ITEM NO. 6

COMMITTEE MEMORANDUM

REVISED

DATE: December 6, 2023

TO: Finance and Administration Committee

FROM: Rochelle Patterson
Chief Financial and Administrative Officer

SUBJECT: Review Facility Capacity Fee (FCF) Revenues and Study Components

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SUMMARY

The Agency periodically updates its Facility Capacity Charges, as identified by the Facility Capacity Fee (FCF) study, typically every 3-5 years. The FCFs are to fund capital improvements necessary for the expansion of the regional water system, and the fees are related to the capital facilities demands of new development. This report is to provide an overview of the Regional Facility Capacity Fee Revenues and Study Components.

DISCUSSION

The legacy Agency CLWA (Castaic Lake Water Agency) started collecting Capacity Fees in 1988. Since then, numerous studies using various methodologies have been completed to update the fees. The 2017 FCF study was implemented prior to the SCV Water merger on January 1, 2018. This revision significantly changed the methodology that had been used in previous studies. Key changes included shifting from a fee basis tied to fixture units or demand per square foot of various building types to a fee basis tied to meter capacity, consolidation of fee assessment "water service areas," elimination of a legacy "black box" financial engine which also included discontinuing an internal tracking of under collection of FCF revenues during periods of low growth activity. While the new fee approach was largely welcomed, the building industry was concerned with impacts of higher fees and a specific assumption about minimum 1-inch meter sizes. Later in 2018, per the terms of the settlement agreement with the Los Angeles/Ventura County Building Industry Association (BIA), a prorated adjustment for meter connections smaller than 1-inch was implemented, and methodology remained the same. At that time, the Agency also agreed to complete a new FCF study by the end of 2019, which was completed and adopted in February 2020. The current FCF structure has been in place for over three years, and this review will provide information on performance and key insights over that time period. Staff anticipates further discussion and information based on the Committee's interest; however this informational report is not intended to be a new FCF study, rather to identify key considerations for the next update to the fee.

Definitions:

The Agency applies two types of one-time fees to connect to the water system: Facility Capacity Fees and Retail Capacity Fees, also referred as Connection Fees or Expansion Fees. Although the legal requirements and definitions are the same, the Agency identifies the fees this way:

- **Facility Capacity Fees** are charges imposed to cover portions of project costs that will upgrade, expand, or provide additional capacity in the water system for the benefit of new users. This fee was developed under legacy predecessor Agency CLWA to address regional imported water treatment and regional distribution projects, regional emergency storage, water banking, water rights acquisition, and related imported water supply projects (except those covered by the State Water Project), development of backbone recycled water system(s), and other regional projects implemented by CLWA..

- **Retail Capacity/Expansion/Connection Fees** are related to legacy retail water Agency facilities put in place within the Newhall County Water District and Santa Clarita Water Division service areas, as well as the recently implemented Valencia Water Division retail capacity fee. This fee is charged to new users to connect to the retail division's infrastructure or to expand existing users' capacity. These capacity fees are designed to recover the proportionate share of the costs for capacity in the water system infrastructure, are aimed at recovering the costs to construct new facilities needed serve future customers, as well as the costs to replace infrastructure that is necessary to ensure an adequate supply of water from the retail system.

  The legacy Newhall Connection Fees as well as the legacy Santa Clarita Expansion Fee have two components to the fee. One component is a Master Plan Fee (or Expansion Fee as identified in the Master Plan) and a Buy-in Fee component. New users that tie into the existing water system pay a proportionate share of those facilities that have already been constructed, referred to as the Buy-in component. The Master Plan component (or Expansion) is used to pay for the expansion of the water system in advance of new users connecting, as identified in the Master Plan.

  The projects to be constructed for the retail systems can include water storage tanks, groundwater wells, booster stations, pipelines, and groundwater treatment that have been identified as a need for future growth.

Prior and Current FCF Studies:

- **2017 Study and 2018 FCF Amendment:**
  - The study was based on changes in planning documents
  - FCFs are charged based on meter equivalents, rather than estimated water usage
  - CLWA combined 10 Water Service Areas (WSA) to 4
    - West Valley: WSAs 1,2,5,6,7,8
    - East Valley: WSAs 3,4
    - Newhall Ranch: WSA 9
    - Whitaker-Bermite: WSA 10
  - CLWA modified its methodology, using a more easily understood model, charging capacity fees similarly to retail connection fees, streamlining the application process and better aligning it with the basis for retail capacity fees (meter size).
  - 2018 Amendment added a prorated adjustment for meter connections smaller than 1- inch

- **2019 FCF Study:**
    - Adopted pursuant to Resolution No. SCV-139 on February 18, 2020.
    - The Agency completed a thorough Facility Capacity Fee Study that complied with Government Code section 66013, which states that capacity charges are imposed to make growth pay for growth by offsetting the impact of new development on utility system infrastructure. The ratepayer advocate reviewed the study.
    - Agency's facility capacity charges are "based on the incremental cost approach, which is typically used in agencies that have little or no capacity available in the current system and require expansion to accommodate growth."
    - The fee calculation was based primarily on projected equivalent meter units ("EMUs") at buildout, using population from the 2015 UWMP.
    - Applied future interest rates for project financing, future construction projects needed to accommodate growth.
    - It was determined in the 2017 study that the Agency was approximately 70% built out. Any future projects or debt related to those projects would be funded 70% from current users and 30% by future users, with the exception of recycled water projects, which would be funded 85% from current users and 15% from future users.
    - The fees are escalated annually by an index (ENR or CPI) up to 3% until a new study is available.

Demand and Revenues

The anticipated number of new connections at buildout 2050 was expected to be 31,230; however, neither the meter size nor the WSA to which these connections belong are occurring as projected, which causes fluctuations in revenue receipts. Nevertheless, the study assumes that, should everything go according to plan [at buildout], the Agency would generate enough revenue to cover the allocated debt service for projects identified in the FCF Study.

Timing is crucial when calculating and collecting facility capacity fees. The fee structure uses a cash flow optimization technique to ensure that the final fund balance at buildout equals the balance of expense obligations. As stated in the adopted 2019 FCF Study, the yearly revenues from FCF will not equal capital and debt payment commitments on an annual basis, as reflected in Attachment 1.

Excerpt from the 2019 Study, page 4:

> *The timing difference between cost incurrence and FCF realization has considerable uncertainty associated with it. The cost components included in the fees are only forward facing; this means that annual infrastructure costs associated to growth (debt principal and interest repayment), if not equal to the FCF realized during the year, are funded by other Agency revenues. The amount of the annual difference between FCF revenues and associated costs cannot be fully considered as a component of future FCF updates as the fee per newly developed meter connection would become prohibitive to growth. This fact was given great consideration and led to the development of a financial model that assigns plausible FCF price points with corresponding levels of confidence as to the likelihood that fees would collect the targeted revenue requirement, if all were paid in 2020.*

Current FCF Challenges

One of the primary issues with FCFs, is that while debt service and capital costs are well known, it is difficult to predict the timing of new service connections and FCF revenue. Typically a

forecast assumes a relatively uniform pattern over the buildout period, but development activity is not usually uniform since it is impacted by factors such as the economic conditions, interest rates for home buyers, timing of regulatory or legal approvals for projects, and even (in 2020-2022) COVID-19.

Potential Solutions to Revenue Recovery

- The Agency cannot recover uncollected revenue and cumulative interest charges of Agency funds from new developers. However, the Agency may account for assets that have been constructed by the Agency prior to receiving FCFs, and one approach is to potentially include that portion in the upcoming fee studies by including a Buy-in component. The amount to be included must reflect the share of such assets attributable to serving new development.

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- Following the completion of the Agency-wide Master Plan, the Agency intends to perform a new FCF study (that may combine the FCF and Retail Capacity Fees), during which the capital project list, estimated demand, and connection per WSA will all be revised, along with the debt service schedule.

In addition, since the 2019 Facility Capacity Fees took effect, the Agency has been monitoring and tracking all the details of the revenues received by developers and by WSA. as well as the size of connections. Through more accurate data and trend analysis, this tracking will help the Agency make more accurate forecasts.

STRATEGIC NEXUS

This FCF review helps support SCV Water's Strategic Plan Goal E: Financial Resiliency – "Maintain a long-range, transparent, stable and well-planned financial condition, resulting in current and future water users receiving fair and equitable rates and charges."

FINANCIAL CONSIDERATIONS

None at this time

RECOMMENDATION

That the Finance and Administration Committee discuss Facility Capacity Fee revenues.

RP

Attachment

Facility Capacity Fees Analysis

	Period Ending / FCF DS Allocation	A Total FCF Share Recovery	B FCF Revenues (Based on # Connections)	C FCF Revenues Received	D FCF +/- Revenues - Connections (C-B)	E FCF +/- Revenues - FCF Share Debt (C-A)	Projected # EMU's	Actual # EMU's	Projected # Connections	Actual # Connections
Actuals	6/30/2021	$ 4,672,843	$ 20,963,369	$ 12,234,202	$ (8,729,167)	$ 7,561,359	2,121	1,188	1,104	1,254
	6/30/2022	$ 20,222,326	$ 21,491,487	$ 8,523,169	$ (12,968,318)	$ (11,699,157)	2,175	860	1,114	948
	6/30/2023	$ 20,832,724	$ 21,674,814	$ 3,636,187	$ (18,038,627)	$ (17,196,536)	2,193	365	1,096	314
Projected	6/30/2024	$ 21,191,651	$ 21,898,618						1,081	-
	6/30/2025	$ 25,780,951	$ 21,694,313						1,032	-
	6/30/2026	$ 25,823,225	$ 22,485,456						1,057	-
	6/30/2027	$ 25,853,274	$ 22,021,118						988	-
	6/30/2028	$ 25,401,810	$ 22,177,270						1,629	-
	6/30/2029	$ 26,108,837	$ 22,391,091						1,644	-
	6/30/2030	$ 26,110,861	$ 22,961,663						1,686	-
	6/30/2031	$ 26,094,843	$ 20,039,197						1,472	-
	6/30/2032	$ 16,583,774	$ 20,431,619						1,500	-
	6/30/2033	$ 16,567,520	$ 20,734,176						1,523	-
	6/30/2034	$ 17,170,589	$ 20,501,908						1,506	-
	6/30/2035	$ 18,196,063	$ 20,399,854						1,498	-
	6/30/2036	$ 18,149,931	$ 9,479,535						696	-
	6/30/2037	$ 15,161,290	$ 10,196,254						749	-
	6/30/2038	$ 10,601,991	$ 10,345,330						760	-
	6/30/2039	$ 10,526,580	$ 9,412,271						691	-
	6/30/2040	$ 10,433,225	$ 9,758,984						717	-
	6/30/2041	$ 10,372,826	$ 10,811,236						794	-
	6/30/2042	$ 10,446,434	$ 10,150,743						745	-
	6/30/2043	$ 10,303,805	$ 10,274,636						755	-
	6/30/2044	$ 10,408,724	$ 10,008,493						735	-
	6/30/2045	$ 10,226,457	$ 10,630,294						781	-
	6/30/2046	$ 10,024,459	$ 10,710,843						787	-
	6/30/2047	$ 10,147,486	$ 10,450,047						767	-
	6/30/2048	$ 9,134,367	$ 11,115,178						816	-
	6/30/2049	$ 8,850,757	$ 10,012,413						735	-
	6/30/2050	$ 6,934,851	$ 10,512,830						772	-
	6/30/2051	$ 1,682,119	$ -							-
		$ 480,016,593	$ 475,735,040	$ 24,393,558	$ (39,736,112)	$ (21,334,334)	6,489	2,414	31,230	2,516

Projected Connections FY 21-23 *3,314*

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