

Indirect Cost Allocation Plan is overcharging water/wastewater rate payers in violation of proposition 218 and the State Constitution

OVERVIEW

- ***Sebastopol rate payers pay more than most cities in the county.*** We pump our own water and use the same sewer treatment operation as others, why are our rates so much higher? **One possible explanation is an overallocation of city expenses to water and wastewater rate payers that is not done by other cities.**

The current cost allocation methodology described in the staff report for the June 3 meeting needs to be revisited to ensure rate payers are not intentionally or unintentionally paying for the city's general expenses that the city council cannot pay with current tax revenues.

- The Clear Source presentation states the model is a **“reasonable method consistent with industry practices for identifying overhead burden on the City’s direct services provided to the community such as utilities”**.
- The Standard stated in proposition 218 is that **rate payers shall not be charged for city expenses unrelated to delivering water/wastewater services.**
- **“Reasonable”** needs to be judged based on the assumptions used in the model. Most of these assumptions are not explicit but buried in the details of the model. Looking at the model outputs as a % of each departments budget casts significant doubts that the assumptions are “reasonable”.

ALLOCATION SCHEME

Overall, the city charges water and wastewater rate payers for 35% of the departmental expenses in the departments allocated to the enterprise funds.

	Water	Wastewater	Total	Department budget	% of Expenses
Finance/Administration	\$ 303,546	\$ 338,103	\$ 641,649	\$ 1,466,539	44%
Public Works Corp Yard	\$ 147,373	\$ 105,858	\$ 253,231	\$ 309,901	82%
Engineering	\$ 91,734	\$ 94,161	\$ 185,895	\$ 772,995	24%
City Manager	\$ 128,272	\$ 157,791	\$ 286,063	\$ 581,282	49%
City Attorney	\$ 69,512	\$ 119,751	\$ 189,263	\$ 643,750	29%
City Council	\$ 49,767	\$ 54,891	\$ 104,658	\$ 183,214	57%
City Clerk	\$ 38,096	\$ 65,629	\$ 103,725	\$ 470,819	22%
Non Departmental	\$ 8,500	\$ 7,564	\$ 16,064	\$ 521,940	3%
Public Works Governmental Buildings	\$ 8,558	\$ 7,216	\$ 15,774	\$ 164,083	10%
Total	\$ 845,358	\$ 950,964	\$ 1,796,322	\$ 5,114,523	35%

The table above shows the expense amounts allocated by the department to the enterprise funds. Also shown is the departmental budget for each department and the % of that budget that is being funded by water and wastewater rate payers.

It is “reasonable” that 57% of city council contribution to the city is being paid for by rate payers? Out of more than 300 agenda items in the past year, 12 were related to water and wastewater. *57% is not close to a reasonable allocation of city council expenses.*

City Attorney – 24% of this budget is allocated. Unfortunately, the model is not just allocating the contract cost, it is allocating the total litigation budget. The public has been told that the \$600,000 litigation budget is largely due to the cost of the ACLU lawsuit. **In what universe does a lawsuit related to parking and the homeless impact on the quality of water or wastewater services? On the surface it doesn’t seem reasonable that these expenses are all related to delivering water and wastewater services as defined in Proposition 218.**

City Manager – 49% of this budget is allocated to rate payers. Perhaps not surprising but very difficult to confirm. **What is not difficult to confirm is that the city manager’s expenses will not be \$581,000. Your own documentation for this meeting for the recruitment of a city manager suggests that the position will be vacant for 6-7 months. Rate payers are being overcharged \$143,000. Is that reasonable?** Quite a bit more than a rounding error. Looking back through past budgets there has never been an adjustment for allocations based on actual expenditure. **Should rate payers be getting a rebate each year?**

LACK OF DEPARTMENTAL DOCUMENTATION/VERIFICATION

“Reasonable” would suggest if city departments are dedicated 30-50% of their time to the enterprises this would be reflected in their accomplishments from last year and their goals for 25-26. *None of these departments have any goals related to water and wastewater.*

Public Works is the largest contributor to the salary and benefit costs to water and wastewater. 44% of the headcount in PW is assigned part time to the enterprises and billed directly to rate payers. **All but one of the city’s maintenance workers are allocated 75%-80% to water and wastewater and their salaries and benefits paid by rate payers.**

Only one PW maintenance worker is fully allocated to all other city operations. Does this seem realistic? It is as if the city’s maintenance work unrelated to water and wastewater is conducted by ghosts. Recall

The allocation model further allocates expense from the PW yard and PW/Engineering where the salaries and benefits of the Director and Assistant Supervisor salaries are accounted for. The Assistant Supervisor is 70% allocated to water and wastewater rate payers. 51% of the Public Works Director/City Engineer is allocated to water/wastewater rate payers indirectly through the allocation of the salary to the PW/yard and Engineering. None of the Public Works Director/City Engineer is allocated to streets, parks, or buildings. Only 49% to engineering and 49% to the PW yard an expense that is then 82% paid by water and wastewater rate payers. **This is not “reasonable”.**

In spite of the extraordinary allocation of PW staff to water and wastewater enterprises, the last monthly activity report only included issuing an RFP for an electrician and supervising their repair to a pump.

The record \$10.5 CIP budget overseen by PW should be causing a dramatic change in assumptions about where work will be done in FY25-26....yet it does not show in the budget?

Public works do have other responsibilities which are increasing dramatically in 2025-26 as the proposed CIP planned budget is increasing to a record \$10.5 MM in capital projects, all overseen by the Public Works department. This is an increase of **1,712%** from last year. **Only 7% of the CIP is for Water and wastewater projects.**

There are \$4MM in **paving projects** including \$500,000 for pot hole repairs and only the equivalent of .65 a worker is allocated to streets. This .65 is actually divided between 4 maintenance workers who are 75-80% allocated to water and wastewater whose salaries and benefits are being paid directly by rate payers. Either the city will be unable to take advantage of this free money, due to lack of staffing, or PW workers will find themselves spending more time on non-water sewer-related projects and the rate payers will be paying for work unrelated to water and wastewater.

It doesn't end there. There is \$4.66 MM in **parks projects**. Again, the PW staff allocated to parks are also 60 to 70% allocated to water and wastewater. Their remaining time is divided between 5 and 10% across parks, parking lots and government buildings. Where will these workers get the added time, they need to oversee these park projects?

A big element of the \$4.66MM in CIP dollars for parks is the unfunded Calder Creek project. A non-profit is “supporting” the city in a search for grant money for the project. **While this may not put demands on maintenance workers it will require supervisory support. Only 10% of the Assistant Superintendent's time is allocated to parks while 75% is allocated to water and wastewater. What will happen when the effort to work with the non-profit exceeds 10% of his time? Who is tracking. Will rate payers be reimbursed?**

It is pretty obvious that PW is going to have to shift resources to manage \$10.5MM in capital projects or the projects will fail to materialize. The current budget fails to address the impact of this “free money” coming to the city for project on workload of city staff. The cost to the general fund for PW salaries and benefits needs to increase substantially.

It would seem that the city has not considered the impact of this CIP money, or you are reluctant to charge the increased cost to administer these projects to the already tight general fund budget. However, by charging that cost to water and wastewater rate payers rather than the general fund you are certainly in conflict with the intent of proposition 218 and opening the city to unnecessary liability.

The consultant presentation states that this method is “reasonable”. Might have been true last year given the assumptions PW gave the consultant about last year’s workload allocations.

IF you increase CIP projects by 1,700% to over \$10MM in a single year, you have to adjust workloads. The direct salary and benefits and PW department allocations need to be dramatically reduced to reflect the changing workload in Public Works.

	FY24-25 Estimated	2025-26
PROJECT CATEGORY EXPENDITURES		
1 Bikes, Pedestrians & Safety	210,250	1,273,200
2 Transition Plan ADA Projects	96,820	
3 Housing Projects		
4 Parks Projects	72,000	4,660,000
5 Paving Projects	8,000	3,076,000
6 Sewer/Wastewater Projects	2,030	187,000
7 Stormwater and Flood Mitigation Projects	91,000	184,000
8 Water Projects	21,530	515,000
9 Arts Projects	56,000	
10 City-owned Buildings & Site Projects		210,000
TOTALS	557,630	10,105,200

Other Allocation Issues:

1. Using “budget” to do the allocations without a corresponding “adjustment” for actual expenditures over states the costs being paid by rate payers. In part this is because some cost estimates are a bit high due to “conservative” budgeting and in part because unexpected vacancies can affect actual costs versus budget significantly
2. Allocations of Liability insurance and workman’s comp insurance are duplicated. First there is an allocation to every department including water and wastewater. It appears, although the model is not terribly clear, that these allocations are then included in the departmental budgets that are being allocated to water and wastewater rate payers. The first allocation may be reasonable based on some assessment by finance of which departments should pay the cost. It does not seem “reasonable” to again allocate a department allocated insurance to the water and wastewater rate payers.