	7.20	13.80	1.00
3/4	Others	21	3	7.20	13.80	1.00
1	SFR	34	3	7.20	26.80	1.94
1	Others	58	14	33.60	24.40	1.77
1-1/2	SFR	43	3	7.20	35.80	2.59
1-1/2	Others	109	34	81.60	27.40	1.99
2	SFR	48	3	7.20	40.80	2.96
2	Others	176	55	132.00	44.00	3.19
3	All	302	120	288.00	14.00	1.01
4	All	506	200	480.00	26.00	1.88
6	All	1,009	420	1,008.00	1.00	0.07
8	All	1,456	600	1,440.00	16.00	1.16

Use over monthly minimum allowance, \$2.40 per hcf.

Table 12  
City of Willits Water Enterprise  
Average Water Bills at Current Rates

Meter Size (inches)	Usage for Avg Bill	Meter Charge	Usage Allowance	Usage Billed	Current Bill	Effective Cost/hcf
5/8 x 3/4	9	\$21.00	3	6	\$35.20	\$3.95
3/4	*	21.00	3	11	48.02	3.37
3/4		21.00	3	29	89.78	2.84
1	*	34.00	3	16	72.41	3.81
1		58.00	14	35	140.91	2.90
1-1/2	*	43.00	3	27	108.71	3.58
1-1/2		109.00	34	29	179.61	2.83
2	*	48.00	3	20	95.07	4.20
2		176.00	55	86	382.05	2.71
3		302.00	120	0	302.00	4.98
4		506.00	200	0	506.00	9.77
6		1,009.00	420	449	2,085.60	2.40

\*Single family residential.

Table 13  
City of Willits Water Enterprise  
Revenue by Customer Class

Meter Size (inches)	No. of Meters <sup>1</sup>	1995/96 Usage (hcf)	Monthly Meter Charge	Use Included (hcf)	Meter Charge Revenue	Usage over Minimum	Usage Revenue	Total Revenue	Percent of Revenue	Percent of Usage
5/8 x 3/4	1,898	203,051	\$21	3	\$478,296	134,723	\$323,335	\$801,631	61.5%	54.5%
3/4	* 25	4,278	21	3	6,300	3,378	8,107	14,407	1.1%	1.1%
3/4	18	6,838	21	3	4,536	6,190	14,856	19,392	1.5%	1.8%
1	* 26	5,929	34	3	10,608	4,993	11,983	22,591	1.7%	1.6%
1	66	38,448	58	14	45,936	27,360	65,664	111,600	8.6%	10.3%
1-1/2	* 7	2,552	43	3	3,612	2,300	5,520	9,132	0.7%	0.7%
1-1/2	31	23,592	109	34	40,548	10,944	26,266	66,814	5.1%	6.3%
2	* 3	814	48	3	1,728	706	1,694	3,422	0.3%	0.2%
2	43	72,681	176	55	90,816	44,301	106,322	197,138	15.1%	19.5%
3	4	2,909	302	120	14,496	-2,851	0	14,496	1.1%	0.8%
4	2	1,243	506	200	12,144	-3,557	0	12,144	0.9%	0.3%
6	1	10,423	1,009	420	12,108	5,383	12,919	25,027	1.9%	2.8%
Fire <sup>2</sup>	29	--	15		5,220			5,220	0.4%	
<b>Total</b>	<b>2,153</b>	<b>372,758</b>			<b>\$726,348</b>	<b>233,870</b>	<b>576,667</b>	<b>\$1,303,015</b>	<b>100.0%</b>	<b>100.0%</b>

\*Single family residential,

1 - December 1996.

2 - Revenue based on average charge of \$15/mo/meter.

**Table 14**  
**City of Willits Water Enterprise**  
**Meter Equivalents**

Meter Size (in)	Rate of Flow with 5-psi Head Loss (gpm)	Ratios Based on Rate of Flow with 5-psi Head Loss	Meter Capacity (gpm)	Ratios Based on Meter Capacity
5/8"	13.5	1.00	20	1.00
3/4"	20.0	1.48	30	1.50
1"	32.5	2.41	50	2.50
1-1/2"	65.0	4.81	100	5.00
2"	125.0	9.26	160	8.00
3"	287.5	21.30	320	16.00
4"	500.0	37.04	450	22.50
6"	1,100.0	81.48	1,000	50.00
8"			1,600	80.00

Source: American Water Works Association.

Table 15  
City of Willits Water Enterprise  
Recommended Water Rates

Meter Size	Meter Charge				
	1997/98	1998/99	1999/00	2000/01	2001/02
5/8 x 3/4	\$18.60	\$20.00	\$20.00	\$21.50	\$21.50
3/4	27.90	30.10	30.10	32.20	32.20
1	46.50	50.10	50.10	53.70	53.70
1-1/2	93.10	100.20	100.20	107.40	107.40
2	148.90	160.40	160.40	171.90	171.90
3	297.90	320.80	320.80	343.70	343.70
4	418.90	451.10	451.10	483.30	483.30
6	930.90	1,002.50	1,002.50	1,074.10	1,074.10
Quantity charge per hcf for all water consumption					
	\$1.76	\$1.89	\$1.89	\$2.03	\$2.03
Surcharge for cash financing					
Meter charge					
5/8 x 3/4	.....		\$7.20	\$7.20	
3/4	.....		10.70	10.70	
1	.....		17.90	17.90	
1-1/2	.....		36.00	36.00	
2	.....		57.30	57.30	
3	.....		114.60	114.60	
4	.....		161.10	161.10	
6	.....		358.00	358.00	
Quantity charge	.....		\$0.68	\$0.68	

Table 16  
 City of Willits Water Enterprise  
 Impact of Recommended Rates

1997/98

Meter Size (inches)	Meter Charge	Usage for Avg Bill	Average Bill		Change	
			Revised	Current	Amount	Percent
5/8 x 3/4	\$18.60	9	\$34.26	\$35.20	-\$0.93	-2.7%
3/4	27.90	14	52.95	48.02	4.93	10.3%
3/4	27.90	32	83.51	89.78	-6.26	-7.0%
1	46.50	19	79.88	72.41	7.48	10.3%
1	46.50	49	131.78	140.91	-9.13	-6.5%
1-1/2	93.10	30	146.47	108.71	37.76	34.7%
1-1/2	93.10	63	204.51	179.61	24.91	13.9%
2	148.90	23	188.62	95.07	93.56	98.4%
2	148.90	141	396.35	382.05	14.30	3.7%
3	297.90	61	404.37	302.00	102.37	33.9%
4	418.90	52	509.89	506.00	3.89	0.8%
6	930.90	869	2,456.79	2,085.60	371.19	17.8%

1998/99

Meter Size (inches)	Meter Charge	Usage for Avg Bill	Average Bill		Change	
			1998/99	1997/98	Amount	Percent
5/8 x 3/4	\$20.00	9	\$36.87	\$34.26	\$2.60	7.6%
3/4	30.10	14	57.08	52.95	4.13	7.8%
3/4	30.10	32	89.99	83.51	6.48	7.8%
1	50.10	19	86.05	79.88	6.17	7.7%
1	50.10	49	141.94	131.78	10.16	7.7%
1-1/2	100.20	30	157.68	146.47	11.21	7.7%
1-1/2	100.20	63	220.18	204.51	15.67	7.7%
2	160.40	23	203.18	188.62	14.56	7.7%
2	160.40	141	426.88	396.35	30.53	7.7%
3	320.80	61	435.46	404.37	31.09	7.7%
4	451.10	52	549.08	509.89	39.20	7.7%
6	1,002.50	869	2,645.77	2,456.79	188.98	7.7%



Table 17  
City of Willits Water Enterprise  
Revenue from Recommended Rates

**1997/98**

Meter Size (inches)	Meter Charge	Number Meters	Usage Avg Bill	Revenue	
				Meter Charge	Quantity Charge
5/8 x 3/4	\$18.60	1,898	9	\$423,634	\$356,711
3/4	27.90	25	14	8,370	7,515
3/4	27.90	18	32	6,026	12,013
1	46.50	26	19	14,508	10,416
1	46.50	66	49	36,828	67,544
1-1/2	93.10	7	30	7,820	4,483
1-1/2	93.10	31	63	34,633	41,445
2	148.90	3	23	5,360	1,430
2	148.90	43	141	76,832	127,683
3	297.90	4	61	14,299	5,110
4	418.90	2	52	10,054	2,184
6	930.90	1	869	11,171	18,311
Total		2,124		\$649,500	\$654,800
Total revenue					\$1,304,300

**1998/99**

Meter Size (inches)	Meter Charge	Number Meters	Usage Avg Bill	Revenue	
				Meter Charge	Quantity Charge
5/8 x 3/4	\$20.00	1,898	9	\$455,520	\$384,151
3/4	30.10	25	14	9,030	8,094
3/4	30.10	18	32	6,502	12,937
1	50.10	26	19	15,631	11,217
1	50.10	66	49	39,679	72,739
1-1/2	100.20	7	30	8,417	4,828
1-1/2	100.20	31	63	37,274	44,634
2	160.40	3	23	5,774	1,540
2	160.40	43	141	82,766	137,505
3	320.80	4	61	15,398	5,504
4	451.10	2	52	10,826	2,352
6	1,002.50	1	869	12,030	19,719
Total		2,124		\$698,800	\$705,200
Total revenue					\$1,404,000

## **APPENDIX**

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# **ANALYSIS OF PROPOSITION 218 AND ITS IMPACT ON WATER AND SEWER USER FEES**

## **A Melodrama in Two Acts**

### **Introduction**

On November 5, 1996, California voters approved Proposition 218, “The Right to Vote on Taxes Act,” an initiative amendment to the California constitution. The proposition added Articles XIII C and XIII D to the state constitution, which contain a number of provisions affecting the ability of California local governments to levy and collect both existing and future taxes, assessments, and fees and charges.

Section 4 of Proposition 218 is entitled “Assessment and Property Related Fee Reform”. This section adds Article XIII D to the constitution. It establishes both substantive and procedural requirements on “fees imposed as an incident of property ownership.” There is considerable difference of opinion about whether user fees for water and sewer are subject to these provisions. The impact of the issue is substantial. If such user fees *are* property related, they then must comply with the procedural and substantive requirements of Proposition 218 (See Act II). If such user fees *are not* property related, then they are exempt from Proposition 218, and must continue to comply with current (i.e. pre-Proposition 218) law.

This paper is based on published sources and analysis by Bartle Wells Associates, independent public finance advisors. It is not a legal opinion and does not constitute legal advice. Each agency should seek guidance from its legal counsel as to the application of Proposition 218 to its individual situation.

### **Act I:**

#### **Are Water and Sewer Fees Charged by Public Agencies**

##### **Property related Fees?**

##### **A Summary of the Arguments**

Act I addresses arguments for and against these fees being subject to Proposition 218. It is not an exhaustive catalog of the arguments which have been or could be made on the subject. It is a compilation of arguments from a number of sources and analysis by Bartle Wells Associates.

### **Definitions**

The proposition includes the following definitions, for application in Article XIII D:

- “Fee” or “charge” means any levy other than an ad valorem tax, a special tax, or an assessment, imposed by an agency upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property related service [Section 2 (e)].

- “Property related service” means a public service having a direct relationship to property ownership [Section 2 (h)].

The proposition establishes a new classification of fees—“property related fees,” or fees imposed “as an incident of property ownership.” There is no consensus as to which fees meet this definition. The drafters have indicated that it was their intention to include most fees commonly billed to property owners, such as water and sewer user fees. Other analysts conclude that fees which are related to a service, rather than imposed solely as a result of property ownership, do not fall within this definition, and consequently are not covered by the proposition.

Within this paper, “user fees” means regular charges for water and sewer, paid by customers connected to municipal utility systems, whether such fees are collected directly by periodic billings or collected on the property tax bill, and regardless of the specific structure of the rate, i.e. flat rates or rates based on volume or usage, unless specifically noted otherwise within the body of the paper.

### **Arguments in Favor**

- The proponents’ statement of intent says “fees and charges” covered by the proposition includes fees for sewer, water, and refuse collection, because of their connection to property.
- The Legislative Analyst’s analysis of the proposition which was contained in the voter handbook for the November 1996 election states that “fees and water, sewer, and refuse collection services probably meet the definition of a property related fee.
- Article XIID, Section (c) specifically exempts fees for sewer, water, and refuse collection from voter approval requirements; this implies that user fees for such services are not exempt from the other requirements.
- Fees for electrical or gas service, also commonly charged as user fees, are specifically excluded from the definition of fees and charges; again, this specific exemption implies that user fees for water, sewer, and refuse collection are not excluded from the definition.
- The proponents could not possibly have intended to exempt such user fees because such an interpretation would drastically reduce the impact of the fee provisions of the proposition.
- Proposition 218 covers fees for services such as water, sewer, and refuse collection that are normally delivered to real property or a permanent location, rather than services that are personal and whose delivery point is easily moveable.
- If a service charge has two components, a fixed charge based upon meter size and a commodity charge which varies based upon use, a court could find that the fixed service charge is levied on a person as an incident of ownership, even though it is levied only if a person chooses to connect to the system.

- Courts will, in conformance with the directive in the proposition, construe its provisions liberally to effect its purposes of limiting local government revenue and enhancing taxpayer consent.

### **Arguments Against**

- Charges based on a customer's request for and use of a utility are not imposed as an incident of ownership.
- "User fee" is included in the definition of fees and charges, but it is listed as an example of a levy imposed as an incident of property ownership, and thus may indicate a user fee that is based on property ownership only and required even if no use is made, rather than a fee that is based entirely on use and required only if use is made.
- Applying the measure to consumption-related fees does not relate to the primary goal of the initiative—protecting property owners from excessive taxation.
- The term "levy" suggests an involuntary payment to the government, as distinguished from a payment for a public service provided upon request.
- Proposition 218 is aimed at assessment-like revenue devices, to stop local agencies from using fees to avoid rules regarding taxes and assessments. The proposition is intended to restrict those fees which resemble taxes or assessments.
- Fees imposed "on a person as a incident of property ownership" means fees that a person must pay *solely* because that person owns property. The statement of drafters' intent says that "the focus of Proposition 218 is on those levies imposed simply by virtue of property ownership."
- Proposition 218's procedures for the adoption of fees appear to contemplate that the fees will be charged solely by virtue of property ownership. For example, the notice to property owners must contain, for each parcel, the amount of the fee that the owner of that parcel must pay. This indicates that the amount of the fee or charge can be calculated prior to its imposition, which is impossible when the fee is based on usage.

### **Why is this important?**

If water and sewer rates are property related fees or fees imposed as an incident of property ownership, they are subject to the substantive and procedural provisions of Proposition 218, which are described in Act II of this paper. If these fees are not property related fees, they are not affected by Proposition 218, and remain subject to the current statutory requirements.

### **Tests for Fees**

The League of Cities Implementation Guide has identified a number of tests which could be used to determine whether a fee or charge is subject to Proposition 218:

- Use of parcel maps: The proposition states that “reliance by an agency on any parcel map, including, but not limited to, an assessor’s parcel map may be considered a significant factor in determining whether a fee or charge is imposed as an incident of property ownership.” As an initial test, therefore, an agency should ask whether the fee is of a type generally based upon reference to the parcel map.
- Property ownership test: A fee or charge is subject to Proposition 218 if it must be paid by a person simply as a result of property ownership. If the fee or charge results from some other reason (for example, requesting service from the public agency), then Proposition 218 does not apply.
- Non opt-out test: If a property owner cannot avoid payment of the fee or charge by declining the service for which the fee or charge is paid, the fee or charge is most likely subject to Proposition 218.
- “On the parcel” test: The fee or charge is subject to Proposition 218 if the fee or charge is a lien on the parcel from the creation of the fee or charge, a distinguished from being a lien on the parcel in the event of a default in payment.

**Who will decide?**

The courts and the legislature. The legislature will be asked to provide clarification of this issue, and there will also probably be litigation. No clear answer may be known for some time. In the meantime, each local agency should follow the advice of its legal counsel.

The Association of California Water Agencies (ACWA) Proposition 218 Subcommittee, made up of water district attorneys, The ACWA Proposition 218 Subcommittee has unanimously reviewed the arguments and concluded that Proposition 218 applies to taxes, assessments, and those fees which share important characteristics with taxes and assessments. Some of these characteristics are: (i) the liability to pay the fee or charge arises due to property ownership alone, and not from any other act, request or status of the property owner (such as a request for water or sewer service); (ii) the amount of the fee or charge to be paid varies depending upon a characteristics of the property (e.g. parcel size or frontage length) and not the behavior of the person using the property.

**Act II:**

**Procedural and Substantive Requirements**

**Property Related Fees**

If water and sewer user fees are found to be subject to Proposition 218, they must then comply with the substantive and procedural requirement of the proposition.

**Substantive Requirements**

Proposition 218 includes five substantive requirements for property related fees and charges:

1. Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.
2. Revenues derived from the fee or charge shall not be used for any other purpose other than that for which the fee or charge was imposed.
3. The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.
4. No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, shall be classified as assessments and shall not be imposed without compliance with Section 4.
5. No fee or charge may be imposed for general governmental services...In any legal action contesting the validity of a fee or charge, the burden shall be on the agency to demonstrate compliance with this article [Section 6 (b)].

These requirements basically make a “cost of service” approach to rates a requirement of the California constitution. The first three requirements also apply under current (i.e. pre-Proposition 218) law, to avoid charges being characterized as taxes.

Like most of Proposition 218, there are questions about the interpretation of these requirements.

According to the drafters, requirements 1 and 2 are designed to prohibit the “practice of siphoning off fee revenue to supplement a city’s general fund...sometimes known as charging an in lieu franchise fee.” They do go on to allow that cost of service may include reasonable overhead factors and will have to be determined on a case by case basis. Calculation of the cost of service should include all the agency’s costs, including administration, capital outlay, operating and maintenance, conservation programs, maintaining a reasonable reserve, and accumulating funds for capital improvements and replacement. The cost should also include the costs of complying with both the procedural and substantive requirements of Proposition 218. Under current law, a municipal utility is also allowed to earn a profit or rate of return. Proposition 218 likely reverses that law, except for gas and electric utilities, which are exempted.

The issue of general fund transfers is of concern to many cities. The drafters of Proposition 218 hold that such transfers are revenues in excess of the cost of providing a service and/or revenues being applied to a purpose other than that for which the fee was charged. Clearly, transfers which reimburse the general fund for overhead costs are a cost of service of the utility. Other cities have in lieu transfers, often set forth in city charters, to compensate the city for the taxes and franchise fees that a private utility would pay.

Requirement 3 will prohibit preferential rates, such as lifeline or senior citizen rates, on property related services. Differences in rates between residential and commercial customers must be based on differences in the cost of service to such customer categories. Rates designed to encourage water conservation such as ascending block rates may be prohibited, unless the agency can demonstrate higher costs of service associated with higher water use.

There is uncertainty about the meaning of “standby charges,” which are not defined in the proposition. The drafters statement describes standby charges as “usually nothing more than flat rate parcel taxes imposed on the theory that water or sewer service may, at some point in the indefinite future, be available to the property being charged” and “this provision is a flat prohibition of such levies.” Many agencies refer to the fixed meter charge portion of water rates as “standby charges.” Agencies should review their rate schedules for the use of terminology to be sure it does not trigger problems with Proposition 218.

### **Procedural Rules**

Under Proposition 218, in order to impose new or increased fees and charges, the agency must:

- Identify the parcels which would be subject to the charge;
- Calculate the amount of the fee to be imposed on each parcel;
- Provide written notice by mail to the record owner of each affected parcel of the amount of the fee, basis of the fee, reason for the fee, and the time and place of a public hearing on the proposed fee or charge.

The agency must conduct a public hearing not less than 45 days after mailing the notice. If the agency receives written protests against the proposed fee or charge at the public hearing from a majority of the owners of the identified parcels (one parcel, one vote), the fee or charge may not be imposed. It will be very difficult in most cases for property owners to assemble protests by owners of a majority of the parcels.

For property related fees *except* for fees and charges for sewer, water, and refuse collection, new or increased fees must be approved by vote of a majority of the property owners subject to the fee or charge or two-thirds of the electorate in the affected areas.

### **Effective Date**

The proposition requires that all fees and charges comply with its requirements by July 1, 1997. However, the effective date is confusing with respect to existing fees and charges. The information presented to the voters indicates that all existing fees that continue in effect after July 1, 1997 must comply with Proposition 218. The Legislative Analyst states that by July 1, 1997, local governments would be required to reduce or repeal existing property related fees that do not meet the proposition’s restrictions on the amount of fees or use of revenues. Some attorneys believe that agencies do not have to submit



existing fees to Proposition 218's procedures requirements, so long as the fees are not being increased, but existing fees must comply with the proposition's substantive requirements.

## **Conclusion**

This is intended as a summary of certain portions and provisions of Proposition 218 as they may apply to water and sewer fees and charges. There are many questions which need to be resolved by the legislature and the courts. Some of the areas which need clarification are:

- What is included in the definition of a property related fee?
- Are water charges that are based on metered water property related fees?
- Are flat rate sewer charges property related fees?
- Are sewer charges based on water consumption property related fees?
- Are charges collected on the tax bill property related charges?

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### Sources:

1. Proposition 218
2. Living with Proposition 218, League of California Cities, November 20, 1996.
3. Understanding Proposition 218, Elizabeth G. Hill, Legislative Analyst, December 1996
4. Proposition 218 Implementation Guide, League of California Cities, January 1997
5. Implementing Proposition 218, Mapping and Navigating the Changing Landscape of Local Government Finance, compilation of papers prepared for January 16, 1997 conference presented by California Debt and Investment Advisory Commission, UCLA Extension Public Policy Program, University Extension, UC Davis.
6. Weathering the Storm of Proposition 218, compilation of papers prepared for January 29, 1997 seminar by Kronick, Moskovitz, Tiedemann & Girard, Stone & Youngberg, and Economic & Planning Systems.
7. Proposition 218, Local Water Agency Guidelines for Compliance, Association of California Water Agencies, February 1997.

Table A-1  
City of Willits Water Enterprise  
Balance Sheet, June 30

	1994	1995	1996
<b>Assets</b>			
<u>Current assets</u>			
Cash and investments	\$200,577	\$98,490	\$108,915
Receivables			
Accounts	96,006	102,868	124,720
Unbilled	59,682	58,064	69,514
Interest	23,768	25,506	21,234
Due from component unit	<u>225,000</u>	<u>225,000</u>	<u>225,000</u>
Total current assets	605,033	509,928	549,383
<u>Restricted assets</u>			
Cash	1,420,818	1,195,667	961,692
Cash with fiscal agent	394,698	362,751	441,327
Unamortized debt issue costs (net)	<u>301,192</u>	<u>287,489</u>	<u>273,788</u>
Total restricted assets	2,116,708	1,845,907	1,676,807
<u>Fixed assets</u>			
Land	423,330	423,330	423,330
Buildings and improvements		265,277	513,197
Equipment	7,046,547	7,069,149	7,098,811
Accumulated depreciation	(1,685,032)	(1,939,042)	(2,203,758)
Construction in progress	<u>10,175</u>	<u>20,525</u>	<u>43,586</u>
Total fixed assets	5,795,020	5,839,239	5,875,166
Total Assets	8,516,761	8,195,074	8,101,356
<b>Liabilities and Fund Equity</b>			
<u>Current liabilities</u>			
Accounts payable	20,705	21,414	15,628
Accrued salaries and benefits	35,558	44,117	47,865
Accrued interest payable	131,365	101,679	99,441
Customer deposits	31,746	32,029	38,297
Current portion of long-term liabilities	<u>297,950</u>	<u>226,005</u>	<u>234,187</u>
Total current liabilities	517,324	425,244	435,418
<u>Long-term liabilities</u>			
Loan payable to another agency	3,143,393	3,067,387	2,988,202
Loan payable (net)	<u>3,699,321</u>	<u>3,591,268</u>	<u>3,478,216</u>
Total long-term liabilities	6,842,714	6,658,655	6,466,418
Total liabilities	7,360,038	7,083,899	6,901,836
<u>Fund equity</u>			
Contributed capital	108,556	108,556	108,556
Retained earnings			
Reserved for capital replacement	1,431,793	1,213,661	975,549
Unreserved	<u>(383,626)</u>	<u>(211,042)</u>	<u>115,415</u>
Total retained earnings	1,048,167	1,002,619	1,090,964
Total fund equity	1,156,723	1,111,175	1,199,520
Total liabilities and fund equity	\$8,516,761	\$8,195,074	\$8,101,356

Table A-2  
City of Willits Water Enterprise  
Statement of Revenues, Expenses, and Changes in Fund Balance

	1993/94	1994/95	1995/96
<b>Operating Revenues</b>			
User fees and charges	\$1,099,742	\$1,183,439	\$1,344,899
Other income	<u>26,501</u>	<u>902</u>	<u>1,844</u>
Total operating revenues	1,126,243	1,184,341	1,346,743
<b>Operating Expenses</b>			
Administration	264,946	272,199	290,923
Operations and maintenance	454,293	416,640	411,355
Depreciation	249,932	254,010	264,716
Amortization	<u>42,960</u>	<u>55,649</u>	<u>55,649</u>
Total operating expenses	1,012,131	998,498	1,022,643
<b>Nonoperating Revenues (Expenses)</b>			
Investment earnings	83,459	108,825	96,654
Proceeds from timber harvest	897,301		(332,409)
Interest expense	<u>(369,074)</u>	<u>-340,216</u>	
Total nonoperating revenues (expenses)	611,686	(231,391)	(235,755)
Net income (loss)	725,798	(45,548)	88,345
Retained earnings, July 1	147,525	1,048,167	1,002,619
Retained earnings, June 30	\$1,048,167	\$1,002,619	\$1,090,964

Table A-3  
City of Willits Water Enterprise  
Combining Statement of Cash Flows

	1993/94	1994/95	1995/96
<b>Cash from Operating Activities</b>			
Operating income (loss)	\$114,112	\$185,843	\$324,100
Adjustments to reconcile operating income to net cash provided by operating activities			
Depreciation and amortization	292,892	309,659	320,365
Change in accounts receivable	308,844	(5,244)	(33,301)
Change in other receivables	(2,962)		
Change in accounts payable	(12,168)	708	(5,786)
Change in other payables	<u>(4,044)</u>	<u>8,842</u>	<u>10,016</u>
Net cash from operating activities	696,674	499,808	615,394
<b>Cash Flows from Noncapital Financing Activities</b>			
Proceeds from timber harvest	<u>897,301</u>		
Net cash from noncapital financing activities	897,301		
<b>Cash Flows from Capital &amp; Related Financing Activities</b>			
Acquisition of fixed assets	(7,675)	(298,227)	(300,643)
Payments on capital lease	(85,000)		(76,004)
Payments on loan from other agency	(70,019)	(72,951)	
Interest on debt obligations	(237,708)	(369,902)	(334,647)
Payment to refunding escrow	(4,320,281)		
Proceeds from loan	4,400,300		
Reclassify capital expansion/reserves	200,866		
Principal on debt obligations		<u>(225,000)</u>	<u>(150,000)</u>
Net cash from capital & related financing activities	(119,517)	(966,080)	(861,294)
<b>Cash Flows from Investing Activities</b>			
Interest on investments	59,691	107,087	<u>100,926</u>
Reduction of cash on deposit	<u>304,326</u>		
Net cash from investing activities	364,017	107,087	100,926
Net decrease in cash	1,838,475	(359,185)	(144,974)
Cash balance, July 1	177,618	2,016,093	1,656,908
Cash balance, June 30	\$2,016,093	\$1,656,908	\$1,511,934