

Guidelines for the Transfer of Water Service Territory Between Cities and Rural Water Districts

Developed in partnership with representatives of the following organizations:



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Guidelines for the Transfer of Water Service Territory Between Cities and Rural Water Districts

Note: This document was prepared to provide assistance to cities and rural water districts to help them deal with water service to annexed land, requests for water service outside of city boundaries, or between other rural water districts. These guidelines were developed by a workgroup composed of representatives of the following: Kansas Rural Water Association, Regional Economic Area Partnership (REAP), Kansas Municipal Utilities and the League of Kansas Municipalities.

Three sample “territorial agreements” are attached to this paper. These are samples only. No particular form should be considered as the only one suitable to a particular situation. Care should be taken to adapt an agreement form as necessary to fit the specific case.

I. BACKGROUND

RURAL WATER DISTRICTS

Rural Water Districts were originally formed for the purpose of providing adequate water supplies to rural areas where there were none. They were constructed using funds provided by loans and grants from the USDA. Each RWD has territory established by the Board of County Commissioners. An RWD is a special unit of government, governed by a board of directors elected by the participating members (customers). As special districts, rural water districts are governed by Kansas Statutes, K.S.A. 82-612 et. seq. Their boundaries may change, generally upon petitions of the affected landowners and approval of the County Commission.

There are approximately 300 rural water districts in Kansas. Many continue to serve widely dispersed populations with drinking water and provide no other services. Some RWDs have evolved to the point that they provide high-level service through large capacity systems, including fire protection. Some RWDs sell water to cities at wholesale, and others serve as the retail supplier to parts or all of some cities. These highly developed districts tend to be located in urbanizing areas and may adjoin growing cities. Districts can partner with cities; Rural Water Districts can help cities serve outside city limit landowners by providing cost of service at no expense for infrastructure to the City.

CITIES

Cities are general jurisdictions of government having powers granted by Kansas Statutes as well as constitutional home rule authority. Cities have statutory authority through K.S.A. 12-801 to purchase, construct, or extend the infrastructure and works necessary to supply the city and its inhabitants with public utilities including water. Many cities in Kansas have been supplying water to their respective communities for well over 100 years. Municipal water supplies were originally developed to provide fire protection and safe drinking water in an urban setting. Today municipal water suppliers in Kansas range from the very small more rural communities to the state’s largest cities.

City water systems are integrally involved in the development and growth of their communities. Not only are municipal water systems involved in supplying fire protection and drinking water for public safety and sanitation purposes, they must also be involved in the planning and development for: existing or new water supplies, annexed territories, new subdivisions, new commercial and industrial development; fire protection (ISO) ratings, and other issues within a more dense urban environment. Cities' jurisdictional limits may change over time due to the annexation of land as allowed by State law. These annexations may include land located within the service territory of a rural water district.

CONFLICTING WATER SERVICE TERRITORY-LEGAL BACKGROUND

In the case of an annexation of land located within RWD territory, the city's limits and the district's territories may overlap and potential for water service territory conflicts may arise. In the case of annexation of rural water district territory, Kansas Statutes, K.S.A. 12-527, provide a procedure to follow. In summary, in the event that the city elects to replace the rural water district as the water supplier to the annexed territory, the city and the RWD are to negotiate an agreement for the city to acquire the title to the facilities owned by the district that are used in the transportation or utilization of water to serve the annexed area. If no agreement can be reached, a three-member panel of appraisers is appointed for determination of this value. The appraisal is "open-ended" and may include a consideration of the going concern value. The payment is due following completion of the appraisers' valuation, and either party may appeal the reasonableness of the appraisers' award to the District Court.

Additional considerations must be made if the rural water district whose territory is annexed has a loan payable to the USDA or guaranteed by the USDA. In these cases, a Federal Statute, 7 U.S.C. § 1926(b) applies. In summary, this Statute provides that if the district is providing water service or has made water service available to the annexed territory, then the RWD has the right to continue to provide that service notwithstanding the annexation. Although the annexing city may require a specified level of water service for fire protection within the city, the RWD need only demonstrate the ability to provide water service for domestic use without fire protection capability in order to assert that it has "made service available". In such case, the city might find it necessary to extend the fire service lines through the annexed area without opportunity to provide domestic water service (which would still be provided by the district), or decline the annexation altogether.

Water utilities, both rural and urban, have an infrastructure to maintain and to serve current and future water users. The larger the number of water users in the district or city, the more that operational cost is shared and the more reasonable the monthly cost per user for water. Similarly, as that number of water system users diminishes, the greater the operational costs are for each remaining user. Additional problems occur with an aging water system as production, transmission and distribution systems need to be maintained and replaced. Both rural water districts and cities are burdened by these cost issues.

II. PREVENTING CONFLICT BETWEEN WATER SERVICE PROVIDERS

In some cases, these overlapping service area issues have resulted in protracted and expensive litigation, resulting in delays and expense ultimately borne by the landowners/developers and consumers of the respective water utilities. In other cases the parties have attempted to negotiate agreements but found their efforts complicated by a lack of guidelines or formula to serve as the framework for the negotiations and eventual agreement. This policy is an attempt to create guidelines that are respectful of the interests of all of the parties concerned in an effort to create an environment in which these water service and/or compensation agreements can be more readily achieved.

There are several factors that contribute to conflicts between cities and rural water districts over water service territory. They include: (1) lack of awareness of the legal rights and responsibilities that each have for water service to their residents; (2) lack of understanding concerning service capabilities and limitations; (3) lack of communication regarding future plans, and (4) emphases on the utilities goals and desires at the expense of those of the present and future customers of the utility.

Cities and neighboring rural water districts should make a concerted effort to address these potential sources of conflict by implementing the following:

- (1) Educate staff and governing body members with the laws concerning the rights and responsibilities of the respective utilities. Network with other cities and rural water districts in an effort to understand how these rules can relate to specific situations in order to be able to apply problem solving techniques successfully used in other places to given situations.
- (2) Periodically perform system service capability studies in order to understand future service capabilities, and share those studies with neighboring rural water districts and cities. Meet with staff and/or representatives of governing bodies of neighboring cities and rural water districts to review future service capabilities of water systems.
- (3) The water system staff and/or representatives of the governing bodies of neighboring cities and rural water districts should conduct joint meetings with planning staff in order to review potential growth and resultant water system demand and to the extent possible, intermediate and long range plans that each have concerning expansion of boundaries and how those may relate to water system capabilities and limitations regarding future service to those areas. Cities should give as much advance warning to RWDs as possible of plans for annexation of RWD territory and not make commitments about water service to landowners/developers until all of the relevant factors have been considered. RWDs should give advance notice to neighboring cities of plans to construct significant infrastructures (large capacity lines and tanks) or develop or contract for new or expanded water supplies or treatment facilities designed in whole or in part to serve areas presently unserved or with limited service adjoining neighboring cities.
- (4) Commit to the principle that the interests of the customer, whether rural or urban, present and future, should be the primary concern of all water utilities. (This principle may be easier to

embrace when the costs of litigation are considered which have exceeded \$1.0 million in at least one case in Kansas.)

(5) Recognize that lack of regard for citizens who are not their own constituents, coupled with a belief that their fiduciary duty to their own constituents negates any need to consider other's positions is not in the best interests of utilities or their customers.

Examples of the application of these principles may include:

a) RWDs should yield their territory to an annexing city for water service if the land is planned for development of a type and density that exceeds the capabilities of the district to provide all of the needed services, including water necessary for fire protection (including capacity for pressure and flow volume required for urban development), with due consideration to its effect on the balance of RWD's service area.

b) The inefficiencies inherent in duplicative water facilities, one set of lines for drinking water provided by one utility and a separate, parallel, high volume set for fire protection by a different utility, is not in the public's interest and should be avoided.

c) Due consideration should be given to the advantages that can be obtained from water service by a RWD to land that already is in its district, that has the capacity and ability to meet the demands for water service following the annexation, and whose existing customers would be hurt by loss of future growth represented by the addition of new service to this area.

d) If the annexing city i) has given notice of its intent to annex and provide water service to the land and ii) thereafter within twelve (12) months in fact annexes such land and gives notice of its intent to assume water service to such land, the RWD in whose territory such land is located should not be compensated for any improvements made to serve such land after the notice under i) above has been given. This limitation should not apply where a city gives more than two notices under i) above for the same land within a three (3) year period, and does not relieve a city for compensating for the value of any improvements that were already in process at the time the notice under i) above was given or for any emergency replacements or upgrades of facilities to serve such areas.

Employing these techniques and principles should lead cities and rural water districts toward a cooperative effort to resolve potential disputes without need for litigation. In most instances the neighboring utilities should consider creation of a long term territorial or service agreement that will govern the provision of water service to their respective territories in the event of future boundary changes and development. Such agreements may include permanent service territory lines that will remain in effect despite changes in political boundaries; emergency interconnect or mutual aid provisions where appropriate; minimum service standards to be achieved within any overlapping areas for which a RWD is to provide service, and/or compensation formulas when territory is surrendered pursuant to the terms of the agreement. Three sample agreements are attached to this paper. These are samples only. No particular form should be considered as the

only one suitable to a particular situation. Care should be taken to adapt an agreement form as necessary to fit the specific case.

In the event that disputes arise, the parties should employ alternative dispute resolution measures, including mediation services offered by the Kansas Water Office and others. Litigation should be employed only as a last resort when vital interests are at stake and all efforts at resolution have failed.

There will be some instances in which it will be necessary for one utility to compensate another due to changes in service territory. These include but are not limited to the compensation that is payable under K.S.A. 12-527 when a portion of rural water district territory has been annexed and the city designates a supplier other than the RWD to serve the annexed area. This compensation is to compensate for the reasonable value of the property, facilities and improvements in the annexed area, including an analysis of their going concern value. No specific formula for computing reasonable value is required, and each case may be different. There will be times when going concern value will be enormously influential and a high-dollar component of reasonable value, and other times when it will have minimal impact and may reasonably be set at zero. Fair consideration should be given to all factors in a given case in an effort to reach a reasonable valuation and settlement. It could also include situations in which neighboring utilities agree to designate one as the service provider to a particular area, whether or not annexation of that area has occurred. These could also include situations in which a rural water district has a USDA loan and is entitled to protection against competition under § 1926(b), but such district and a neighboring utility agree that a transfer of service responsibility is appropriate upon payment of adequate compensation.

In all of these cases, the following factors should be considered in arriving at reasonable compensation:

- (1) The value of any property rendered useless or valueless or diminished in value to the Rural Water District. An example of applications of this factor would be an annexation that severs territory of the District, resulting in an inability by the District to use certain facilities and improvements necessary to serve other areas of the District;
- (2) The amount of loss of value or increase in cost to property remaining in the ownership of the water district following the transfer;
- (3) The reasonable and prudent costs of detaching the water system facilities to be sold and all reasonable and prudent costs of reintegrating the remaining water system facilities of the water supplier whose service rights are terminated;
- (4) The impact on the existing indebtedness of the system and that system's resulting ability to repay that debt;
- (5) The value of the service facilities of the system located within the area transferred, and the impact on those facilities located outside the area. This value may be calculated based on a

variety of methods, including any one or a combination of the following: depreciated cost, replacement cost, depreciated replacement cost, projected income stream reduced to present value, or other suitable method;

(6) The amount of expenditures for planning, design or construction of service facilities of the system located outside of the transferred area that are allocable to the service of that area;

(7) The amount of the system's contractual obligations allocable to the area transferred;

(8) Any demonstrated impairment of service or increase of costs to the consumers of the system remaining after the transfer of the area in question and the impact on future revenues lost from existing and potential customers of that system;

(9) The necessary and reasonable legal expenses and professional expenses incurred by the system as a result of the transfer;

(10) Any factors relevant to maintaining the current financial integrity of the system following the transfer;

(11) The growth and the number of customers in the area transferred during the three years immediately preceding the transfer;

(12) If the area transferred consists of land for which no water service is being provided by the system at the time of the transfer, the value of such land based on the planning, design and/or construction of improvements located outside the transferred area reasonably made to provide future water service to the transferred area;

(13) The potential for development of area transferred compared to cost of that development.

Information should be developed and shared with the other party to the transfer as quickly as possible. Both parties share responsibility for insuring that this process proceeds timely and that determination of value and compensation is made as quickly as possible.

Neither the City nor the Water District should be working in a vacuum. The secret is communication, but it is imperative that this communication be honest and timely. Reference is made to the Checklist attached for additional emphasis of this point.

Sample 1.

**AGREEMENT FOR TRANSFER OF TERRITORY
NO SERVICE BEING PROVIDED – NO COMPENSATION – NO USDA LOAN**

THIS AGREEMENT made and entered into this ____ day of _____,
20____, by and between [CITY] and [RWD].

WHEREAS, City owns and operates a water supply and distribution system which produces an adequate supply of water, which water has been approved by the Kansas Department of Health and Environment for domestic uses and fire protection; and

WHEREAS, RWD owns, operates and maintains a water system, consisting of water mains and distributions line within the boundaries of RWD; and

WHEREAS, due to annexation, City's boundary overlaps RWD's district boundary as shown on Exhibit "A" which is attached hereto and incorporated herein by reference, and hereinafter referred to as "overlap territory".

WHEREAS, RWD does not currently have any facilities for providing water service in the overlap territory and RWD believes it is not financially feasible for RWD to do so in the foreseeable future, and

WHEREAS, City has the facilities and capability to provide water service to the overlap territory; and

WHEREAS, RWD does not and will not object to City providing water service to the overlap territory; and

WHEREAS, City and RWD are subject to K.S.A. 12-527 and desire to enter into an agreement as authorized by that statute.

NOW THEREFORE, in consideration of the mutual promises contained herein, the parties hereto agree as follows:

1. **DEFINITIONS.** The following words and phrases as used in this agreement shall have the meanings as follows:
 - (a) "Overlap Territory" shall mean the territory where City's boundary overlaps RWD's district boundary as indicated on Exhibit "A".
2. **WATER SERVICE TO AREAS WITHIN OVERLAP TERRITORY.**
 - (a) RWD agrees, that due to annexation a portion of City is located within the boundaries of RWD, and RWD will not serve or offer water service to any land within City, which land is the overlap territory as indicated on Exhibit "A".

(b) City agrees it will not serve or offer water service to any land located within the boundaries of RWD and outside the overlap area.

(c) No compensation is due or shall be paid by City to RWD on account of this transfer of water service territory. The City agrees to reimburse RWD for RWD's reasonable fees and expenses, including it attorneys and engineering fees in the amount of \$_____ incurred by RWD in relation to this transfer.

3. **TERM.** The term of this agreement shall be perpetual.
4. **RELEASE OR MODIFICATION.** Any release or modification of this agreement or additional obligation assumed by any party in connection with the agreement shall be binding only if in writing and signed by each party or an authorized representative of each party.
5. **ASSIGNMENT OF RIGHTS.** The rights of each party under this agreement are personal to that party and may not be assigned or transferred to any other person, firm, corporation, or other entity without the prior, express, wand written consent of the other party.
6. **ENTIRE AGREEMENT.** This agreement shall constitute the entire agreement between the parties and any prior understanding or representation of any kind preceding the date of this agreement shall not be binding on either party except to the extent incorporated in this agreement.

IN WITNESS WHEREOF, the City and RWD, respectively, have caused this agreement to be duly executed, the day and year first herein written.

[CITY]

By: _____, Mayor

ATTEST:

SEAL

, Clerk

[RWD]

By: _____, Chairman

Sample 2.

**WATER SERVICE AREA AGREEMENT
USDA LOAN INVOLVED – COMPENSATION FOR TERRITORY AND FACILITIES
AND PERMANENT WATER SERVICE TERRITORIES ESTABLISHED**

This Agreement is entered into this ____ day of _____, _____ by and between the City, a duly organized Municipal Corporation (hereinafter referred to as the “City”), and Rural Water District (hereinafter referred to as the “District”).

WHEREAS, the City owns and operates a waterworks and water distribution system serving land within its corporate limits; and

WHEREAS, the District is a Rural Water District organized and existing pursuant to K.S.A. 82a-612 *et. seq.* The District as established by orders of the Board of County Commissioners provides water service to customers and property located within the territory of the District; and

WHEREAS, the City has annexed certain land within the territory of the District and it plans to annex certain additional land located within the District territory in the future; and

WHEREAS, the parties are governed by the provisions of K.S.A. 12-527. In addition, the District is the borrower on an obligation guaranteed by the United States Department of Agriculture, thereby invoking the provisions of 7 U.S.C. §1926(b); and

WHEREAS, the parties desire to enter into an agreement that resolves all annexations of district territory that have occurred prior to the date of this Agreement; to provide for the transfer of certain existing District customers and facilities to allow for City water service to those areas; and to establish service areas that will govern water service within the territory of the District in the event of future annexations of portions of that territory by the City.

NOW, THEREFORE, in consideration of the mutual covenants contained herein, the parties agree as follows:

1. DEFINITIONS

The following words and phrases as used in this Agreement shall have the meanings as follows:

- a.
- b.
- c.
- d.

2. EXISTING DISTRICT AND CITY BOUNDARIES

See Exhibit “A”, attached.

The parties agree that Exhibit A depicts the territory of the District as established by the Board of County Commissioners. It further depicts the boundary of the City as established by ordinance, including all annexations that have been accrued to date; and the resulting overlap of the service territory of each party (hereinafter “overlapping area”).

3. EXISTING DISTRICT WATER SERVICE TO OVERLAPPING AREAS – WHERE CITY IS TO BE WATER SUPPLIER

a. The parties agree that the City shall assume responsibility for providing water service to certain portions of the overlapping area, which area is further on Exhibit “A”. As to this area only, transfer of such service from the District to the City shall be coordinated between the parties, and shall occur after the construction by the City of a new water main transmission line to serve the overlapping areas, but in any event shall occur not later than December 31, _____.

b. Payment for facilities:

The parties agree that in satisfaction of any obligations the City has to the District as a result of annexations that have occurred to District territory pursuant to 7 U.S.C. §1926(b) and K.S.A. §12-527, including all elements of value associated therewith, the City shall pay the District the following:

(1) Payment for customers:

The City shall pay the District a sum of approximately \$_____ per customer for each existing customer (benefit unit) located within the annexed area as of the effective date of the transfer of service from the District to the City.

4. EXISTING DISTRICT WATER SERVICE TO OVERLAPPING AREAS – WHERE DISTRICT IS TO REMAIN WATER SUPPLIER

The parties agree that the District shall remain the water supplier to certain other portions of the overlapping area, which area is further delineated and depicted on Exhibit “A”. Notwithstanding the City’s annexation thereof, this area (and any future attachments of Land to the West thereof) is and shall remain part of the exclusive service territory of the District, subject to any amendment as provided herein. The City shall have no duty to compensate the District as a result of the annexation of the areas described in this paragraph 4 pursuant to 7 U.S.C. §1926(b) or K.S.A. §12-527.

5. ADDITIONAL WATER SERVICE AREAS

- a. In addition to land in District territory that has been annexed to date, as shown on Exhibit “A”, the parties agree to establish other permanent and exclusive water service areas that will be unaffected as a result of future changes in corporate boundaries or any other unilateral actions which may occur in the future. In recognition of the location, size and capacity of the parties' existing facilities and in order to best utilize those capacities and facilities, the parties agree to establish and maintain water service areas as depicted on the map, attached as Exhibit “B”. Notwithstanding future annexations by the City, the area shown on Exhibit “B” as “District Service Area” shall be served exclusively by the District. The area depicted on Exhibit “B” as “City Service Area” will, following annexation by the City, be served exclusively by the City and shall henceforth be included in and be part of the City service territory as if included within the boundaries of the City. These respective service areas shall be subject to change only upon written agreement, executed by the parties in the form of an amendment hereto.
- b. The parties each agree to make good faith efforts to provide water service to their respective water service areas that is in compliance with all U.S. Environmental Protection Agency and Kansas Department of Health and Environment regulations; to meet the reasonable requirements of landowners desiring water service within those areas so as to not discourage reasonable growth and development; and to provide facilities and flow necessary for adequate fire protection. Customers within the City service area shall be governed by the applicable state and federal laws and City Ordinances. Those customers within the District service area that are also within the limits of the City shall additionally be subject to District bylaws, rules and regulations, and policies. In the event it is determined to be necessary, the City shall grant the District a franchise to serve those areas annexed by the City in accordance with state law, K.S.A. 12-2001, *et. seq.*, and that any such franchise shall be granted with no compensation or charge payable to the City in consideration of that franchise.

c. This Agreement providing for establishment of these water service areas is intended to be an entire Agreement, in satisfaction of all of the rights and obligations that the parties may have to each other with respect to such areas pursuant to state and federal law. So long as the parties comply with the terms of this Agreement, neither party shall assert any rights to payment or to protection against competition that may otherwise exist under K.S.A. 12-527 and/or 7 U.S.C. §1926(b).

USDA Approval

The parties acknowledge and agree that the District is indebted on a loan guaranteed by the United States of America/USDA. This Agreement shall be conditioned upon its approval by the USDA unless such approval is expressly waived by that agency.

IN WITNESS HEREOF, the parties have hereto executed this Agreement as of the day and year first about written.

CITY

By: _____
_____, Mayor

ATTEST:

By: _____
_____, City Clerk

RURAL WATER DISTRICT

By: _____
_____, Chairman

Sample 3

**WATER SERVICE AREA AGREEMENT
COMPENSATION FOR TERRITORY AND FACILITIES
AND PERMANENT WATER SERVICES TERRITORIES ESTABLISHED**

This Agreement is entered into this ____ day of _____, _____ by and between the City, a duly organized Municipal Corporation (hereinafter referred to as the “City”), and Rural Water District (hereinafter referred to as the “District”).

WHEREAS, the City owns and operates a waterworks and water distribution system serving land within its corporate limits; and

WHEREAS, the District is a Rural Water District organized and existing pursuant to K.S.A. 82a-612 *et. seq.* The District as established by orders of the Board of County Commissioners provides water service to customers and property located within the territory of the District; and

WHEREAS, the City has annexed certain land within the territory of the District and it plans to annex certain additional land located within the District territory in the future; and

WHEREAS, the parties are governed by the desire to meet customers’ current and future needs and cooperate toward that end; and

WHEREAS, the parties desire to enter into an agreement that resolves all annexations of district territory that have occurred prior to the date of this Agreement; to provide for the transfer of certain existing District customers and facilities to allow for City water service to those areas; and to establish service areas that will govern water service within the territory of the District in the event of future annexations of future portions of that territory by the City.

NOW, THEREFORE, in consideration of the mutual covenants contained herein, the parties agree as follows:

1. DEFINITIONS

The following words and phrases as used in this Agreement shall have the meanings as follows:

- a.
- b.
- c.
- d.

2. **ANNEXATIONS OF DISTRICT TERRITORY / PREVIOUS ANNEXATIONS**

See Exhibit "A", attached.

The parties agree that Exhibit A depicts the territory of the District as established by the Board of County Commissioners. It further depicts the boundary of the City as established by ordinance, including all annexations that have been accrued to date; and the resulting overlap of the service territory of each party (hereinafter "overlapping area").

3. **EXISTING DISTRICT WATER SERVICE TO OVERLAPPING AREAS – WHERE CITY IS TO BE WATER SUPPLIER**

a. The parties agree that the City shall assume responsibility for providing water service to certain portions of the overlapping area, which area is further described on Exhibit A, attached hereto as "Overlap Area on A". As to this area only, transfer of such service from the District to the City shall be coordinated between the parties, and shall occur after the construction of a new water main transmission line to serve the overlapping areas, but in any event shall occur not later than December 31, _____.

b. Payment for customer / and area of service / and/or infrastructure:

The parties agree that in satisfaction of any obligations the City has to the District as a result of annexations that have occurred to District territory, the City shall pay the District the following:

(1) Payment for customers:

The City shall pay the District the sum of approximately \$_____ per customer for each existing customer (benefit unit) located within the annexed area as of the effective date of the transfer of service from the District to the City. The parties agree that the cost per customer being paid by the City to the District for these customers is based on the calculations in Exhibit "C", attached.

(2) Payment for development area:

City agrees to compensate District \$_____ per acre for District agreeing District will not provide service in the future. City compensation to the District for this Release of service area is set out in Exhibit "C".

(3) Payment for infrastructure:

District line and improvements affected by City's annexation shall be resolved by payment to District for the value of infrastructure. Exhibit "C" has examples of compensation options.

4. **EXISTING DISTRICT WATER SERVICE TO OVERLAPPING AREAS – WHERE DISTRICT IS TO REMAIN WATER SUPPLIER**

The parties agree that the District shall remain the water supplier to certain other portions of the overlapping area, which area is further delineated and depicted on Exhibit A, attached hereto and incorporated herein by reference and hereafter referred to as "Overlap Area A". Notwithstanding the City's annexation thereof, this area (and any future attachments of Land to the West thereof) is and shall remain part of the exclusive service territory of the District, subject to any amendment as provided herein. Under these circumstances, the City shall have no obligation to compensate District as a result of annexation(s).

5. **ADDITIONAL WATER SERVICE AREAS**

- a. In addition to land in District territory that has been annexed to date, as shown on Exhibit "A", the parties agree to establish other permanent and exclusive water service areas that will be unaffected as a result of future changes in corporate boundaries or any other unilateral actions which may occur in the future. In recognition of the location, size and capacity of the parties' existing facilities and in order to best utilize those capacities and facilities, the parties agree to establish and maintain water service areas as depicted on the map, attached as Exhibit "B". Notwithstanding future annexations by the City, the area shown on Exhibit "B" as "District Service Area" shall be served exclusively by the District. The area depicted on Exhibit "B" as "City Service Area" will, following annexation by the City, be served exclusively by the City and shall henceforth be included in and be part of the City service territory as if included within the boundaries of the City. These respective service areas shall be subject to change only upon written agreement, executed by the parties in the form of an amendment hereto.
- b. The parties each agree to make good faith efforts to provide water service to their respective water service areas that is in compliance with all U.S. Environmental Protection Agency and Kansas Department of Health and Environment regulations; to meet the reasonable requirements of landowners desiring water service within those areas so as to not discourage reasonable growth and development; and to provide facilities and flow necessary for adequate fire protection. Customers within the City service area shall be governed by the applicable state and federal laws and City Ordinances. Those customers within the District service area that are also within the limits of the City shall additionally be subject to District bylaws, rules and regulations, and policies. In the event it is determined to be necessary, the City shall grant the District a franchise to serve those areas annexed by the City in accordance with state law, K.S.A. 12-2001, *et. seq.* and that any such franchise shall be

granted with no compensation or charge payable to the City in consideration of that franchise.

- c. This Agreement providing for establishment of these water service areas is intended to be an entire Agreement, in satisfaction of all of the rights and obligations that the parties may have to each other with respect to such areas pursuant to state and federal law. So long as the parties comply with the terms of this Agreement, neither party shall assert any rights to payment or to protection against competition that may otherwise exist.

IN WITNESS HEREOF, the parties have hereto executed this Agreement as of the day and year first above written.

CITY

By: _____
_____, Mayor

ATTEST:

By: _____
_____, City Clerk

RURAL WATER DISTRICT

By: _____
_____, Chairman

EXHIBIT “C”
Compensation for Customer / Released Service Area / Infrastructure
(Compensation for Infrastructure)

1. Compensation for Customers:
 - A. Capitalization formula based on customers’ usage
Formula: Income Approach (attached as Exhibit C₁)
2. Compensation for Release of Service Area:
 - A. Lump Sum based on negotiated acceptable amount to both
 - B. % of water sales from that area paid by new users in area
 - C. Amount per house served by City in new area paid by new property owners at the time new City meters installed
 - D. Capitalization Formula based on potential customer usage (attached Exhibit “C₁”)
3. Compensation for Infrastructure:
 - A. City used District line – reimburse for value of line
 - B. City not use District line – reimburse for depreciated value
 - C. District continues to use line – no reimbursement from City
 - D. District improvements to service this area – reimburse for portion of improvements
District no longer needs to serve this area.

EXHIBIT “C₁”

VALUATION METHOD USED AND CONCLUSIONS OF VALUE FOR WATER BENEFIT UNITS (EXISTING OR AVAILABLE TO SERVE)

Income Approach

The capitalization of income approach was selected because of the District’s historical financial performance, current business plans, and the future outlook for the District.

The value of the District’s property being valued can be considered to be the present value of the future earnings stream to be derived from owning the _____ lots (# of Benefit Units). Future earnings can be projected and then discounted back to arrive at a present value.

Earnings Stream – We used projected cash flow as the stream of earnings to be capitalized. Net cash flow represents the difference in water bill and the cost of water paid for the cost of water. The average usage in the District is _____ gallons and the average water loss % is _____.

Capitalization Rate – The capitalization rate is the expected rate of return (applicable to the stream being discounted) required for attracting capital to the investment, which is considered as being the expected rate of return available in the market from other investments of comparable risk and other factors, as of December 31 of the year of taking. The discount rate is derived by adding together the risk free rate (current rate on 20 year U.S. Treasury bonds) and a risk premium for the District. The specific risk premium for the District was determined by analyzing numerous factors.

The capitalization rate, which is summarized below, is derived by subtracting the estimated growth rate for the District from the computed discount rate.

CAPITALIZATION RATE DEVELOPMENT

As of December 31, 20

Example (these numbers as of April, 2008):

Risk free rate (20-year Treasury bond)	4.36%
Risk premium	<u>1.00%</u>
Discount rate	5.36%
Less estimated growth rate	_____
Capitalization rate	<u>5.36%</u>

COMPUTATION OF VALUE

Cash flow estimate

Expected cash inflow	\$ 9,072
Expected cash outflow	<u>3,785</u>
Net cash flow	5,287
Divided by capitalization rate	<u>5.36%</u>
	<u>\$98,638</u>

The expected cash inflow was based on an average bill of \$36 per month (amount of average bill) for 21 meters (# of meters existing/potential involved). The expected cash outflow was based on a water loss % of 9% (insert water loss of District) and rate per 1,000 of \$2.65 (insert cost per thousand). The average water bill was based on the average usage of the District, excluding wholesale water in 2007 (prior year), which was 5,271 (insert # of gallons) gallons.

Benefit Unit Cost: 21 (insert # of BU/potential) lots x \$4,000 ea. (insert income per applicant)	\$84,000.00
City's share of system wide capital improvements for 21 lots (insert # involved) (value of improvements to serve that #)	\$17,500.00
City's share of the present value of the fixed maintenance cost for these improvements over 20 years (# of years)	\$25,000.00

Total compensation: \$225,138.00 (for Benefit Units involved and improvements)

CHECKLIST

Water suppliers anticipating a change in water service territory should use the following action checklist:

A. BEFORE THE ANNEXATION

1. Regular meetings of City staff and Rural Water District staff should be held, no less than annually.
2. As soon as the City or RWD learns of potential expansion, City or District should immediately contact the other and advise of the possible annexation or expansion of service area.
3. **DO NOT** make commitments to landowners or developers concerning future water service until after completion of the steps contained in the section.
4. The annexing city staff and RWD staff should meet together with planning agency staff to review the proposed annexation, current and future land use and resulting water service needs, and capability of both systems to provide service to the area. Landowners and developers should be included in these meetings when appropriate.
5. The parties should jointly develop a water service plan for the proposed annexed area if possible. Any agreement by which the RWD is to continue water service to any portion of the annexed area should be in writing, and submitted to the governing bodies for approval.
6. If the water service provider to all or any portion of the annexed area is to change, the parties should negotiate a written agreement for compensation as appropriate. Such agreement should be submitted to the governing bodies for approval.

B. AFTER THE ANNEXATION OCCURS:

1. If agreement has not been reached for water service and/or compensation to the RWD whose territory is affected by the annexation, the parties should submit to mediation. Mediation services are available through the Kansas Water Office (Phone: 785-296-3185 - - Contact: Kim Christensen, General Counsel).
2. The city and the RWD should cooperate and communicate with any affected property owners, developers and water service customers regarding any changes in or transfer of water service.