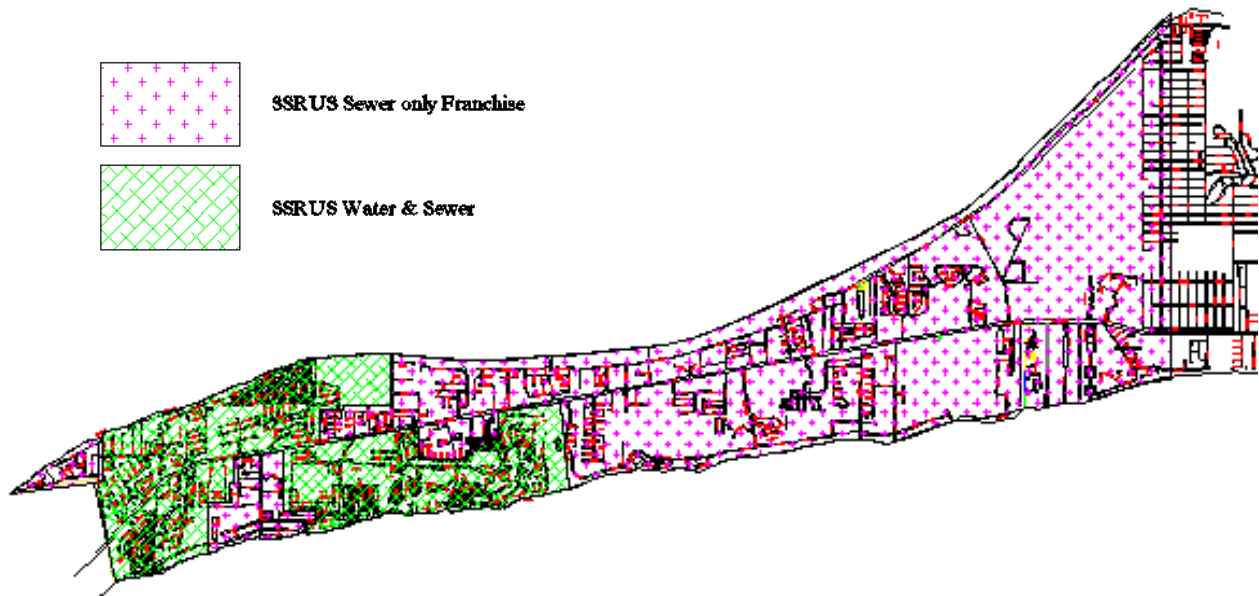


## Historical Perspective of South Santa Rosa Utility System

The South Santa Rosa Utility System, Inc. is a utility/enterprise fund designated as 403 on the City's chart of accounts. As October 2010, SSRUS consists of 352 water, 3,868 water and waste water, and 1,956 wastewater only customers (5,824 total wastewater). The physical assets of the SSRUS include water distribution systems and wastewater collection and treatment facilities necessary to serve these customers as well as future customers in the SSRUS franchise area. The sewer-only franchise area receives water service from Midway Water, Inc.



As with any enterprise utility system, the rates and charges established for SSRUS services are designed to cover costs to generate profit. These costs include operations and maintenance of the water distribution facilities, wastewater collection and treatment facilities, capital improvements, debt service and establishment of a prudent level of cash reserves.

Current utility operations, including rates and charges for service, have evolved over the more than 20 years the City has owned the SSRUS. This document outlines the organizational and operational evolution as well as the basis for rates and charges in the current system.

### Origin

Water and Wastewater service was originally provided to the Peninsula, to the west of the Holley Navarre utility franchise area by the following entities:

**City of Gulf Breeze:** water and sewer service inside the city limits.

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**Gulf Isle Utility:** water and sewer service to Villa Venyce, Sand Piper and Whisper Bay subdivisions.

**South Santa Rosa Utility Inc:** water and sewer service to Santa Rosa Shores and Tiger Point Subdivisions.

**Midway Water:** water only service, intermingled with Gulf Isle Utility franchise on west end. The main portion of franchise is from Tiger Point East to the Holley by the Sea Subdivision.

**The City of Gulf Breeze maintains** a publicly owned utility service for city residents. In 1985 the system consisted of approx.1000 sewer customers. The City owned and operated a wastewater collection system, a WWTP capable of treating 0.500 MGD with effluent discharge to Santa Rosa Sound. Water distribution facilities served approx. 2100 customers with a large ground level water storage tank with necessary pumping equipment. The City's potable water supply came from Midway Water ready for consumption by City customers with only re-chlorination as treatment. Water-only customers used septic tank systems for waste treatment.

**Gulf Isle Utility** was a privately owned utility service. In 1985 it consisted of approximately 600 customers and a small .250 mgd WWTP with Disposal to percolation ponds located on the property where the SSRUS Field Operations is currently located. The Utility utilized six (6) 2" shallow water wells located along Hwy 98 near the current Oaks elevated tank to provide potable water service via a hydro-pneumatic system after ph adjustment and chlorination.

**Midway Water System** is a community owned 501C3 Not for Profit Corporation. In 1985 it consisted of a water-only utility providing service to areas not served by Gulf Isles or SSRUS. Midway also provided wholesale water to the City via a long term 30 year contract and served as backup supply to both Gulf Isle and SSRU Utilities.

**South Santa Rosa Utilities, Inc.** was a privately owned utility. In 1985 it consisted of approximately 2000 wastewater customers and a WWTP capable of treating 0.600 mgd. The sewage collection system included lift stations, gravity and force mains. The potable water system served approximately 2000 customers with four well of four (4) inch diameter and 140-220' depth located on the West Golf Course, treatment systems and an elevated water tank located at the WWTP known as the "Golf Ball". This tank was functionally replaced by a new tank constructed on Hwy 98 in 1987 at The Oaks Subdivision. The Golf ball tank was dismantled in 1993. SSRU, Inc also owned an office and utility billing system.

These independent small utility systems commenced operations as areas began to be developed along the peninsula in the early 1960's. The typical wastewater treatment methods were known as Imhoff tanks, operated on the same principle as a septic tank. In the late 1960's the Utilities expanded and improved their WWTP's to an activated sludge

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aerobic process initially using the extended air process and later moving to contact stabilization as wastewater flow increased over the years with population growth.

In the mid 1980's each of the 3 WWTP's located on the Peninsula were reaching the end of their useful life, and significant plant upgrades were needed to comply with the more stringent regulations being promulgated by the Florida Department of Environmental Regulation. This included higher levels of treatment for nitrogen, phosphorus, and turbidity removal, which would require larger and more sophisticated treatment plants, increased staffing, a requirement to provide for surplus capacity for growth, and, for the private systems, still make a profit. Each utility on their own did not have the customer base necessary to absorb the costs of the necessary upgrades and maintain reasonable rates. Each Utility was also maintaining their own operations including permitting, staffing, billing, repairs, etc.

SSRU Inc. purchased Gulf Isle Utility (GIU) in 1985 and consolidated operations by shutting down the GIU shallow water wells and WWTP. The GIU WWTP was no longer a viable operation due to the percolation ponds being located in an area known for a high water table. The functionality of the ponds was a chronic concern and they would not meet new regulatory standards.

SSRU Inc. obtained a DEP WWTP permit to construct a new 2.0 mgd WWTP (1.3mgd disposal via land application) in 1987 at the site of the existing plant on Tiger Point Golf Course. They also constructed a new 150,000 gallon elevated tank located at The Oaks Subdivision to serve the combined water systems as previously mentioned.

The City's compartmentalized WWTP tank, constructed in 1968 with a capacity of 0.500 mgd, used contact stabilization as the operation process. In 1986 the aeration was upgraded to provide better dissolved oxygen levels and an additional blower was installed to provide redundancy. The City also undertook significant efforts to reduce infiltration in the sewer system by inspection and correction of problems mainly on Bear Dr. and a section of pipe between Washington and Camelia streets. These repairs and improvements provided the time necessary for the City to evaluate the options available for the long term wastewater needs of the City.

Similar to SSRU and GIU, the City was also facing the prospect of costly upgrades of its wastewater treatment facility to comply with FDEP regulations. There was also pressure from FDEP to eliminate the City's surface water discharge. The distribution of the cost to upgrade and operate the City's wastewater facilities over a small customer base with limited future growth possible would have caused service rates to increase dramatically.

The Department of Community Affairs also played a role in the shaping the way that the Peninsula would be developed as they were considering imposing a ban on development in the south end of Santa Rosa County until a plan was in place (or facilities in place and operable) to insure potable water and wastewater service was available to areas east of Gulf Breeze.

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Area leaders from inside and outside the City limits requested the City help or sponsor construction of needed utility services for the area. When the idea of the City sponsoring what eventually became the SSRUS became public knowledge, the citizens of Gulf Breeze protested and did not favor the proposal. They did not want to pay for or be responsible for utilities outside the City limits.

Over the course of 1988-1990, facing increasing costs to remain independent, and seeing a benefit to all in the economy of scale achievable by consolidation, the City decided to purchase South Santa Rosa Utilities, Inc. From an operational and long-term planning perspective, there were several factors that guided the decision of the City Council.

1. The City was already in the business of providing utility service outside its corporate limits through Gulf Breeze Natural Gas.
2. The current owners of SSRU were not interested in partnering with the City to combine the WWTP(S). They would only consider a complete purchase of all utility assets.
3. Closure of the City's wastewater treatment plant and diversion of City wastewater to the new Upgraded Tiger Point facility enabled wastewater to be provided from one central facility with a better economy of scale.
4. The City, FDEP, and US EPA all desired to remove the effluent discharge from Santa Rosa Sound.
5. The profit motive was removed from utility operations.
6. Unified management and consolidation of utility operations by the City was encouraged by Santa Rosa County in order to meet the growth needs of the region in an orderly fashion. To this end, the City of Gulf Breeze/SSRU was granted a franchise by the County to be the exclusive provider of water and wastewater services in certain areas of South Santa Rosa County.)
7. A separate financing mechanism would be used for the acquisition of the utility systems outside the City's corporate limits to insulate City residents from SSRU system liability. An independent board would be established to oversee SSRU utility staff, operation and financing.
8. The City Council assured the citizens that the acquired utility would stand alone to be responsible for all capital costs (bonds) and would be self-sufficient in for operating and maintenance costs.

### **Evolution**

The City closed its wastewater treatment plant in March 1992 and diverted its wastewater flow of approximately .350-.420 mgd of wastewater per day to the new SSRU WWTP (Tiger Point). Anticipated economies of scale were achieved as the staffing of the City and SSRU plant were merged. The City transferred funds to account 403 to cover the

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proportion of the treatment plant costs represented by the proportion of flow. In addition the City paid for the cost of a force main to transfer wastewater to the SSRU system.

In 1993 potential saltwater intrusion issues were recognized in SSRU wells by utility staff and the Northwest Florida Water Management District. A decision was made to shutdown the water wells and water treatment facilities owned by SSRU by switching SSRUS to Midway for water supply and transfer City customers to water provided by Escambia County Utility Authority (ECUA). ECUA was in the process of designing/installing a water line to serve Pensacola Beach and both the City and SSRUS participated in the upsizing of the water line crossing Pensacola Bay in order to serve the future water needs of both entities.

In 1994 the City refinanced, the original bonds that were used to finance the purchase of SSRU at a lower rate. A better financial position was achieved for the utility by eliminating subordinate debt requirements and providing added cash for extension of a 5.5 mile wastewater force main to the east. This action enabled SSRU to retain sewer franchise rights over that portion that was not currently served.

Water rates for 403 customers were recalculated to include the purchase cost per thousand gallons of water provided by Midway. This was added to water debt service costs for original acquisition of the now scrapped water facilities, operational costs for the distribution system, capital improvement needs and cash reserves.

Wastewater rates for 403 customers now consisted of cost of operations for the collection system, cost of operations for the wastewater plant (less the proportion paid by the City), cost of the debt for acquisition of the WWTP and collection systems (less the proportion of the WWTP debt paid by the City), and the funding of capital improvements and cash reserves.

Attached to this report is a compilation of utility rates paid by SSRU and the City customers over the years. The rates for each were developed to cover costs in each fund.

From 1997 to 2002 several upgrades of SSRUS infrastructure were undertaken.

- 1.74 million gallon water storage and booster pumping facility located in Villa Venyce.
- A Field Operations Building was also constructed on the same site.
- 5.5 miles of force main was installed to serve the East end of the Sewer Franchise.
- The WWTP was upgraded to Advanced Waste Treatment capability
- Approx. 8 miles of new Reclaim Water Main were constructed to convey effluent from the WWTP to new spray fields located near the ZOO.
- 4 parcels of land were purchased and developed for uplands effluent distribution
- The effluent disposal capacity of the WWTP was increased.

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In each case, a proportionate share of the new debt was assigned to the City consistent with the benefit realized by the City of the new facilities. Rates were established for funds 401 and 403 to cover costs.

Rapid growth in the SSRUS area resulted in payment of significant impact fees to the 403 fund. These were used for capital upgrades of the systems, debt service and to establish a cash reserve.

The refinancing of the debt and financing of new debt for improvements and upgrades of SSRUS was done with the full backing and guarantee of the City. As a result, better long term interest rates were realized.

The costs of debt, operation and capital improvement for the 401 and 403 funds were sequestered, allocated, and assigned on a proportionate basis. Each year the SSRUS Board evaluates costs and rates and recommends any changes necessary to sustain SSRUS operations, debt service, capital improvements and reserves. Customer rates recommended by the Board are ultimately approved by the City Council.

### **The KPMG Report**

The City Council authorized the hiring of the consulting firm KPMG Peat Marwick LLP in September 1997 after questions were raised about the allocation of costs to the 403 fund. The firm was to accomplish three (3) tasks:

1. Analyze the sufficiency of the current rate structures in covering current costs.
2. Properly allocate costs of the two utility funds between City and non-City users SSRUS.
3. Examine the current rate structures and comment on the policy implications of each.

After the Report was submitted to the City, a number of workshops were held by KPMG with members of the Council, SSRUS Board members, Staff, and concerned utility customers.

The recommendations and implemented decisions from the workshops provided the following changes to the allocation criteria:

#### City Fund 401

City continues to pay % share of WWTP costs based on usage.  
City continues contribution to % of WWTP R&E based on usage.

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City continues to transfer 80% of sewer tap fees to SSRUS  
City Debt Service for Original Construction \$77,072 - annually  
**City Debt Service for Original Acquisition \$85,301** - annually  
**City Debt Service for Reuse Expansion \$21,685** - annually

The outcome of the workshops provided two (2) new revenue allocations for implementation into the 1999 SSRUS Budget from the City's 401 fund. Staff also changed the budget presentation to better illustrate the allocations between the 401 and 403 funds.

The new allocation for Original Acquisition was implemented to reflect the value gained by City customers through the purchase of an existing WWTP with surplus capacity, essentially as a tap or connection fee for the City as an SSRU customer. The arrangement did not include a termination date for the new allocation. However if the City paid this fee for the same period of time as existed for the original bonds, (20 years), this fee would be retired in 2018. The total payment after 20 years would be \$1,706,020 or approx. \$1,499 for each of the 1,138 existing City sewer customers in March 1992 who connected to the WWTP. This is equivalent to the sewer tap on fee for both utilities (\$1,500) at the time of the 1989 purchase.

The City has paid these amounts over the years from City customer service rates. City utility rates have been independently established by the City Council by review of City revenues from all water and sewer sources, cash revenues and capital improvement requirements within the City limits.

The allocation for Reuse Expansion (\$21,685) represents the City's share of costs associated with the reduction in Golf Course Capacity from 1.1 mgd to .850 mgd in 1998 and also a nominal amount (\$5,000 annually) that the City would contribute to expand/improve the reclaim system. A review of the Reuse Expansion Debt Service Schedule indicates that the City needs to increase its payment by (\$722.14) to (\$22,407.14) for F/Y2010 due to increases in the schedule of payments.

Since the Utility was required to expand its own reclaim disposal capacity, a portion of this debt was assigned to existing customers and allocated between funds 401 and 403. The Golf Course's disposal amount was subsequently increased to 1.3mgd effective with the DEP Permit issued in 2007 and due for renewal in 2012.

It is our understanding that the Reuse Expansion Debt Service for F/Y 2010 of \$17,407.14 plus \$5,000 annually will run concurrent with the \$5.5 million dollar loan currently financed with Coastal Bank and Trust initiated in 1998. This loan is projected to retire on 11/1/20.

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Current Utility Financing

<b>Loan Title</b>	<b>Amount</b>	<b>Date Initiated</b>	<b>Retirement Date</b>
Coastal A	4,730,000	1996	2011
Coastal B	4,400,000	1998	2020
SSRUS Refunding & Acquisition	14,310,000	1994	2021

Projected 5 Year Annual Debt Service

2010	1,795,000
2011	1,550,400
2012	1,315,500
2013	1,311,800
2014	1,314,700

During the life of most utility systems, long term financing is typically undertaken when the cost of a project is too great to pay from cash on hand. In addition, the benefits or use of a new project, or facility will be realized for a 20 or 30 year period. The beneficiaries of the utility services financed, therefore, also are the ones who pay for it, requiring allocation of debt service between existing and future 401 and 403 customers. Whenever such a financing is undertaken, a proportionate share of the debt will be allocated to the 403 (SSRUS) and to the 401 (City) funds. These decisions are made by the advisory board and the City Council with City and SSRU staff recommendations.

**2002 Burton and Associates Rate Study**

In 2002 the SSRUS Board desired to have an independent firm review the Utility's water and sewer rates including a revenue sufficiency analysis, and provide a report for consideration by the Board. The selected firm, Burton and Associates met with staff and the Board and provided their report in April 2002, detailing different rate increase scenarios in conjunction with rate structure recommendations.

The Board endorsed some of the findings from the report and implemented a rate increase to begin positioning the utility to better recoup its operational costs. Soon after, a discussion began within the Board about the proper allocation of tap fees to service expenses or capital improvements and whether it was appropriate to increase customer's water and sewer service rates when the utility had significant cash reserves. This discussion kept the rates unchanged for several years, effectively shifting tap fee capital dollars to offset operational expenses.

**Future of the Utility**

The SSRUS Board and City Council in the fall of 2009 requested Staff to evaluate three (3) options for the future ownership and operation of SSRUS. This directive was precipitated by customers concern over the current unequal utility rates between Fund 401 and 403. There were also questions raised over representation on the Board, as members are appointed not elected. The options reviewed for the future of the utility are:

**SSRUS remain an Enterprise Fund of the City:** We would continue allocating revenues and expenses between funds based on utilization or capacity provided.

The goal of this arrangement is to allow each to fund to be self sufficient while also receiving the benefit of larger economies of scale that can realized. There are also cash flow benefits resulting from being part of a larger organization.

**Combine City Water and Sewer (Fund 401) with SSRUS (Fund 403):** This arrangement would combine all aspects of the water and sewer assets, liability, and operations functions into one fund. It is anticipated that utility rates would be uniform for each class of customer and debt liability and expense costs would be equally shared with out regard to municipal jurisdiction or lack thereof. If the systems were combined, it is unclear how the SSRU Board and City governance of the utility would change. The citizens of the City of Gulf Breeze, as an incorporated entity, have the legal right to maintain control of their own utility service independent of and not governed by non-City citizens.

**Sell the Utility:** The City could sell or divest itself of SSRUS to either a private, governmental, or not for Profit Corporation. This would transfer all SSRUS assets and liabilities to the new owners who would then be responsible for all operations. Since the Utility's debt is financed with the full faith and credit of the City, new financing would have to be secured by the purchasers in order to transfer ownership of SSRUS. It is anticipated that the City would negotiate a long term agreement for wastewater treatment and disposal with the new owner as a condition or stipulation of the sale. Depending on the type of entity formed as a result of the sale, the utility could be governed by:

- Private Owners and the Florida Public Service Commission
- Governmental, with Elected Officials
- Not for Profit Organization typically governed by a Board elected by the membership and also USDA Rural Development for budget and rate approval if any funds are borrowed or owed to the state.

It is the opinion and recommendation of the City and SSRU staff, that SSRUS continue as an Enterprise Fund of the City. This provides the lowest cost for operations with the benefit of a local governing board with both elected and appointed Advisory Board Members selected from the customer base.