TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER
DEPARTMENT: PUBLIC WORKS
DATE: SEPTEMBER 13, 2004
CMR: 393:04

SUBJECT: ENDORSEMENT OF THE BLUE RIBBON STORM DRAIN COMMITTEE’S RECOMMENDATIONS FOR STORM DRAIN FUNDING AND DIRECTION TO PURSUE A STORM DRAINAGE FEE ELECTION IN FEBRUARY/MARCH 2005

RECOMMENDATION
Staff recommends that Council:
1. Endorse the recommendations of the Blue Ribbon Storm Drain Committee.
2. Direct staff to pursue a property owner election in February/March 2005 for approval of an increase in the monthly Storm Drainage Fee to $10.00 per Equivalent Residential Unit (ERU) to fund the proposed enhanced storm drain program.

BACKGROUND
The City’s storm drain capital improvement, maintenance and water quality protection programs are funded through the Storm Drainage Fund, an enterprise fund established by Council in 1989. Revenue is generated by a Storm Drainage Fee, which is collected through monthly City utility bills. The fee, $4.25 per month for a single-family residential parcel, has not been increased since 1994 and is insufficient to cover the program’s operating costs. For the current year, the General Fund is providing $800,000 in supplemental funding to maintain a baseline level of service for storm drain maintenance and storm water quality protection. There is no funding provided for storm drain capital improvements, despite a backlog of capital needs.

The Storm Drainage Fee is a property-related fee subject to the provisions of Proposition 218. A majority of property owners must approve a fee increase. The City conducted a property owner election in September 2000, seeking approval to increase the Storm Drainage Fee from its current level of $4.25 per month up to $9.00 per month to cover needed storm drain improvements. The ballot measure was unsuccessful, with an approval rate of only 37 percent.
On March 18, 2002, Council approved staff’s recommended conceptual strategy for identifying a funding mechanism for future storm drain improvements, including the appointment by the City Manager of a Blue Ribbon Storm Drain Committee to review storm drain funding needs (CMR:175:02). The Committee, composed of fifteen residents, business representatives and community leaders, had its first meeting on May 3, 2002 and met 15 times for a total of 37 hours.

The Committee presented its findings to Council at a study session on November 12, 2002 (CMR:443:02). The Committee formulated recommendations addressing future storm drain program elements and funding. The recommended storm drain program included augmented maintenance practices, a specific set of prioritized capital improvements, and expanded storm water quality protection activities. The Committee recommended funding the storm drain program on a pay-as-you-go basis by increasing the Storm Drainage Fee to $13.90 per month. The Committee also addressed fee sunset provisions, the creation of an oversight committee, and other policy issues related to the City’s storm drain program.

In light of the state of the City budget, the City Manager decided to suspend active discussion of storm drain funding in February 2003. Future consideration of the issue was deferred to the Finance Committee budget deliberations during Spring 2003 in order that storm drain needs could be reviewed in the larger context of the City budget and the multiple financial challenges facing the City. During the public hearings for the FY 2003-05 budget, Finance Committee members directed staff to reexamine the alternatives for funding of the City’s storm drain program and to return to Council with an update.

On February 17, 2004, staff made a presentation to Council entitled “Storm Drains 101,” which provided an overview of the workings of the City’s storm drain system and a description of the specific conditions in Palo Alto that make effective drainage more difficult. Staff explained the relationship between storm drains, creeks and watersheds and described how Palo Alto’s flat, low-lying topography necessitates the pumping of a significant portion of storm runoff into the creeks, particularly in the eastern portion of the city.

At the March 23, 2004 Finance Committee meeting, staff submitted a report outlining a set of alternative storm drainage levels of service and funding schemes for the Committee’s review (CMR:193:04). In response to direction from Council, staff devised alternatives comprised of a downsized list of capital projects and operational upgrades that could be funded with a reasonably-sized increase in the Storm Drainage Fee. Staff also presented options for permanently supplementing the Storm Drainage Fund’s user fee revenue with General Fund dollars. The Finance Committee provided preliminary comments on staff’s proposals and directed staff to reconvene the Storm Drain Committee to solicit its input and suggestions for future storm drain funding.
DISCUSSION
Storm Drain Committee’s 2004 Recommendations
The Blue Ribbon Storm Drain Committee, chaired by former mayor Larry Klein, was reconvened for a short series of meetings. Nine of the original fifteen Committee members were available and willing to meet to review the latest storm drain funding proposals (see list of 2004 Committee members, Attachment A). The Committee met on June 11, July 9, and July 23, 2004 for a total of six hours. At the first meeting, staff presented an update on the status of storm drain funding and described the alternatives submitted to the Finance Committee on March 23, 2004. At the following two meetings, the Storm Drain Committee had detailed discussions on potential storm drain capital improvements, each maintenance and operational element of the storm drain program, and various funding options. At its final meeting, the Committee voted on and approved a set of recommendations. The specifics of the recommended funding plan were reviewed by the Committee members by e-mail following the group’s last formal meeting.

The Committee’s recommendations for an enhanced storm drain program and funding mechanism are contained in the attached report (Attachment B). To provide a basis for review, staff has prepared a table with side-by-side comparisons of the Storm Drain Committee’s 2002 recommendations, the staff proposal presented to the Finance Committee on March 23, 2004, and the Storm Drain Committee’s updated recommendations (Attachment C). Members of the Committee will be present at the September 13, 2004 Council meeting to address the Council and respond to questions about the report.

The following is a summary of the key elements of the Committee’s recommendations:
- The Committee identified a set of high-priority storm drain capital projects to be implemented as the initial set of drainage improvements funded through an increased Storm Drainage Fee (see attached list of projects [Attachment D] and map of project locations [Attachment E]). The total cost of these projects is $17 million (Year 2004 dollars). These projects comprise a subset of a larger group of capital improvements identified in the Storm Drain Master Plan and Condition Assessment studies that are needed to provide upgraded drainage service throughout the City. Following completion of the initial projects, the Committee recommends that the City seek property owner approval for funding of the remaining projects.
- The Committee strongly advocates that the Storm Drainage Fund should be a financially independent, self-sufficient enterprise separate from the General Fund and funded through user fees.
- The Committee generally endorses a “pay-as-you-go” approach for funding of operational and capital expenses in order to avoid the additional long-term costs of debt financing.
• In order to “front load” the construction of the proposed storm drain capital improvements, the Committee recommends that Council authorize advance payment of the cumulative Storm Drainage Fee assessed to City-owned properties for a period of 12 years (the proposed implementation period for the initial set of capital projects). This would generate approximately $3 million to be used to accelerate construction of drainage improvements during the first three years following the approval of an increased Storm Drainage Fee.

• The Committee recommends that financial support for the San Francisquito Creek Joint Powers Authority (JPA) and San Francisquito Watershed Council and funding for curb and gutter repairs should be paid from City sources other than the Storm Drainage Fund. The Committee believes that these programs are valuable to the community and are worthy of strong consideration for ongoing annual funding from an alternative source, presumably the General Fund. Current year funding for the JPA and Watershed Council is approximately $80,000. Although no funding is provided for curb and gutter repairs in this year’s Storm Drainage Fund budget, $200,000 per year was budgeted in past years, and the Committee had recommended in its 2002 report that $200,000 to $800,000 per year be spent on curb and gutter repairs.

• In order to increase the likelihood of a successful rate hike election, the Committee recommends that the initial Storm Drainage Fee be set at $10.00 per month for the typical single-family residential property owner.

• In order to keep the Storm Drainage Fee at a reasonable level and to enable the completion of the highest priority capital improvements within a 12-year period, the Committee recommends deferring the establishment of the sinking funds for pump station equipment replacement, future storm drain system repairs, future storm drain system condition assessments, and additional storm drain system capacity upgrades, as were recommended by the Committee in 2002. The Committee believes, however, that the sinking funds should be retained as an important component of the long-term planning for the City’s storm drain system and advocates the creation of these funds when additional revenue becomes available.

Staff Response to the Storm Drain Committee’s Recommendations
Staff concurs with the recommendations contained in the Storm Drain Committee’s report to the City Manager. Staff agrees that the $17 million of storm drain capital improvements listed in Attachment D are the projects with the highest priority and the greatest potential to provide tangible improvements in the performance of the storm drain system. Furthermore, staff concurs with the Committee’s position that these projects constitute only a portion of the total drainage needs throughout the City, and that they are merely an interim set of improvements that should be supplemented in the future by the remainder of the drainage projects identified in the Storm Drain Master Plan and Condition Assessment studies. The number and cost of projects slated for initial implementation was intentionally limited in order to craft a funding proposal that could
be supported with a reasonably sized user fee and could be constructed within a relatively short period of time. Staff is hopeful that the benefits of these initial projects will be evident to the members of the community, leading to support for the funding of additional improvements in the future.

Staff supports the approach of accelerating the construction of capital projects in the two to three years immediately following the approval of an increased Storm Drainage Fee in order to produce tangible drainage improvements. Staff examined several options for generating up-front money to fund these improvements, including inter-fund borrowing, issuance of revenue bonds, and pre-payment of the Storm Drainage Fee for City-owned properties. It was determined that the borrowing of money between enterprise funds is prohibited by law. Council does have the ability to transfer funds from the general funds to support other programs. Staff believes the General Fund pre-pay option recommended in this report meets the committee’s goal. Further debt financing for storm drain capital work (there is already outstanding debt for storm drain improvements previously funded through revenue bonds) was rejected due to the high costs of bond issuance, reserve requirements, and long-term interest payments. For example, to issue $4.5 million worth of 15-year revenue bonds would require the payment of $675,000 in bond issuance costs and reserve costs and $1.9 million in interest over the life of the bonds. The burden of debt financing would also hinder the City’s ability to seek future approval for funding of additional storm drain capital improvements following the completion of the initial set of recommended projects. Pre-payment of Storm Drainage Fees for City-owned properties is the recommended methodology for generating up-front funds for drainage capital improvements. This approach, which would only be implemented following a successful property owner election approving an increase in the Storm Drainage Fee, would allow the Storm Drainage Fund to generate approximately $3 million in additional funding for capital work in the first three years following the election. This strategy would avoid bond issuance costs and interest payments.

Since the Storm Drainage Fee is a property-related fee, it is subject to the requirements of Proposition 218 and cannot be increased unilaterally by Council. Proposition 218 specifies an approval process for fee increases that includes a formal protest hearing, followed by a property owner ballot measure conducted by mail. In order to have the fee increase approved, a simple majority of those property owners returning ballots must vote in favor of the measure. An outline of the approval process mandated by Proposition 218 is attached for information (Attachment F).

Staff and the Storm Drain Committee believe that there will be a higher likelihood of gaining property owner approval of a Storm Drainage Fee increase if the City continues to take steps to address the lessons learned following the unsuccessful 2000 storm drain election. The most important change since 2000 is the appointment of the Storm Drain Committee to work with staff to develop a community-based storm drain funding proposal. Further examples of corrective measures are inclusion of a provision for the
fee to “sunset” after a specified time period, appointment of an oversight committee to monitor spending of the revenue generated by the fee increase, and inclusion of funding for innovative projects that reduce storm water runoff. Timing of the election will also be a critical factor affecting the likelihood of success. Staff recommends that the election be conducted during the rainy season in February/March 2005 when there is a higher awareness of drainage problems throughout the community.

**RESOURCE IMPACT**
The City Clerk would need assistance from a professional election specialist in order to conduct a property owner election by mail. Implementation of staff’s recommendations (following a successful property owner election) would have the following financial impacts:

- The monthly Storm Drainage Fee for developed properties would increase from $4.25 to $10.00 per Equivalent Residential Unit.
- The General Fund’s current $800,000 direct subsidy to the Storm Drainage Fund would be eliminated.
- Council would need to identify new funding source(s) for City contributions to the San Francisquito Creek Joint Powers Authority and the San Francisquito Watershed Council and would need to consider whether or not to fund curb and gutter repairs.
- Prepayment of fees will reduce the Budget Stabilization Reserve (BSR) and affect the potential surplus contribution to the Infrastructure Reserve (IR). Since BSR policy is to maintain itself at 18.5 percent of operating expenses, a contribution to IR in year of prepayment may not be likely. This should be offset in future years as the General Fund will experience a reduction in costs and a potential surplus due to prepayment of fees.
- There is a potential opportunity cost for the prepayment. Should the City’s return on its portfolio exceed the rate of inflation on the fee increase, the General Fund may forego interest income. This amount depends on the rate of inflation and interest rates. Staff believes the importance of beginning an enhanced storm drain program outweighs this potential opportunity cost.
- A portion of City storm drain fees are paid by the Enterprise Funds, and staff is still working to determine if their obligations can be used to support the early, intensive storm drain capital program.

**POLICY IMPLICATIONS**
Staff’s recommendations are consistent with the Comprehensive Plan: Policy N-24 states that the City should “improve storm drainage performance by constructing new system improvements where necessary and replacing undersized or otherwise inadequate lines with larger lines or parallel lines.” Program N-36 further states that the City should “complete improvements to the storm drainage system consistent with the priorities outlined in the City’s 1993 Storm Drainage Master Plan, provided that an appropriate funding mechanism is identified and approved by the City Council.”
**TIMELINE**
In order to conduct the protest hearing and mail ballot process during the 2004-05 rainy season, the Finance Committee will need to make its final recommendation to Council regarding an enhanced storm drain program and funding mechanism by early November 2004 (see proposed timeline, Attachment G).

**ENVIRONMENTAL REVIEW**
Consideration of financing options for storm drainage program operational enhancements and capital improvements does not require additional California Environmental Quality Act (CEQA) review. Individual storm drain infrastructure improvement projects will be subject to additional environmental review as they are developed.

**ATTACHMENTS**
- Attachment A: List of 2004 Storm Drain Committee members
- Attachment B: Storm Drain Committee Summary Report
- Attachment C: Comparison of Storm Drain Committee 2002 recommendations, March 2004 staff proposal, and Storm Drain Committee 2004 recommendations
- Attachment D: Description of proposed storm drain capital improvements
- Attachment E: Map of proposed storm drain capital improvements
- Attachment F: Proposition 218 Property Owner Election Process
- Attachment G: Proposed Proposition 218 Property Owner Election Timeline

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