



EDUCATIONAL SERIES

Release 4, May 13, 2021

CAPITAL FACILITY FEES – BUY-IN COMPONENT

FVC's Educational Series serves as educational communications to Vallecitos Water District Board Members and advocates to provide information sufficient to acquire an understanding and comfort level for initiating and supporting Board actions for positive change for the benefit of ratepayers.

Board Members, please see "Caution – Open Meeting Act Compliance" at the end of this release. These communications cannot be a means to reach a consensus of the Board majority or communicate a position on an issue. That must be done at meetings posted and open to the public. These communications are strictly to educate, inform, and mitigate the current lack of transparency at the Vallecitos Water District.

Background

Vallecitos Water District (VWD) is a publicly-owned, sole purpose, special district (political subdivision of the State of California). Its sole purpose is providing water and sewer service to its customers. VWD is also obligated to accommodate new customers, provided the projects that bring growth within VWD service boundaries are approved by respective land planning agencies, like the City of San Marcos or the County of San Diego. VWD is not a land planning agency.

Being a publicly-owned entity, the public (customers) own their respective share of the capacity of VWD's water system and wastewater (sewer) system. As a corporation divides its ownership into shares of stock, a publicly-owned utility divides its ownership into shares of its systems' capacity in Equivalent Dwelling Units (EDUs).

For VWD, one water EDU is capacity ownership of, or the right to use, 500 gallons of water per day. One sewer EDU is the right to discharge 250 gallons of effluent per day into the sewer system. New customers must purchase the appropriate amount of EDUs before commencing service from VWD. A single family residence on less than one acre is assumed to equal one EDU. For all other development projects, the number of EDUs to be purchased is based on acreage and estimated usage (demand).

The cost per EDU, known as a Capacity Charge, or Capital Facility Fee (Cap Fee), should be determined within the constraints of relevant legal provisions of the California Constitution and industry guidelines.

Capital Facility Fees – Legal Provisions

Capacity charges are governed by the 1987 Mitigation Fee Act resulting from the passage of Assembly Bill 1600 (California Government Code Section 66000 et. seq.). Section 66013 pertains specifically to water and wastewater capacity and defines a "capacity charge" as "a charge for public facilities in existence at the time a charge is imposed or charges for new public facilities to be acquired or constructed in the future that are of proportional benefit to the person or property being charged, including supply or capacity contracts for rights or entitlements, real property interests, and entitlements and other rights of the local agency involving capital expense relating to its use of existing

or new public facilities.” The charge “shall not exceed the estimated reasonable cost of providing the service for which the fee or charge was imposed.” If the fee exceeds the cost of the service, the fee is considered a tax and needs to be approved by a two-thirds vote to become effective.

The statute provides that capacity charges can recover costs for facilities in existence at the time a charge is imposed or for new facilities to be constructed in the future that will provide benefit to the property for which the charge is assessed.

In 1998, Senate Bill 1760 was enacted requiring agencies to deposit Cap Fees received “in a separate capital facilities fund” along with interest earned on the balance of the fund, “and shall expend those charges solely for the purposes for which the charges were collected.” If the Cap Fee was imposed “for new facilities to be acquired or constructed in the future,” the separate capital facilities fund is restricted and can only pay for capital improvement projects that increase system capacity.

*If the Cap Fee was imposed for the “use of existing facilities,” the Cap Fee revenue can be deposited in an unrestricted fund for capital replacement and **offset the need for water and sewer rate increases to fund capital replacement.***

Capital Facility Fees – Industry Guidance

While Federal and State law is the highest authority for rate setting, American Water Works Association’s Principles of Water Rates, Fees, and Charges, M1 Manual provides generally accepted industry guidance for determining legally defensible fees, and defines the three methods to calculating Cap Fees as follows:

“The **buy-in method** is based on the value of an existing system’s capacity. This method is typically used when the existing system has sufficient capacity to serve new development now and into the future.

The **incremental cost method** is based on the value or cost to expand the existing system’s capacity. This is typically used when the existing system has limited or no capacity to serve new development and new or incremental facilities are needed to serve new development now and into the future.

The **Combined [Hybrid] Approach** is based on a blended value of both the existing and expanded system’s capacity. This method is typically used where some capacity is available in parts of the existing system ..., but new or incremental capacity will need to be built ... to serve new development at some point in the future.”

The Combined, or **Hybrid Approach** is most appropriate for VWD. VWD has enough capacity in their system to accommodate new customer connections. As far back as 2012, when VWD imposed a Sewer Density Impact Fee to recover future costs needed for additional sewer treatment capacity due to growth in excess of planned densities, developers argued that VWD’s system had sufficient capacity to add anticipated growth. VWD has also identified capital improvement projects in their Master Plan needed to accommodate future demands.

Relevant law allows for VWD to charge capacity fees for “public facilities in existence at the time a charge is imposed.” **The buy-in puts new connections on par with existing customers who have paid for replacement and maintenance of existing systems and funded unrestricted capital replacement reserves.** In a publicly-owned utility like VWD, existing customers and newly connected customers both own the assets of the District and share in the burden of repaying outstanding debt.

A Cap Fee calculated using the **Hybrid Approach** would include an **Incremental Cost** component and a **Buy-In** component.

Capital Facility Fees – VWD

According to relevant legal provisions and industry guidelines, VWD should be using the **Hybrid Approach**. VWD has calculated the current Cap Fees using the **Incremental Cost Method**. VWD does not recover any value of the existing system from developers as allowed by the California Constitution and as dictated in industry guidelines.

The City of Carlsbad and VWD are the only water agencies in San Diego County that do not require developers to pay fees to buy-in to their systems. Revenue received from the Buy-in directly offsets the need for water and sewer rate increases. While developer’s pay less for Cap Fees then they should, VWD customers are paying more for water and sewer service than they should. In contrast, the City of Carlsbad reported a \$47.7 million surplus in combined water and sewer developer funds as of June 30, 2020, while VWD reported a \$15.4 million deficit, funded by VWD customers (ratepayers).

\$15.6 Million Negative Fiscal Impact to VWD Ratepayers

Had the latest Cap Fee increase not been delayed for four years, and if a buy-in component was added pursuant to legal provisions and industry standards, the water Cap Fee would have been about \$6,034 per EDU more than the amount adopted, and the sewer Cap Fee about \$3,529 more. Revenue from these additional assessments would have added to replacement reserves and reduced the amount needed to increase water and sewer rates.

Following industry standards, the calculations, if timely prepared, would have been as follows based on 2015 audited financial statements and the June 2015 reserve report. These are merely rough estimates as a list of all assets is needed to estimate the replacement value of each asset.

Water Cap Fee Buy-In Component Calculation		Sewer Cap Fee Buy-In Component Calculation	
Replacement cost - water assets	\$229,681,162	Replacement cost - sewer assets	\$147,357,508
Capital replacement reserves	19,316,848	Capital replacement reserves	22,842,081
Outstanding capital-related debt	<u>(27,838,813)</u>	Outstanding capital-related debt	<u>(37,995,662)</u>
Value of existing water system	\$221,159,197	Value of existing sewer system	\$132,203,927
System capacity in EDUs	<u>36,652</u>	System capacity in EDUs	<u>37,466</u>
Estimated Water Buy-In Component	<u>\$ 6,034</u>	Estimated Sewer Buy-In Component	<u>\$ 3,529</u>

Assumptions:

1. Replacement cost equals original cost less depreciation inflated to present value at 70%. The inflation factor was derived from the average of three recent buy-in calculations: Leucadia 67.4%, Padre Dam 76.2%, Rincon 70%, average = 71.2%.
2. Capital replacement reserves as of June 30, 2015, are stated without the developer subsidy since that amount is to be recovered from the Incremental Cost Component.
3. System capacity in EDUs for water is calculated based on the greatest annual amount of VWD water sales - 20,528 acre feet in 2007.
4. System capacity in EDUs for sewer is assumed to be equal to the EDUs connected plus committed per VWD’s historical budget graph for 2016.

The following revenue estimates may be overstated because they do not account for housing developments that may have been too costly to pursue had a buy-in component been added – an additional \$9,563 per home. Developers cannot add these additional costs to the price of the home. The market (demand) sets the home price. The additional cost from the buy-in requirement would have reduced developers’ profit margins.

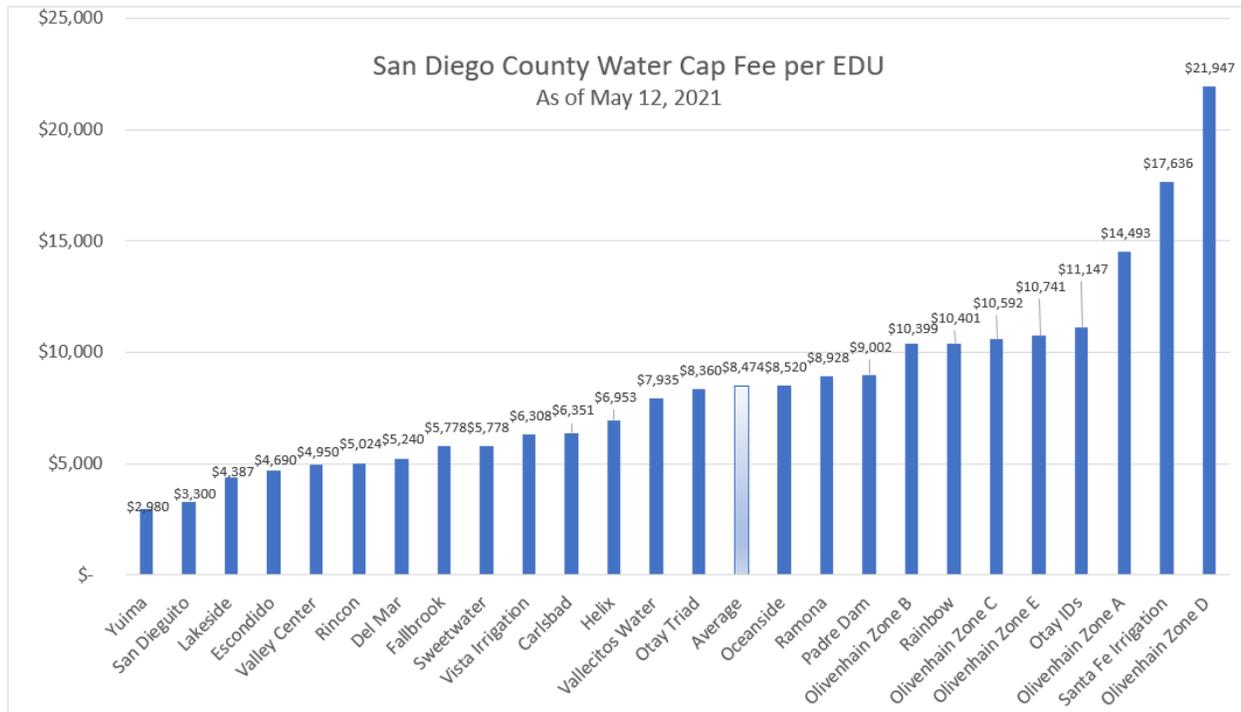
Foregone Buy-In Component Revenue by Fiscal Year					
	2017	2018	2019	2020	Total
<u>Water</u>					
EDU additions	394	403	414	223	
Buy-In Charge	\$ 6,034	\$ 6,233	\$ 6,274	\$ 6,388	
Buy-in Revenue	\$ 2,377,396	\$ 2,511,899	\$ 2,597,436	\$ 1,424,524	\$ 8,911,255
<u>Sewer</u>					
EDU additions	382	344	572	524	
Buy-In Charge	\$ 3,529	\$ 3,645	\$ 3,669	\$ 3,735	
Buy-in Revenue	\$ 1,347,939	\$ 1,253,880	\$ 2,098,668	\$ 1,957,140	\$ 6,657,627
Total	\$ 3,725,335	\$ 3,765,779	\$ 4,696,104	\$ 3,381,664	\$15,568,882

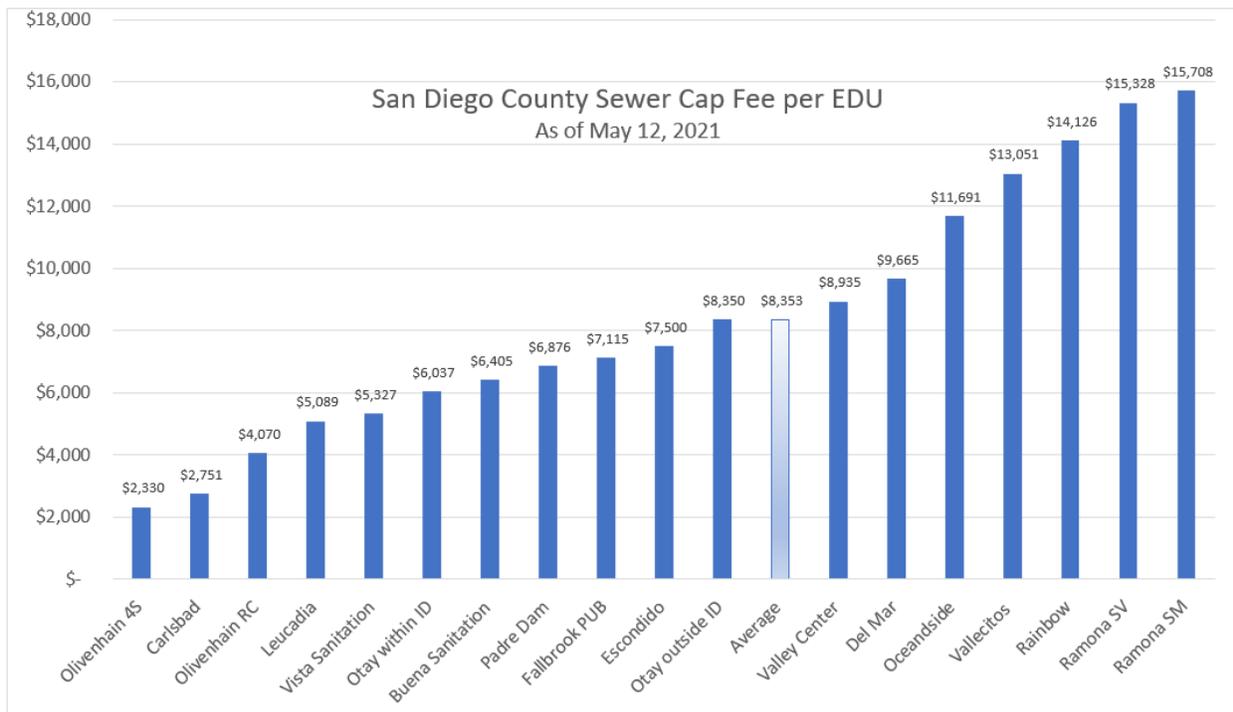
Assumptions:

1. The effective date of the Cap Fees with the buy-in component is July 1, 2016. The original anticipated date of adoption was in 2015.
2. The Buy-In charge increases each year by the same inflationary increase applied to the current Cap Fees.

The foregone revenue from the water buy-in component for the first three years, \$7.5 million, exceeds the “transfer to capital reserves” of \$6.9 million that was added to water rates in 2020, constituting 14.5% of a VWD customer water bill. VWD water rates could be at least 14.5% less if the Board had a ratepayer focus and the District followed industry fee setting guidelines. However, developer fees would not have been “competitive.” That was the directive from VWD’s Finance Committee to staff during the Cap Fee setting process – keep developers’ Cap Fees “competitive” – a developer focus that cost ratepayers millions.

Surveys – Cap Fees





Recommendation

Add a Buy-In Component to the Cap Fee ASAP. Adding a buy-in component does not require a new Master Plan Study or Capital Facility Fee Study. The calculation is based on historical accounting records to assess the value of the system assets. The author of this release has offered to perform the calculation without compensation – that offer stands. Alternatively, Raftelis, the rate consultant currently engaged for VWD’s water and sewer rate study can increase the scope of their engagement and prepare the buy-in component calculation. They are a reputable firm that has prepared scores (maybe hundreds) of capital facility fee studies.

Tentative Release Schedule

Educational Series Topic	Anticipated Release Date
Introduction and the Deficit	April 8, 2021
Reserves	April 14, 2021
Debt	April 29, 2021
Capital Facility Fees – Buy-In Component	May 13, 2021
Capital Facility Fees – Incremental Cost Component	May 31, 2021
Roles, Responsibilities, Ethics, and Transparency	June 15, 2021
Water and Sewer Rates	June 30, 2021

Agency	Rate Method	Cap Fee Components		Rate per
		Incremental	Buy-In	EDU
<u>Water</u>				
Carlsbad	Incremental	\$ 6,351	\$ -	\$ 6,351
Del Mar	Buy-in	-	5,240	5,240
Escondido	Buy-in	-	4,690	4,690
Fallbrook	Buy-in	-	5,778	5,778
Helix	Hybrid	-	6,953	6,953
Lakeside	Buy-in	-	4,387	4,387
Oceanside	Buy-in	-	8,520	8,520
Olivenhain Zone A	Hybrid	na		14,493
Olivenhain Zone B	Hybrid	na		10,399
Olivenhain Zone C	Hybrid	na		10,592
Olivenhain Zone D	Hybrid	na		21,947
Olivenhain Zone E	Hybrid	na		10,741
Otay IDs	Hybrid	3,456	7,692	11,147
Otay Triad	Hybrid	2,592	5,769	8,360
Padre Dam	Hybrid	2,935	6,067	9,002
Rainbow	Buy-In	-	10,401	10,401
Ramona	Buy-In	-	8,928	8,928
Rincon	Buy-In	-	5,024	5,024
San Dieguito	Buy-In	-	330	3,300
Santa Fe Irrigation	Buy-in	-	17,636	17,636
Sweetwater	Buy-in	-	5,778	5,778
Vallecitos Water	Incremental	7,935	-	7,935
Valley Center	Buy-in	-	4,950	4,950
Vista Irrigation	Buy-In	-	6,308	6,308
Yuima		-	2,980	2,980
<i>Average</i>		<i>1,163</i>	<i>5,872</i>	<i>8,474</i>
<u>Wastewater</u>				
Buena Sanitation	Buy-In	\$ -	\$ 6,405	\$ 6,405
Carlsbad	Incremental	2,751	-	2,751
Del Mar	Buy-In	-	9,665	9,665
Escondido	Buy-In	-	7,500	7,500
Fallbrook PUB	Buy-in	-	7,115	7,115
Leucadia	Buy-in	-	5,089	5,089
Oceanside	Buy-in	-	11,691	11,691
Olivenhain 4S	Buy-In	-	2,330	2,330
Olivenhain RC	Buy-In	-	4,070	4,070
Otay outside ID	Hybrid	2,589	5,762	8,350
Otay within ID	Hybrid	1,871	4,165	6,037
Padre Dam	Hybrid	1,115	5,761	6,876
Rainbow	Hybrid	2,095	12,031	14,126
Ramona SM	Buy-In	-	15,708	15,708
Ramona SV	Buy-In	-	15,328	15,328
Vallecitos	Incremental	13,051	-	13,051
Valley Center	Buy-In	-	8,935	8,935
Vista Sanitation	Buy-In	-	5,327	5,327
<i>Average</i>		<i>1,304</i>	<i>7,049</i>	<i>8,353</i>

Additional Information

Please consider obtaining additional background from the following:

FVC Educational Series, Release 1, Introduction and the Deficit

<https://friendshipvallecitoswater.files.wordpress.com/2021/04/fvc-educational-series-release-1-introduction-and-the-deficit.pdf>

FVC Educational Series, Release 2, Reserves

<https://friendshipvallecitoswater.files.wordpress.com/2021/04/fvc-educational-series-release-2-reserves.pdf>

FVC Educational Series, Release 3, Debt

<https://friendshipvallecitoswater.files.wordpress.com/2021/04/fvc-educational-series-release-3-debt.pdf>

Letter to VWD General Manager, February 23, 2021

<https://friendshipvallecitoswater.files.wordpress.com/2021/03/feb-23-2021-email-to-vwd-gm.pdf>

Letter to VWD General Manager, February 18, 2021

<https://friendshipvallecitoswater.files.wordpress.com/2021/03/feb-18-2021-email-to-vwd-gm.pdf>

Vallecitos Water District Hidden Subsidies - A case study in the need for transparency and accountability
October 8, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/10/vallecitos-brief.pdf>

San Marcos Water Rates and Politics, a presentation to the San Marcos Democratic Club, June 13, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/san-marcos-dems-presentation-print-version.pdf>

Attorney General Consumer Complaint, May 22, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/ag-consumer-complaint-support.pdf>

California Water Politics and Pricing, a presentation to the American Institute of Certified Public Accountants Government Performance & Accountability Committee May 5, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/aicpa-california-water-politics-and-pricing.pdf>

San Diego County Taxpayers Association Golden Fleece Nomination, February 12, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/02/sdcta-vwd-golden-fleece-nomination.pdf>

Rate Protest Letter, February 3, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/03/scaglione-rate-protest-letter.pdf>

San Marcos Water Rates and Politics, a presentation to the Republican Women of California, February 3, 2020

<https://friendshipvallecitoswater.files.wordpress.com/2020/07/rwc-hand-out.pdf>

San Marcos Water and Politics – The Price We Paid, Palomar College Political Economy Days, October 23, 2019

Presentation slides – <https://friendshipvallecitoswater.files.wordpress.com/2019/10/san-marcos-water-and-politics-print-version.pdf>

Recorded lecture – <https://www.youtube.com/watch?v=0AXsalWSWjI>

News article – <https://thecoastnews.com/140102-2/>

Press release regarding developer subsidies

<https://friendshipvallecitoswater.files.wordpress.com/2019/09/fvc-article-20191002.pdf>

Letter to VWD General Manager regarding Cap Fee deficiencies, May 28, 2019

<https://friendshipvallecitoswater.files.wordpress.com/2019/08/vwd-letter-to-glenn.pdf>

Caution – Open Meeting Act Compliance

Article IX of the California Constitution requires the business of the public to be conducted in open meetings. The Board can take action, arrive at consensus, and take positions only in open meetings. While two Board Members do not constitute a majority, the potential for stating a position or attempting to gain consensus could happen, either intentionally or inadvertently, with a series of replies or communications. FVC’s Educational Series communications cannot be a means to reach a consensus of the Board majority or communicate a position on an issue. That must be done at meetings posted and open to the public. These communications are strictly to mitigate the current lack of transparency at VWD, educate, and inform.

Excerpt for Article IX of the California Constitution:

11122.5.

(a) As used in this article, “meeting” includes any congregation of a majority of the members of a state body at the same time and place to hear, discuss, or deliberate upon any item that is within the subject matter jurisdiction of the state body to which it pertains.

(b) (1) A majority of the members of a state body shall not, outside of a meeting authorized by this chapter, use a series of communications of any kind, directly or through intermediaries, to discuss, deliberate, or take action on any item of business that is within the subject matter of the state body.

[https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=GOV§ionNum=11122.5.](https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=GOV§ionNum=11122.5)