

# Critique of the Current Cost Allocation Methodology

4/25/2025

# Overview

- The city for 20 years or more allocated a fixed % of each departments budget to water and sewer
- The Clear Source Model is purpose built to allocate “overhead costs” to various departments
  - The model is formally structure to meet Federal Contract requirements allowing overhead to be charged to the contract
  - **The concept of overhead costs specified in Federal Contracts is not the same as Propositions 218 and 26 requirements**
  - **The model is charging rate payers 41% of the total budgets for fully allocated departments?**
- Proposition 218 specifically requires that costs charged to rate payers are directly associated with providing services
  - “Overhead” has been targeted in lawsuits and not allowed by judges without extensive documentation (timesheets)
- Recent actual departmental cost analyses for delivering water and wastewater services demonstrate that the Clear Source Modeled costs exceed actual by multiples
  - Finance, Legal, Engineering and Public Works costs directly related to delivering services show much lower costs than recent allocations using the Clear Source Model
- City needs to evaluate the Clear Source Model
  - It fails to meet the city’s goal of transparency
  - It lacks specific assumptions that could be used to defend the city’s choices to a judge
  - It is too complex – no need to allocate overhead from every department to all other departments
- A simplified model based on actual expenses impacting service delivery is proposed here

# Model is charging rate payers up to 61% of departments total budget

	<b>FY25-26 Cost</b>	<b>26-27 Proposed</b>	<b>% of</b>
	<b>Allocation</b>	<b>Budget</b>	<b>Budget</b>
City Council	\$ 104,658.00	\$ 171,408	61%
City Manager	\$ 286,063.00	\$ 594,766	48%
City Attorney	\$ 189,263.00	\$ 643,750	29%
City Clerk	\$ 103,725.00	\$ 282,477	37%
Admin Svs(Finance)	\$ 641,649.00	\$ 1,512,645	42%
	<b>\$ 1,325,358.00</b>	<b>\$ 3,205,046</b>	<b>41%</b>

- Difficult to argue this is reasonable overhead expense
- No rationale that these expenses are critical to delivering water or sewer services to individual parcels
- Following slides estimate the direct costs to service utilities compared to historical allocations

# Finance Enterprise Billing Cost Analysis

Item	Utility Operations Responsibilities	Hours per Month		
		Admin Tech	Acctn	Total Hours
<b>Customer Service</b>				
1	Monitor and manage the customer service email inbox	4.0	0.5	4.5
2	Reconcile and prepare entries for NSF checks and NSF ACH returns	-	2.0	2.0
3	Process refunds for duplicate payments and credit balance adjustments	-	1.0	1.0
4	Complete connect and disconnect paperwork for customer accounts	4.0	6.0	10.0
5	Monitor customer accounts for high usage and notify customers about potential leaks	8.0	2.0	10.0
6	Respond to all customer phone calls regarding billing inquiries, account updates, and service questions	30.0	2.0	32.0
7	Review and process leak adjustment requests	-	2.0	2.0
8	Assist customers with reactivating accounts, resetting passwords, or verifying emails for online access	1.0	1.0	2.0
9	Process and update customer vacation status requests	1.0	2.0	3.0
10	Conduct customer account research and investigations as needed	2.0	2.0	4.0
11	Support Autopay or ACH customers—online or via paper authorization forms	4.0	2.0	6.0
<b>Collections</b>				
1	Process cash, credit card and ACH payments received by phone or in person	15.0	7.0	22.0
2	Record and reconcile daily cash receipts	30.0	15.0	45.0
3	Process ACH autopay batches	0.5	1.0	1.5
4	Generate and issue 45-day late notices	2.0	-	2.0
5	Generate and issue 10-day late notices	1.0	-	1.0
6	Call customers who have not responded to 10-day notices	2.0	-	2.0
7	Prepare and issue 48-hour shut-off notices	1.0	-	1.0
8	Prepare and issue final shut-off notices	1.0	-	1.0
9	Set up customer payment plans and monitor compliance	3.0	-	3.0
10	Complete the final billing non-payment and collections process	4.0	-	4.0
11	Create late fees and billing adjustments as needed	2.0	2.0	4.0
12	Process write-offs for late fees and billing adjustments	-	2.0	2.0
13	Transfer balances and move overdue balances to appropriate accounts	1.0	2.0	3.0
<b>Billing</b>				
1	Monitor and respond to incoming service requests	2.0	8.0	10.0
2	Track and resolve open service requests	1.0	2.0	3.0
3	Maintain and update the opt-out spreadsheet for manual meter reads	-	1.0	1.0
4	Process Water Tower Tags for utility billing (Public Works enters tags into the tracking spreadsheet)	-	1.0	1.0
5	Complete the bi-monthly billing cycle	-	20.0	20.0
6	Prepare and manage bill inserts for distribution	-	1.0	1.0
7	Process final billings	-	8.0	8.0
8	Review and establish new winter averages	-	1.5	1.5
9	Update water and sewer rates in the billing system	-	0.5	0.5
10	Create and maintain the manual read list for malfunctioning transmitters	-	2.0	2.0
11	Prepare and provide the monthly water report for Public Works	-	0.5	0.5
<b>Miscellaneous</b>				
1	Update the website with current forms, documents, and related materials	0.5	-	0.5
2	Complete special project tasks, such as BayRen program close-out activities	-	3.0	3.0
3	Process and pay water and sewer-related invoices (e.g., Badger, Santa Rosa Subregional, debt service)	2.0	1.0	3.0
<b>TOTAL</b>		<b>122.0</b>	<b>101.0</b>	<b>223.0</b>
	Monthly Hours	173.33	173.33	346.67
	Percentage (%) of Total Hours	0.70	0.58	0.64

Estimate of Admin Tech and Accountant Salaries & Benefits		
	Admin Tech	Accountant
Hourly Pay*	45.19	55.53
Benefits **	31.18	38.32
Total Hourly	76.37	93.85

\* Sourced from City of Sebastopol - Pay Rates, Ranges & Stipend (February 4, 2025)  
 \*\* FY25-26 Budget Benefits as a % of Salaries =69%

Function	Annual Expense	%
Customer Service	\$ 74,827	33%
Collections	\$ 89,937	40%
Billing	\$ 53,989	24%
Miscellaneous	\$ 6,796	3%
	<b>\$ 225,548</b>	<b>100%</b>

- current allocated cost in the CAP Model \$641, 648
- **Rate payer Overcharge: \$416,100**

# Other Departments are Also Charging Rate Payers Significantly More than Actual Estimated Costs -

ENGINEERING					
Fiscal Year	Total Department Actual**	Total Allocation	% Department Budget Allocated	Actual W/S related expense	% Dept Budget
2020-21	\$447,445	\$214,063	48%	\$79,853	18%
2021-22	\$362,300	\$259,904	72%	\$253,228	70%
2022-23**	\$516,510	\$251,946	49%	\$78,613	15%
2023-24	\$1,401,180	\$288,047	21%	\$14,200	1%
		<b>\$ 1,013,960</b>		<b>\$ 425,894</b>	
<b>Over Charge (4 years)</b>				<b>\$ 588,066</b>	

\* Estimated Correct is 25-26 (based on hours) adjusted for % change Y/Y Department Bu

\*\* Actual allocations not reported beginning in 24-25; Used Approved Budget

Legal					
Fiscal Year	Total Department Actual**	Total Allocation	% Department Budget Allocated	Actual W/S related expense	% Dept Budget
2024-25	\$647,900	\$46,692	7%	\$4,926	1%
2025-26	\$647,900	\$189,263	29%		
		<b>\$ 46,692</b>		<b>\$ 4,926</b>	
<b>Over Charge (1 year)</b>				<b>\$ 41,766</b>	

\* Estimated Correct is 25-26 (based on hours) adjusted for % change Y/Y Department Bu

\*\* Actual allocations not reported beginning in 24-25; Used Approved Budget

Public Works currently direct bills to rate payers 2.85FTE (water) 2.3FTE (sewer) Salary and Benefits

- \$280,890 Water Salaries
- \$253,365 Sewer Salaries
- Additional Salaries appear to be allocated indirectly
  - \$309,277 Water
  - \$217,364 Sewer
- Current allocation for Corporate Yard is 52% of total expense

This is well over 1/2 of total PW expenses - Seems high given the number of other responsibilities (Streets, public buildings, parks, landscaping, homeless cleanup)

**ACTUAL COSTS HERE ARE ESTIMATES AT THIS POINT BUT THEY ARE SO FAR ABOVE CURRENT ALLOCATION THAT THEY NEED TO BE FIRMED AND ALLOCATIONS ADJUSTED.**

# Allocation Rules Directed By Law: Proposition 218 and Proposition 26

- These Propositions are well described in the California League of Cities Report
- Proposition 218 “Right to Vote on Taxes Act” was passed in November of 1996. It is now part of the California State Constitution
- Addressed growing practice by many local governments to shift from general taxes (which require voter approval) to fees, assessments and utility charges that did not require voter approval
- Voters voted to:
  - Stop hidden or disguised taxes
  - Require voter approval of most local taxes
  - Protect property owners from unfair assessments
  - **Limit utility rates to the actual cost of service**

# Key Prop 218/26 Rules for Water & Sewer Utilities - “Pipes and Pumps”

- Use Restriction
  - Revenue may only be used for the purposes for which it was collected
  - ***No diversion to administration unrelated to delivering services***
- Cost of Service Requirement
  - ***Cannot exceed funds required to provide service***
  - Must be proportional to cost of serving an individual parcel
  - Must have a specific service nexus, repair equipment, billing etc.
- No Cross-Subsidy
  - ***No using utility revenue to subsidize unrelated general fund expenses***
- Prop 26 defines ***burden of local government to prove:***
  - The charge is not a tax
  - It does not exceed cost of service
  - It is not used for general revenue purposes

Sourced for League of Cities

## Here are key clauses from Article XIII D that the courts cite most in Proposition 218 utility rate lawsuits

- Section 6(b)(1)
  - “Revenues derived from the fee or charge shall not exceed the funds required to provide property related service.” (AKA water and sewer)
- Section 6(b)(3)
  - “The amount of a fee or charge imposed upon any parcel shall not exceed the proportional cost of service attributable to the parcel”
- Lawsuits have documented:
  - Roseville and Fresno lost suits as they had not documented the actual costs of services.
  - Capistrano lost a suit over tiered pricing – court ruled tiered “conservation” pricing violated proposition 218 because the tiers were not tied to cost.

# Legal Cases helped to clarify the law

- Howard Jarvis Taxpayers Assn. v City of Riverside (1999)
  - Confirmed water fees are property related fees under Prop 218
- Bighorn-Desert View Water Agency v. Verjil (2006)
  - Water rates are subject to voter initiative repeal
  - Citizens can challenge water rate increases
- Capistrano Taxpayers Assn. v. City of San Juan Capistrano (2015)
  - Tiered rates must be justified based in increased cost to provide service at higher volumes
  - Conservation pricing must be tied to cost
  - You cannot charge higher tiers solely to penalize usage
  - ***Many cities removed tier rate structures***
- City of Palmdale v. Palmdale Water District (2011)
  - ***Transfers from utility funds to general funds are highly restricted***
  - ***Must be tied to actual cost of services provided***
- Jacks v. City of Santa Barbara (2017)
  - Capital Planning is legitimate cost of service
- Plantier v. Ramona Municipal Water District
  - ***Cost of service studies must support rate structures***
  - Agencies must demonstrate proportionality

# Courts Expect Documentation

- Staff time
- Accounting hours
- Billing Costs

NOT

- X% of Department Budget
- X% of City Overhead

# What this means to Sebastopol

- The city must demonstrate:
  - Admin/finance allocations are tied to actual services provided.
  - Legal allocations reflect direct legal services to the enterprise funds.
  - Engineering allocations reflect actual utility engineering.
  - Council/Clerk/City Manager allocations are proportionate to utility-related work.
  - **No general fund shortfall is being backfilled by utility ratepayers.**
- If not, it may violate:
  - Article XIII D §6(b)(2) (no revenue exceeding cost of service)
  - §6(b)(3) (no revenue for other purposes)
  - Prop 26 burden-of-proof standards

# CAP Methodology Too Complex – Not compliant with Proposition 218 and 26

- The model is purpose built to correctly allocate overhead costs to departments that may be subject to a Federal Grant.
  - Overhead is specifically described in the documentation
  - Overhead is allocated not once but twice maximizing the charge to water and sewer rate payers
- The stated premise of the model is: “Allocated costs must comply with OMB 2CFR 200 –Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards”
  - Proposition 218 and 26 provisions of law unrelated to Federal Awards
  - Using the premise of Federal Direct Cost modelling does not address the fact that only costs directly related to delivering services to each property may be charged
  - Direct costs can be directly budgeted without a model