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SUBJECT: UPDATE ON REGIONAL WATER QUALITY COMMITTEE'S FINANCIAL POLICIES WORK GROUP

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POLICY ISSUE: Staff will provide a briefing for Council on the work of the Financial Policies Work Group (FPWG). This is the group established by the Regional Water Quality Committee (RWQC) to review a number of financial policies in the Regional Wastewater Services Plan (RWSP). The FPWG is composed of staff representing key stakeholders, including Bellevue, in the County's regional wastewater system. The primary policy to be reviewed is Financial Policy-15 (FP-15), regarding the capacity charge which includes the policy of "growth pays for growth". The FPWG was asked to review and verify whether "growth is paying for growth" under the Robinswood Agreement. This refers to the agreement arrived at in 1998 that, in part, said "new customers" connecting to the regional wastewater system would be asked to pay for the new capacity being added to the system over the next 30 years, as identified in the RWSP. The purpose of this briefing is to receive direction from Council on the extent and circumstances under which it supports this policy and/or supports potential refinements to the policy.

DIRECTION NEEDED FROM COUNCIL: This briefing is intended to summarize the work of the FPWG to date, note issues with FP-15 (capacity charge) identified thus far, and seek direction to guide the City's interests in the continuing discussions regarding the capacity charge.

BACKGROUND

Last fall, the Regional Water Quality Committee commissioned a Financial Policies Work Group (FPWG) comprised of staff representing stakeholders in the wastewater system to review a select group of financial policies in the Regional Wastewater Services Plan (RWSP). The primary policy to be reviewed being FP-15 regarding the capacity charge and the policy of "growth pays for growth".

The FPWG was asked to review and verify if "growth is paying for growth", referring to the Robinswood Agreement arrived at in 1998. This agreement, in part, said that "new customers" connecting to the system would be asked to pay for the new capacity being added to the system over the next 30 years, as identified in the RWSP.

When a new connection is made to the wastewater system, whether in a city or in an unincorporated area — it creates a new demand for service — and requires additional capacity in the system for conveyance and treatment. King County's capacity charge is collected to cover the capital costs of that new capacity that is added to the system. The 2010

capacity charge is \$49.07 per month. The capacity charge may be paid in two ways: an upfront charge at the time of purchase totaling \$5,873, or in monthly payments totaling \$8,575 over 15 years. The capacity charge is proposed to increase by 2.8% in 2011 to \$50.45 per month. County staff reviews the capacity charge every three years to ensure that actual costs of system expansion to serve new customers are reflected in the charge.

Background and History of the Capacity Charge

Attachment 1 provides an informative history of the capacity charge originally prepared by King County staff. It includes material used in briefing the FPWG on the background and history of the capacity charge for its assessment of whether “growth is paying for growth”. The capacity charge is a uniform charge assessed to customers establishing new connections to the regional system after January 1, 2003. The level of the charge is based on the costs, customer growth and related financial assumptions used for the RWSP planning period which is 2003 – 2030. The period remains fixed until the RWSP is replaced by a new plan, at which time it is assumed the period for the capacity charge will be changed to match the period of the new plan.

The current policies that provide a methodology for calculating the capacity charge were adopted by the King County Council October 1, 2001 and provide for the following:

- All customers with new connections will pay both a uniform capacity charge and the monthly sewer rate.
- New customer rate and capacity charge revenues will recover 95% of total growth costs during the entire period—this does not imply that 95% will be recovered in each year, but during the entire 2003 – 2030 period.
- Projections underlying the capacity charge are updated every three years.
- System costs will be defined for the RWSP planning period of 2003 – 2030.
- System costs will be allocated among three categories: growth-related, existing and shared.

FPWG Review and Status

King County staff presented information over several meetings on the general methodology it uses to calculate the capacity charge. The meetings served to acquaint the members of the FPWG with some aspects of the County’s methodology with which the members were not familiar. The discussions in these meetings revealed some key issues that the FPWG members believe should be addressed before they can make any recommendations on changing or retaining the current methodology. The group has also spent considerable time discussing the impacts to the regional system of the Brightwater Treatment Plant. The most significant cost factor driving the capacity charge is the cost of constructing Brightwater. Currently under construction near Woodinville, the plant’s costs have nearly doubled to almost \$2 billion. Serious problems with construction of the conveyance tunnels have increased costs even more and will delay startup of the plant to 2012. Some FPWG members have questioned whether it is fair to charge ALL Brightwater costs to new customers given that the decision on where to site the plant was not made to provide the best value for new customers. If the full costs of Brightwater are passed along only to new customers, the capacity charge is likely to continue to escalate.

Another issue discussed by the group is the 2030 end date for the RWSP and its relationship to the capacity charge. Additional treatment facilities are scheduled to be added around 2025 at the County’s South Treatment Plant in Renton. Limiting the capacity charge calculations to only the 2030 planning period does not fully account for these additional treatment facilities. In all likelihood, this limitation would result in a much higher capacity charge for new customers who connect prior to 2030. Some members of the FPWG have suggested recommending that the capacity charge should not be tied to the artificial 2030 end date of the RWSP. Rather, they suggest the capacity charge should be tied to the facilities identified within the RWSP and allocated to customers who will benefit even if the customers connect to the system beyond the RWSP’s 2030 end date.

Some FPWG discussion has addressed the possibility of modifying the current methodology to address these and other issues. With the possibility of multiple methodology choices, the group developed a set of ratemaking principles to be used, along with the terms of FP-15, to evaluate the current and the potential alternative methodologies. These FPWG principles are essentially the same as those adopted by the Bellevue City Council to guide the Utilities Department ratemaking, and include the following:

- Equity between existing and new customers
- Predictability
- Stability
- Revenue certainty
- Transparency
- Simplicity
- Accountability

How the Capacity Charge could Impact Bellevue in the Future

Council recently adopted a resolution updating the Countywide Planning Policies (CPPs) to provide for housing and employment targets for the period 2006 – 2031. For Bellevue, the housing target is 17,000 new units and the employment target is 53,000 new jobs by 2031. Bellevue is designated as a “Metropolitan City” in the CPPs and slated for increased growth under the Puget Sound Regional Council’s recently adopted *Vision 2040* plan. The amount of the capacity charge has the potential to impact whether developers and businesses will seek less expensive places than King County to develop and/or relocate and affect implementation of the region’s growth plan.

Next Steps

Two of the questions under discussion by the FPWG have a direct bearing on the policy of “growth pays for growth” and whether this policy should be continued in its current form or modified. These questions are:

- Should all of the costs of the Brightwater Treatment Plant construction be charged to new customers regardless of the impact on the capacity charge? In addition, should there be a limit or cap on the capacity charge?
- Should the 2030 end date for the capacity charge be eliminated in order to incorporate in the calculation of the capacity charge the costs of the new facilities that will add capacity and the new customers served by and benefitting from that capacity beyond 2030? Incorporating these facilities would likely result in a more equitable and lower capacity charge for new customers.

ALTERNATIVES

Staff is seeking a sense of Council opinions on the questions identified above in order to help develop options at the FPWG. Once the FPWG develops alternative for calculating the capacity charge or other recommendations based on these policy questions, staff will return to Council for further direction.

ATTACHMENT

- (1) History and Background on the Capacity Charge Prepared by King County Council Staff



King County

Metropolitan King County Council

BACKGROUND AND HISTORY OF THE CAPACITY CHARGE:

When a new connection is made to the wastewater system, whether in a city or unincorporated area – it creates a new demand for service – and requires additional capacity in the system for conveyance and treatment. King County’s capacity charge is collected to cover the capital costs of that new capacity that is added to the system.

History

Prior to the merger of King County and Metro – the Metro Council sought to establish a capacity charge based on recommendations from an advisory committee comprised of elected and appointed officials that that worked throughout the 1980s to develop a means for growth to pay for the costs of growth. When authority was sought from the State legislature to levy a “growth” or capacity charge – the intent was to establish an up-front charge or fee to be paid at the time of sewer connection – similar to the connection fee authorized by the state for local utilities. However, the initial legislation approved in 1989 – only authorized Metro to levy a monthly capacity charge which was limited to \$7.00 per single family residence (or equivalent) for 15 years. In 1998 the rate was raised to the statutory limit of \$10.50.

On November 29, 1999, the King County Council adopted Ordinance 13680, which, in turn, adopted the Regional Wastewater Services Plan (RWSP). This plan is intended to ensure that the region’s water quality will continue to be protected as residential and commercial growth continues. Implementation of the RWSP was estimated at the time to cost more than \$1 billion over the 30 year planning horizon. An important principle embodied in the RWSP, and embraced by the Regional Water Quality Committee at Robinswood House on October 29, 1998, was that those contributing to growth should pay the costs of growth.

Participants at the Robinswood House retreat included elected representatives from King County, the City of Seattle, Suburban Cities Association, and special districts served by King County. Specific points of consensus developed at Robinswood were memorialized in a letter signed by participants and dated November 16, 1998. One of these points was that the “regional wastewater financing structure should reflect uniform regional rates for existing and new customers and achieve the principle of growth pays for growth.” Another is that the RWSP need to “establish a uniform capacity charge within the service area to cover growth costs not captured by the monthly sewer rate for new customers”.

Robinswood participants also acknowledged the need to change state law to allow a higher capacity charge. Towards that end, Section 16 of Ordinance 13680 stated that King County would seek changes in state law to obtain the flexibility and authority to set capacity charges locally. State law at that time significantly restricted the county’s ability to use its capacity charge to recover the growth related costs of the RWSP.

In the 2000 legislative session, collective efforts of King County, cities and special districts, obtained the changes in state law that were sought resulting in RCW 25.80.570. The new law, which still requires that the capacity charge be a monthly charge approved by the county annually, became effective June 8, 2000.

Section 16 (Financial Policy-12 at the time) of Ordinance 13680 at the time stated the following: "Within six months of achieving the authority to set charges locally, the executive shall propose for consideration by the council, after consultation with the RWQC, explicit policies for setting the capacity charge including recommendations to achieve growth paying for growth."

On March 15, 2001 the Executive transmitted proposed legislation amending FP-12 to fulfill the policy direction of Section 16 of Ordinance 13680. At the time of the transmittal, the Executive noted in his transmittal letter that setting the capacity charge according to his proposed policies would save existing ratepayers more than \$277 million (net present value) over the life of the plan.

Prior to transmitting the Executive proposed policy – he had already convened an expert panel to review the proposed capacity charge methodology on January 29, 2001. The panel members, Jim Hattori, Alan Cohen of HDR, and Dick Howell of Montgomery Watson, were all well-qualified financial experts. They concluded that the method provides the mechanism to recover growth-related costs from new customers; results in a fair allocation of costs; supports the credit worthiness of King County; and appears to be affordable.

Reviewing the record of briefings and staff reports as the revised financial policy FP-12 was reviewed and finalized in the King County's Regional Water Quality Committee and Utilities and Natural Resources Committee reveals some of the concerns of the RWQC and Council at the time.

Specifically – in 2001 the committees reviewed the policy as proposed by the Executive to implement the directive "growth pays for growth". The committees reviewed:

- What is new growth?
- What costs benefit the region?
- What costs benefit new growth alone?
- What costs benefit existing customers alone?

The committees also looked at the issues of a uniform rate, how customer classes are treated, etc. In the end, the policy proposed and adopted called for implementation of a methodology allocating costs in the following manner:

- All existing and new capital facilities that are needed to serve new growth will be paid by new residential and commercial customers.
- The outstanding bonded indebtedness for existing facilities and that share of new facilities needed to serve existing customers will be paid by existing customers.
- The capital asset maintenance program for the existing system will be paid by existing customers.
- The capital asset maintenance program for the new system will be paid by new customers.
- Operational costs for both the new and old systems will be proportionally paid by new and existing customers.
- CSO control costs are proposed as regional costs and are allocated proportionally between new and existing customers.

An issue that emerged during the review was a legal one concerning the potential to essentially “overcharge” new customers for the cost of the new facilities which would also be benefiting existing customers. Outside legal counsel was retained and they recommended that the proposed policy be amended. As a result – the policy adopted by the Council sets the capacity charge to be a minimum of 95% of the projected costs of new facilities to serve new customers. The factor of 95% (though other percentages were evaluated) was set pursuant to legal advice that the capacity charge cannot exceed the cost of new facilities needed to serve new customers.

Financial Policy FP-15

The policy recommended by the RWQC and adopted by the Council in Fall 2001 was adopted as a revised FP-12, now FP-15 (in 2006 the RWQC and Council amended and added some financial policies making FP-12 now financial policy FP-15):

FP-15: King County shall charge its customers sewer rates and capacity charges sufficient to cover the costs of constructing and operating its wastewater system. Revenues shall be sufficient to maintain capital assets in sound working condition, providing for maintenance and rehabilitation of facilities so that total system costs are minimized while continuing to provide reliable, high quality service and maintaining high water quality standards.

1. Existing and new sewer customers shall each contribute to the cost of the wastewater system as follows:

a. Existing customers shall pay through the monthly sewer rate for the portion of the existing and expanded conveyance and treatment system that serves existing customers.

b. New customers shall pay costs associated with the portion of the existing wastewater conveyance and treatment system that serves new customers and costs associated with expanding the system to serve new customers. New customers shall pay these costs through a combination of the monthly sewer rate and the capacity charge. Such rates and charges shall be designated to have growth pay for growth.

2. Sewer rate. King County shall maintain a uniform monthly sewer rate expressed as charges per residential customer equivalent for all customers.

a. Sewer rates shall be designed to generate revenue sufficient to cover, at a minimum, all costs of system operation and maintenance and all capital costs incurred to serve existing customers.

b. King County should attempt to adopt a multiyear sewer rate to provide stable costs to sewer customers. If a multiyear rate is established and when permitted upon the retirement by the county of certain outstanding sewer revenue bonds, a rate stabilization reserve account shall be created to ensure that adequate funds are available to sustain the rate through completion of the rate cycle. An annual report on the use of funds from this rate stabilization account shall be provided annually to the RWQC.

c. The executive, in consultation with the RWQC, shall propose for council adoption policies to ensure that adequate debt service coverage and emergency reserves are established and periodically reviewed.

3. Capacity charge. The amount of the capacity charge shall be a uniform charge, shall be approved annually and shall not exceed the cost of capital facilities necessary to serve new customers. The methodology that shall be applied to set the capacity charge is set forth in FP-12.3.a*.

a. The capacity charge shall be based on allocating the total cost of the wastewater system (net of grants and other non rate revenues) to existing and new customers as prescribed in this subsection. The total system cost includes the costs to operate, maintain, and expand the wastewater system over the life of the RWSP. Total estimated revenues from the uniform monthly rate from all customers and capacity charge payments from new customers, together with estimated non rate revenues, shall equal the estimated total system costs. The capacity charge calculation is represented as follows:

$$\text{Capacity Charge} = \frac{[\text{Total system costs} - \text{rate revenue from existing customers}] - \text{Rate revenue from new customers}}{\text{Number of new customers}}$$

where:

(1) total system costs (net of grants and other non rate revenues) minus rate revenue from existing customers equals costs allocated to new customers.

(2) costs allocated to new customers minus rate revenue from new customers equals the total revenue to be recovered through the capacity charge.

(3) total capacity charge revenue requirements divided by the total number of new customers equals the amount of the capacity charge to be paid by each new customer.

b. The capacity charge may be paid by new customers in a single payment or as a monthly charge at the rate established by the council. The county shall establish a monthly capacity charge by dividing that amount by one hundred eighty (twelve monthly payments per year for fifteen years). The executive shall transmit for council adoption an ordinance to adjust the discount rate for lump sum payment. The executive shall also transmit for council adoption an ordinance to adjust the monthly capacity charge to reflect the county's average cost of money if the capacity charge is paid over time.

c. King County shall pursue changes in state law to enable the county to require payment of the capacity charge in a single payment.

d. The capacity charge shall be set such that each new customer shall pay an equal share of the costs of facilities allocated to new customers, regardless of what year the customer connects to the system. The capacity charge shall be based upon the costs, customer growth and related financial assumptions used for the Regional Wastewater Services Plan adopted by Ordinance 13680 as such assumptions may be updated. Customer growth and projected costs, including inflation, shall be updated every three years beginning in 2003.

e. The county should periodically review the capacity charge to ensure that the actual costs of system expansion to serve new customers are reflected in the charge. All reasonable steps should be taken to coordinate the imposition, collection of and accounting for rates and charges with component agencies to reduce redundant program overhead costs.

f. Existing customers shall pay the monthly capacity charge established at the time they connected to the system as currently enacted by K.C.C. 28.84.055. New customers shall pay the capacity charge established at the time they connect to the system.

g. To ensure that the capacity charge will not exceed the costs of facilities needed to serve new customers, costs assigned and allocated to new customers shall be at a minimum ninety five percent of the projected capital costs of new and existing treatment, conveyance and biosolids capacity needed to serve new customers.

h. Costs assigned and allocated to existing customers shall include the capital cost of existing and future treatment, conveyance and biosolids capacity used by existing customers, and the capital costs of assessing and reducing infiltration and inflow related to the use of the existing conveyance and treatment capacity.

i. Capital costs of combined sewer overflow control shall be paid by existing and new customers based on their average proportionate share of total customers over the life of the RWSP.

j. Operations and maintenance costs shall be paid by existing and new customers in the uniform monthly rate based on their annual proportionate share of total customers.

k. Any costs not allocated in FP-12.3 f, g, h, i and j* shall be paid by existing and new customers in the sewer rate.

l. Upon implementation of these explicit policies, the Seattle combined sewer overflow benefit charge shall be discontinued.

4. Based on an analysis of residential water consumption, as of December 13, 1999, King County uses a factor of seven hundred fifty cubic feet per month to convert water consumption of volume-based customers to residential customer equivalents for billing purposes. King County shall periodically review the appropriateness of this factor to ensure that all accounts pay their fair share of the cost of the wastewater system.

*Reviser's note: Ordinance 15602 added new policies FP-3, FP-4 and FP-5, but this reference was not changed.

A chart showing the allocation of costs to existing and new customers was referred to in the ordinance (Attachment 1) and has subsequently been simplified for presentations to the Council. The same principles apply when the cost estimates are updated every three years with assessments of excess capacity and proportional rationing of operations and maintenance of the "old" and "new" system allocations to existing and new customers.

The policy as adopted calls for updating the costs projections and other assumptions regarding residential customer equivalents (RCEs), etc., every three years and adjusting the capacity charge. In recent years, at the urging of MWPAAC and stakeholders, the Council has increased the capacity charge by 3% in the intervening years (between the 3 year update) to reflect average inflation over the 30 year period. Customer growth and projected costs, including inflation, are due to be updated this year for incorporation into the 2011 capacity charge. The capacity charge history is shown in the table below.

Capacity Charge History

Effective Period	Monthly Rate
2/1/1990 – 12/31/1997	\$7.00
1/1/1998 – 12/31/2001	\$10.50
1/1/2002 – 12/31/2002	\$17.20
1/1/2003 – 12/31/2003	\$17.60
1/1/2004 – 12/31/2004	\$18.00
1/1/2005 – 12/31/2006	\$34.05
1/1/2007 – 12/31/2008	\$42.00
1/1/2008 – 12/31/2008	\$46.25
1/1/2009 - 12/31/2009	\$47.64
1/1/2010 – 12/31/2010	\$49.07

Prior RWQC Review of FP-15

The RWQC has also expressed interest in the issue of “lump sum” payments for the capacity charge since the adoption of the policy in 2001. King County offers the option for the capacity charge to be paid off in a lump sum (at a discounted amount) at any time during the 15-year duration of the charge – including when the charge is first assessed. In response to a 2004 budget proviso, the Executive provided an analysis and report to the Council on “Administrative Barriers to Upfront Payment” of the Sewage Treatment Capacity Charge.

If a new homeowner is aware of the charge at the time financing is being arranged for a home or condominium – the lump sum payment can potentially be financed as a part of the mortgage – thereby providing tax advantages. However, for various reasons purchasers are not always aware of the capacity charge or the option to pay it in a lump sum at the time they are arranging financing. The report discussed the actions being taken by WTD to better alert and inform customers.

ALLOCATION OF CUSTOMER COSTS

COST	PAID BY NEW CUSTOMERS	PAID BY EXISTING CUSTOMERS	SHARED IN PROPORTION
New treatment capacity	X		
New conveyance - new customers	X		
New biosolids capacity	X		
Existing excess capacity	X		
Current treatment capacity		X	
Current conveyance capacity		X	
Current biosolids capacity		X	
I/I assessment and reduction		X	
New conveyance - existing customers		X	
CSO control	X	X	X
O&M for new system operation	X	X	X
O&M for current system operation	X	X	X
O&M central administration	X	X	X