



**Water Resources
Economics**

PROMOTING THE VALUE AND PRICE OF
WATER SERVICE

ACWA

How to Conduct a Rate Study While Avoiding Common Pitfalls and Maintaining Best Practices

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Adopting Rates is Risky

- Rates need to recover the correct amount of revenue each year to pay for operating expense and CIP needs while maintaining reserve levels and coverage ratio requirements
- Rates need to comply with Prop 218, which requires a nexus between the cost of providing service and the customer demand on the system
- Given the time and cost of conducting a rate study, it is important to have early buy-in from elected officials
- Rates can be legally challenged, so proper documentation of the process is critical

Best Practices - Preliminary Steps



1

Build the team

- Internal
- External

2

Identify needs and goals

3

Analyze context

- Political appetite for change / Elections
- Customer concerns
- Cost-saving measures

Elephant in the Room

What do we want to accomplish?

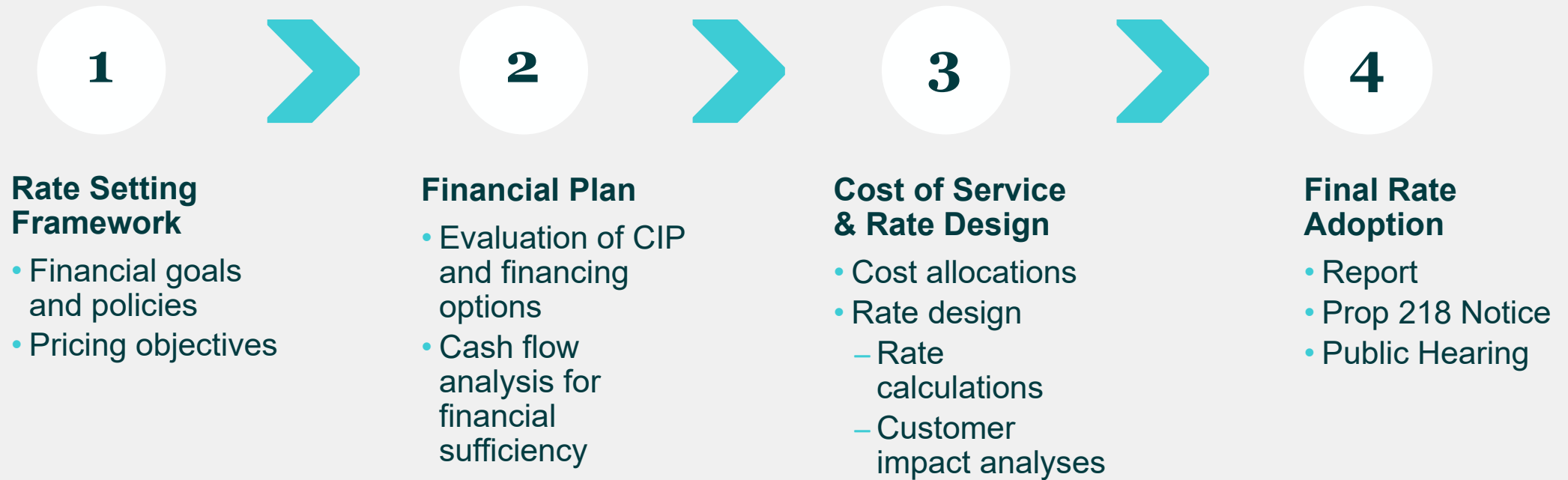
- Financial plan – How much revenue is required on an annual basis to fund O&M, CIP, and meet reserve / coverage ratio requirements?
- Cost of Service – Allocation of cost of providing service to each customer class based on their consumption profile?
- Rate Evaluation – Should we examine a different rate structure?

Rate study can be completed within 6 months to over a year. It all depends on when data is available and what you want to accomplish.

Schedule and Timing

- Develop a detailed schedule based on when you want the rates to be implemented
- Work backwards
- Items to consider:
 - › Are rates being adopted by ordinance or resolution? Do you need a 2nd reading?
 - › When is the Prop 218 Public Hearing? Does the timing of elections matter?
 - › When do we want the report to be finalized? Will the Board/Council receive the report prior to the issuance of the Prop 218 notice?
 - › Who should review the report? The report should be lengthy and detailed.
 - › When will you hold the rate workshop to make sure we are aligned with the Board/Council?
 - Early buy-in is key
 - › When do you expect to have your consultant on board?

Rate Study at a Glance



Step 1: Rate Setting Framework

- Should we update our reserve policy?
- Should we develop policy objectives to evaluate alternative rate structures?

Step 2: Financial Plan

- Do we have a good understanding of future O&M cost increases?
 - › Water supply mix?
 - › Prefunding of OPEB?
 - › PFAS?
 - › CIP schedule? Does the Board understand the capital needs of the system?
- Have the consultant create a presentation that summarizes all the major financial inputs
 - › The consultant does not know if they have the wrong information
- Confirm the baseline revenues by calculating price x quantity
 - › This will confirm they have the right quantities
 - › **This is the most common mistakes made**

Step 3: Cost of Service

- Cost of Service is a zero-sum game
 - › We will have winners and losers
 - › Understand your appetite for change given legal requirements
- Confirm that the proposed rates calculate the right amount of revenue
 - › Proposed rates x quantity
 - › **Again, this is a common mistake**

Step 4: Rate Adoption

- Is the report detailed enough to support your rates if challenged?
- Did you meet all the procedural requirements of Prop 218?
- Are elected officials on board with adopting the rates?

Major Takeaways

1. Develop a detailed schedule – when will the rates be implemented?
 - › Work backwards to determine Public Hearing, Workshop ect . .
 - › Provide ample time for internal review with Executive Staff and Legal Counsel
2. Have the consultant create a presentation that summarizes all the major financial inputs
 - › The consultant does not know if they have the wrong information
3. Confirm the baseline revenues by calculating price X quantity
 - › This will confirm they have the right quantities
4. Confirm that the proposed rates calculate the right amount of revenue
 - › Proposed rates X quantity
5. Detailed report – the report should both examine the logic and math derivation of the rates

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