

# Sewer Fund

Update 2010



This newsletter is being sent to sewer users in Delano. Beginning in February 2010, sanitary sewer users will notice a new \$8 base fee and additional \$1 rate increase per 1,000 gallons of water used on a monthly basis. The information contained in this newsletter will provide some background information to help explain the details of the rate increase.

The City receives sewer revenues from two sources – **user rates** and **hook-up fees**. Quite simply, with the substantial slowdown in the housing market and business sector, there has been a substantial drop in new hook-up fees that has continued through 2009.

The City’s sewer fund operates with an approximate \$2,000,000 annual budget. In terms of the expense ledger, there are two main areas of costs:

- Operations = \$600,000 annually (approximate)
- Debt Service = \$1,400,000 annually (approximate)

Traditionally, the sewer fund financial model has been constructed to recover operations expenses through user rates and debt service expenses through hook-up fees. The rationale behind this approach is that the operations costs maintain the existing system and treat the wastewater produced; and the debt service expenses are those expenses of capital improvements necessary to provide the benefit of municipal services to new users.

Historically, this model has worked effectively. A snapshot look at 2005 shows the impact of this policy.

<b>2005</b>	<b>User Rates</b>	<b>Hook-up Fees</b>
<b>Revenues</b>	\$941,727	\$1,455,247
<b>Operations Cost</b>	\$458,167	---
<b>Debt Service</b>	---	\$919,724
<b>Year-end Fund Balance Gain</b>	\$483,560	\$535,523

By 2006, the City’s sewer fund had a reserve balance exceeding \$5,000,000. Also, growth had curtailed a bit but was still holding revenues near a balanced-budget projection. With this information, the City decided to reduce user rates in 2006. As part of this decision, the City expected to use its reserve balance slowly to offset any deficits created by the rate decrease over time. The slow reduction of reserves would support reduced user rates.

The timing of the 2006 user rate reduction and the crash of the new construction housing market, however, created a significant challenge for the sewer fund. By 2007, operations expenses had increased as projected due to energy increases and increased costs to operate the new Wastewater Treatment plant. Additionally, debt service for a new sanitary sewer extension – the Northwest Interceptor – also had become an expense.

By the end of 2007, the snapshot of the fund’s annual performance looked much different than it did in 2005.

<b>2007</b>	<b>User Rates</b>	<b>Hook-up Fees</b>
<b>Revenues</b>	\$665,034	\$225,129
<b>Operations Cost</b>	\$564,025	---
<b>Debt Service</b>	---	\$1,299,165
<b>Year-end Fund Balance Gain</b>	\$101,009	-\$1,074,036

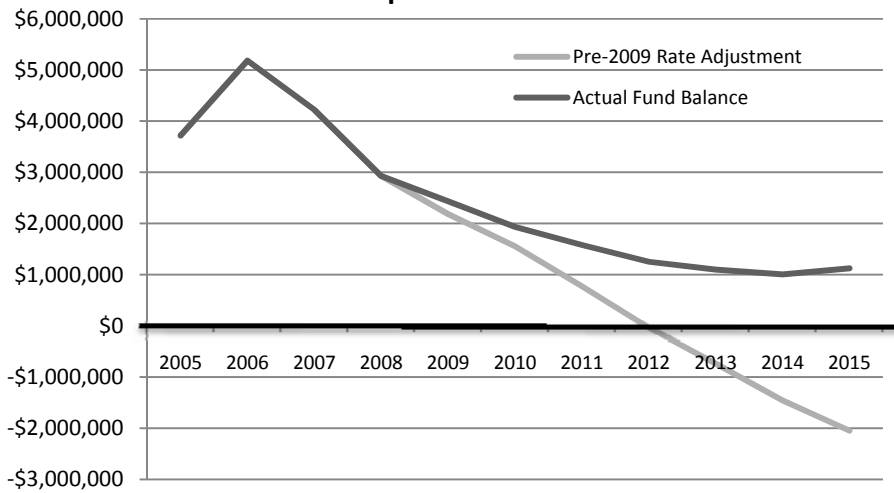
In 2008, the City Council reviewed this data in great detail. The summary, however, can be simplified by stating the slowdown in new utility hook-up fees resulted in a significant deficit on the debt service side of the fund. The City, as a result, used almost \$1,000,000 in sewer reserve funds in 2007 to balance the budget. In 2008, the number was about the same.

Therefore, effective in 2009, the City returned user rates back to the pre-2006 level. This resulted in additional rate revenue to offset planned hook-up fee shortfalls. It wasn’t anticipated to solve the annual deficit, but slow the use of reserve funds until the market recovered and allowed for a return in growth.

By repealing the 2006 rate reduction, the City was able to stem the loss of reserves to approximately \$640,000 in 2009 (exact figures will not be available until the completion of the 2009 Audit in spring 2010).

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## 2009 – Impact of Rate Correction



The graph titled “2009 Impact of Rate Correction” shows the sanitary sewer fund balance with two alternate courses of action. The light line shows the course the sewer fund was on—even with the aforementioned slow growth recovery. The dark line shows the course of the sewer fund with the repeal of the 2006 user rate reductions. The chart assumes a slow recovery to growth, using for example 40 residential equivalent units of new construction in 2009 and 50 units in 2010.

In the fall of 2009, the City Council completed its annual review of the fund and considered several courses of action. The City received eight new sanitary sewer hookups in 2009, which was 80% less than the projected hookups. In light of this continued slow growth, the Council has discussed a conservative approach when looking ahead to future years.

### 2010 – Options to Consider and Action Taken

The City considered four options in terms of managing the sanitary sewer fund in 2010 which would not require refinancing debt and deferring capital interest to future years.

1. Leave rates alone, utilize fund balance as needed.
2. Establish an \$8.00 base fee each month, per user.
3. Increase user rates, with two considered levels:
  - a. \$1.00 per 1,000 gallons of use
  - b. \$2.50 per 1,000 gallons of use

The chart to the right of this page shows the impact of each option. All four options, represented by the incremental blocks, are projected to come short in 2010 of meeting the necessary debt burden of the fund.

The City has elected to move forward implementing two changes. First, the Council has established (effective for use in 2010) an \$8 base fee per sanitary sewer user (option 2). Additionally, the City has increased user rates by \$1.00 per 1,000 gallons of use (option 3 “a”). These options combined are projected to cost the average sanitary sewer user \$14 per month, and generate approximately \$350,000 in revenue during 2010. This additional revenue

will be used to curtail losses incurred by fewer-than-anticipated hook-up fees.

The City approved this rate adjustment with intent on staying ahead of significant financial troubles in the sanitary sewer fund. It most certainly has been acknowledged that times are difficult and the increase is an added burden on families and businesses. However, as growth moderates and returns in coming years, connection fees that are associated with new construction will reduce the obligation of current rate payers and return the burden of debt service back to new growth. As this occurs, the City Council has stated it hopes to reduce rates as soon as the financial health of the Sewer Fund improves.

## Sanitary Sewer Fund Projections

Hook-up Fees and Rate Revenue compared to Debt Service

