

CITY COUNCIL REFERRAL REPORT

Request From the City of Kelley for Water Service

October 26, 2012

On September 25, 2012, Council referred a letter to staff from the City of Kelley, requesting that the City of Ames consider a possible connection to and supply of water from the City of Ames to the City of Kelley. Council requested a brief report on the history of previous wholesale water and sewer agreements, along with a recommended response to the City of Kelley.

Currently, the City of Ames has two wholesale agreements for drinking water and four for wastewater. A summary of the quantities and revenues for these accounts over the past fiscal year is shown below.

	Average Day Demand, gallons per day	Peak Month Demand, gallons per day	Annual Gross Revenues ¹ , \$
Water Contracts			
ISU Central Campus	951,600	1,336,783	\$ 803,326
Xenia Rural Water	2,360	6,100	\$ 3,240
Wastewater Contracts			
ISU Central Campus	871,425	1,016,667	\$ 604,333
USDA – NADC	178,356	314,333	\$ 268,733
USDA – NVSL	11,095	19,333	\$ 13,181
City of Kelley	22,584	30,084	\$ 25,466

1 – Excludes any high strength surcharges for wastewater more concentrated than typical domestic wastewater.

ISU Wastewater

The very first agreement was signed on June 3, 1947 when the City of Ames and Iowa State University entered into an agreement whereby the City would accept and treat wastewater from the University. Prior to this agreement, ISU owned and operated its own wastewater treatment facility. The original agreement was developed during the planning for the City of Ames' then-new treatment facility. The State of Iowa made an up-front payment of 30% of the estimated construction costs, and the final expenses were reconciled based on the University's proportional load to the facility during the first 12 months of operation. This agreement has been modified twice, first in 1972 when discussions first occurred about constructing the next wastewater treatment facility, and a substantial rewrite in 1985 as construction for the next treatment facility was beginning.

ISU Drinking Water

In 1962, the City first signed an agreement with Iowa State University for drinking water when the Applied Science Center was constructed on Scholl Road north of Ontario Street. At that

time, the Applied Science Center complex was outside the city limits. According to the agreement documents, the City constructed the pipeline to connect the new facility, and the University reimbursed the City for the construction cost upon completion. The cost to maintain the line was the responsibility of the City, and the unit rate charged to the University was the same rate established by ordinance that applied to customers within the city limits. The Applied Science Center was covered by this agreement until 1990.

In 1976, the City entered into a second agreement with Iowa State University. Up until that time, ISU had owned and operated a separate drinking water treatment plant to serve the central campus. In 1976, ISU decommissioned its facility and entered into an agreement with the City of Ames to purchase water. Under the terms of the agreement, ISU pays for the water on a pro-rated basis, where they reimburse the City a percentage of the total operating cost of the water utility based on ISU's demand as a percentage of the total system demand. ISU also made a payment of \$600,000 over a period of 10 years that was described as compensation for "...taking up presently available utility capacity what has been previously financed by the City."

The agreement describes those specific ISU facilities that are covered by the agreement. Any outlying facilities not specifically identified in the agreement are considered to be "non-contract" accounts and are billed at the City's normal ordinance rate. That agreement was updated in 1978 and again in 1990. As a part of the 1990 revision, the previous agreement for the Applied Science Center was voided; and that facility was incorporated into the central campus contract.

National Animal Disease Center (NADC)

An agreement was executed between the City of Ames and the United States Department of Agriculture on July 2, 1975 by which the City agreed to provide drinking water service to the National Animal Disease Center at the same rate established for all other water customers within the City of Ames.

The agreement also provided for the City to provide and charge the USDA for sewage treatment service, including treatment plant capital costs at an equitable rate based on its actual sewer use proportional to the total flow in the system. There was no provision for any one-time capacity reimbursement. The agreement was last updated in 1985.

National Veterinary Services Laboratory (NVSL)

Similar to the agreement with the USDA to serve the National Animal Disease Center, an agreement was signed in 1976 that addressed water and sewer service for the National Veterinary Services Laboratory. The description of the water service arrangements simply documented that the NVSL had paid the customary water connection fees and water meter installation fees and that the NVSL would be billed for water at the published rate schedule that applied to all water customers. The charge for sanitary sewer service is very similar to the

NADC agreement. There was no provision for any one-time capacity reimbursement. The agreement was last updated on May 2, 1990.

Xenia Rural Water District

On October 22, 1996, the City entered into an agreement with Xenia Rural Water District to provide water on a wholesale basis for Xenia to redistribute to its customers. The agreement includes a provision whereby the City agreed to provide up to 250,000 gallons per day to Xenia at a unit rate that was established at the time of the agreement. That rate has increased over time in tandem with increases in the City's ordinance rate for other customers. The agreement included a one-time payment of \$280,550 for reimbursement to the City of existing capacity and associated expenses previously incurred. The agreement was last modified on June 24, 1997.

City of Kelley Wastewater

Financing for the City of Ames' current Water Pollution Control Facility was provided in large part by the federal Construction Grants Program. That program required that the grant applicant (Ames) evaluate the cost-effectiveness of regionalization, or having smaller communities connect to a larger facility that can operate more efficiently. Ames completed the feasibility evaluation for a number of surrounding communities and determined that regionalization was not cost-effective. The exception was the City of Kelley. Kelley was also applying for construction grant funds, and Kelley's consultant had performed an independent feasibility analysis and determined that connecting to Ames was the most cost-effective means of providing wastewater treatment for its community. With that determination already in place, providing Kelley with a sanitary sewer connection became a "string" attached to receipt of the grant funds for Ames.

The original agreement, dated September 24, 1975, included a limitation of 144,000 gallons per day. Kelley was responsible for the cost and construction of the pump station, force main, and their portion of the gravity outfall sewer. Kelley was to pay its proportionate share of the total operating and capital costs incurred by the City of Ames. There was no up-front capacity reimbursement provision. Because federal construction grant funds were being used to finance Kelley's connection, the U.S. EPA had to review and approve the agreement. That review was completed in 1977, and some small revisions were made on September 20, 1977 to resolve some U.S. EPA concerns. The agreement was again amended in 1985 as the City of Ames began its grant-funded construction to address new U.S. EPA requirements.

The original agreement was replaced with a new agreement in July 2005, after damage to a City of Ames sanitary sewer line was caused by the discharge from Kelley and it was determined that the existing language did not allow Ames to recover repair costs from Kelley. The new agreement included language stating that "...any costs directly attributed to Kelley's sanitary sewer discharge...shall be paid for by Kelley..." The current agreement includes billing provisions whereby Kelley pays a monthly minimum bill fee that is twice the established

ordinance minimum bill for other customers and that the unit rate paid by Kelley will be 115 percent of the established ordinance rate. Should the strength of wastewater being discharged by Kelley exceed the established surcharge rates, Kelley will be billed 125 percent of the established surcharge rate. (This last provision has not been needed to date.)

Current Request from the City of Kelley

During the summer of 2009, the Ames City Council gave its approval to a plan to design and construct a new 15-million-gallon per day water treatment plant. As a part of the discussion related to the size of the facility, staff suggested to Council that if there was any interest in exploring regionalization of the water utility, this would be the most opportune time to do so. With Council's approval, letters were sent to the City of Gilbert and to the City of Kelley inquiring if either community had an interest in considering a purchased water agreement. At that time, Kelley responded with an invitation for Ames staff to attend a Kelley City Council meeting. Ames Water and Pollution Control Department Director John Dunn attended a meeting on September 8, 2009 and discussed how such an arrangement might be developed. No additional discussions took place at that time. No response was received from Gilbert.

In the intervening period, Kelley has been notified by the Iowa Department of Natural Resources (IDNR) that they need to take a series of actions to improve the viability of their drinking water system. These modifications, estimated by Kelley's consultant to cost approximately \$1,000,000, are exceedingly expensive for a community of 309 people and fewer than 150 customer accounts over which to spread the costs. Because of the large price tag associated with the improvements, Kelley is interested in resuming discussions with the City of Ames. Ames staff members have talked with Kelley's consultant and met once with the Kelley City Council, but felt a request from Kelley's Council to the Ames City Council would be appropriate before investing additional staff time to further explore the possibilities. It should be noted that Kelley has received funding commitments that have a limited window of opportunity, and receiving an answer from Ames in a timely manner is of importance to them.

Based on water demand characteristics provided by Kelley's consultant to Ames staff, the City of Kelley has an annual average demand of approximately 15,500 gallons per day and a peak day demand of approximately 40,000 gallons per day. For comparison purposes, this would put the demand for the connection to Kelley roughly comparable to the average demand of Hickory Park restaurant. An estimate of the revenue generated from taking on Kelley as a customer would be in the neighborhood of \$24,000 per year, using the provisions of the Kelley wastewater agreement as a model.

If the City Council decides to provide water to the City of Kelley the following issues should be addressed in any contract for water service.

- Seasonal Rates. The rate structure for residential customers in Ames is a seasonally inclined block structure, with a flat rate in the winter and an inclining block rate in the summer. Some consideration should be included to a rate provision with Kelley that

accomplishes the same water conservation goals. In particular, any agreement should somehow ensure that a residence in the City of Kelley is not able to excessively water its lawn at a cheaper rate than a residence within Ames.

- Water Rationing. The City of Ames has adopted an ordinance that allows mandatory water use restrictions to be implemented in stages based on the need for conservation. Any contract with Kelley should somehow ensure that the same levels of restrictions are imposed and/or the same level of use reduction achieved, in the City of Kelley as is targeted in Ames.
- Delineation between Systems. There are a number of different ways that an agreement could demark the separation point between systems. The simplest for Ames would be to follow the model that has been used with all other wholesale agreements; namely, Ames provides water, at whatever point in its existing system is closest or most convenient, through a single master water meter. The water would then be the responsibility of the City of Kelley from the outlet of the meter, and Kelley would continue to operate as a separate Public Water Supply and would be responsible for operating and maintaining the distribution system, metering, and billing its customers. That would be the form of agreement that Ames staff would recommend.

Staff Comments:

The challenges being faced by the City of Kelley are not unique and are not necessarily reflective of a lack of care by that community. In staff's professional opinion, the requirements being imposed on Kelley by the Iowa Department of Natural Resources are reasonable and prudent. It is also staff's opinion that the improvements proposed by Kelley's consultant to comply with the IDNR requirements are not exorbitant or "overkill." Kelley is simply being caught by the math of having to divide a large dollar amount by a small number of customers. Where the typical residential customer in Ames pays a water bill of between \$20 and \$25 each month, it was reported by a Kelley Councilmember that their average bill is between \$60 and \$80 each month already; and that does not include the \$35 each month spent buying bottled water because the tap water is not palatable.

Ames has a history of providing water and wastewater services on a wholesale basis to other governmental entities dating back over 65 years. It has proved to be the most cost-effective means for entities such as Iowa State University and the USDA research facilities. More specifically, Ames has provided sewer service to the City of Kelley since 1975. During that period, there has been only one major issue, when septic wastewater from Kelley significantly damaged a sewer line in Ames. Unfortunately that one incident cost the City of Ames \$325,000 which was not ever reimbursed by the City of Kelley. Because of this problem, our agreement with Kelley was modified to hold them financially responsible for any similar future occurrence.

The City Council should understand that while great care is taken by the staff to develop contractual language that protects each party's interests, any contractual agreement runs the

risk, to either party, of an unforeseen condition arising that was not anticipated or fully addressed by the agreement.

Advantages of serving Kelley with Ames water

- There appears to be a small financial advantage of providing this service to the City of Kelley. Based on the annual average water demand data provided by Kelley's consultant, the annual revenue from an agreement is estimated to be approximately \$24,000.
- It could be argued that there is positive aspect of being a "good neighbor" by helping an adjacent community.

Disadvantages of serving Kelley with Ames water

- While not significant, there will be a small amount of staff that will be necessary to negotiate the agreement and oversee the connection.
- There is always the risk of an unanticipated liability similar to the issue with the original Kelley wastewater agreement.
- As far as the net impact of the increased demand on the available water supply for the City of Ames, the likely demand from this proposed agreement would be similar to adding another restaurant the size of Hickory Park. Therefore, staff has concluded that the increased demand would have a negligible impact on the utility's capacity.

Next Steps

If the City Council would like to pursue this matter with the City of Kelley regarding their request to purchase water from the City of Ames, Council should direct staff to initiate discussions with the City of Kelley regarding a possible agreement for water service.