



Water and Wastewater Rate Adjustments -- A Challenge for Arizona Utilities

A Presentation to the GFOAz Summer Conference

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Introduction



- ◆ Utilities across USA are all facing a similar challenge:
 - ❖ Costs are increasing, and must be passed through to customers
 - ❖ Customers do not want their rates to increase
 - ❖ Councils will not want to increase rates

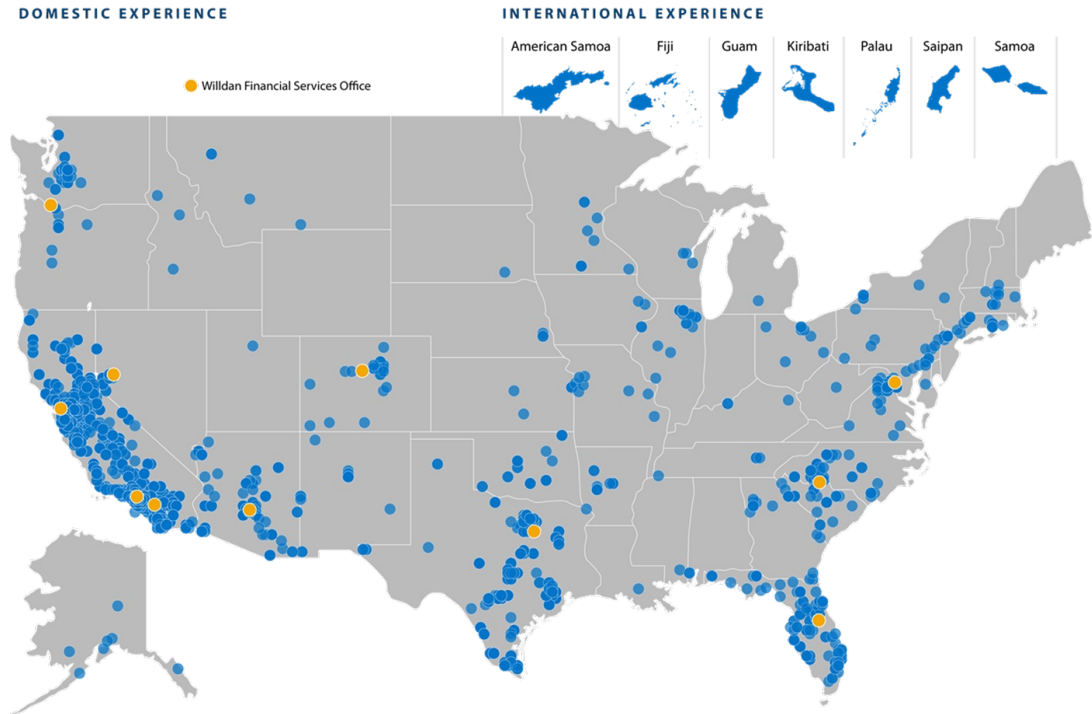


- ◆ Purpose of today's presentation: to discuss how to address and implement rate adjustments, in a manner that gets you the funds you need while maximizing acceptance in the community
- ◆ This is **not** a seminar on ratemaking!

Introduction to Willdan



- ◆ Publicly-traded corporation founded in 1964
- ◆ 3 divisions, 1,500+ employees in offices throughout USA
- ◆ Nationwide leader in rate analysis and development of ratemaking methodology
- ◆ Financial Services Division – 40 + clients in Arizona over past 25 years

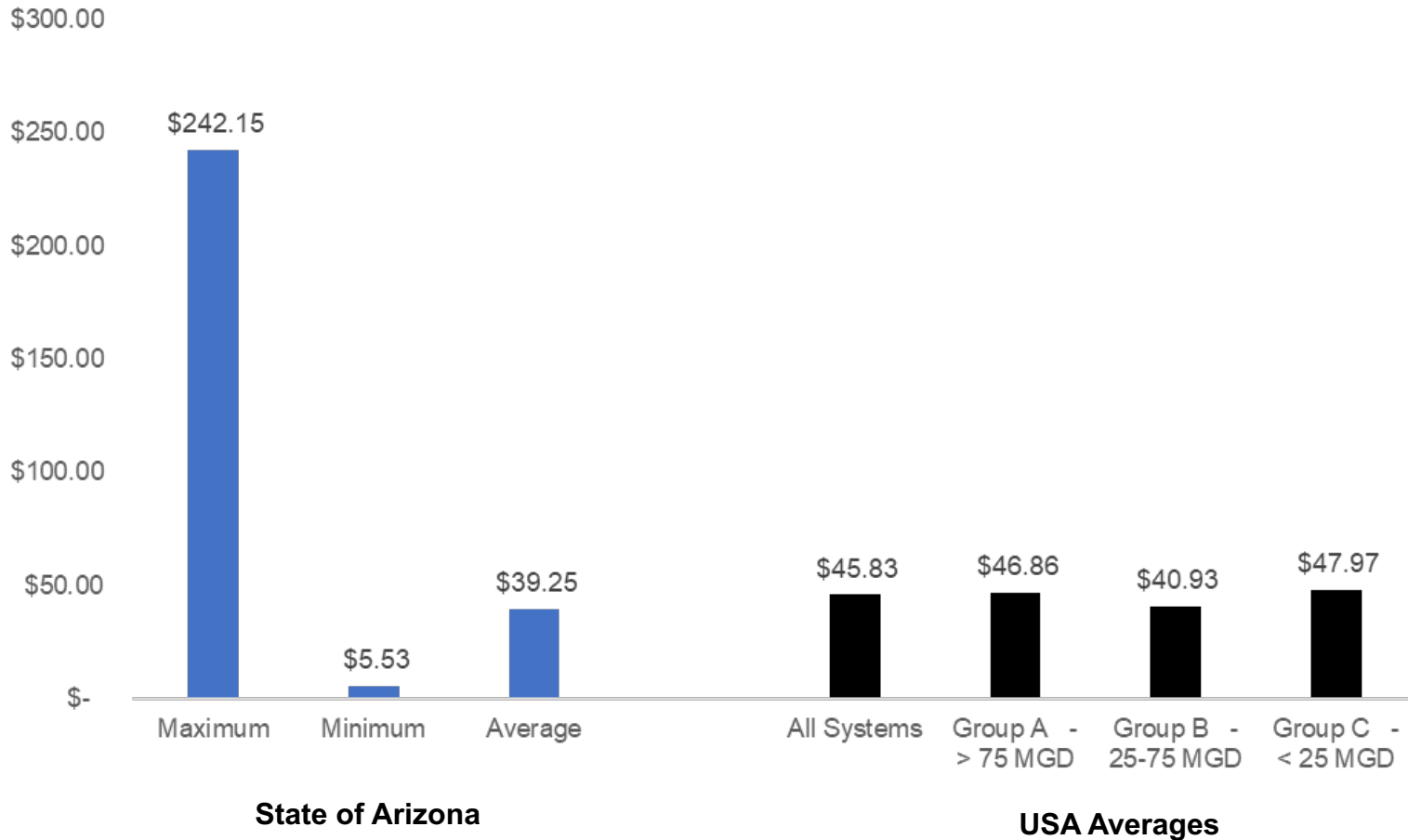


Facts About Water and Wastewater Rates in the 21st Century



- ◆ Average utility has been increasing rates **5-6% per year**, a trend that is expected to continue and may accelerate
- ◆ American Water Works Association (AWWA) forecasts that water and wastewater rates across the U.S. will **triple** in the next 15 years
- ◆ Rate adjustments are primarily due to reasons beyond a utility's direct control – inflation, necessary Capital Improvement Plans, wholesale costs, and other indirect expenses
- ◆ 30-40% of utilities charge rates that **do not cover their costs**

Average Monthly Residential Charge 1,000 CF -- 7,480 Gallons



Common Rate Plan Objectives



- ❖ Recover sufficient revenue to fund operations
- ❖ Fund Capital Improvements needed to maintain quality and reliability of system
- ❖ Maintain required financial ratios
- ❖ To the best extent possible, minimize the impact of any rate adjustments on ratepayers



Challenges and Objectives for Rate Plan Implementation



- ◆ Remember, ratemaking is an “art”, not a “science”
 - ❖ There are hundreds of rate plans that will recover sufficient revenues to fund operations
 - ❖ Utility’s challenge: finding a rate plan that the largest number of customers will find to be just, reasonable and fair
- ◆ Rate increases are as much a **social, community** and **political** decision as they are a financial decision

Challenges and Objectives for Rate Plan Implementation



- ◆ Objective: convince ratepayers and decision-makers to do something **they do not want to do** because it is in the best interest of the utility and the community
 - ❖ There will always be an unpersuadable percentage of the population that will be opposed to any rate increase
 - ❖ But most ratepayers are rational – they will accept the inevitability of a rate adjustment if the reasons are properly explained



Guidelines for Implementing Rate Adjustments



Tip #1 -- Try to make rate adjustment coincide with a major facilities expansion/repair

- ◆ New plant, lines etc. will show ratepayers “where the money is going”
- ◆ Will also allow utility to assert that it is “improving the quality of service”
- ◆ Utility can also assert that it is being compelled to increase rates by lenders/bondholders

Guidelines for Implementing Rate Adjustments



Tip #2 – Prepare a formal study assessing the need to adjust rates

- ◆ Now required to comply with ARS 9-511
- ◆ Will show that Utility has conducted “due diligence” and offers a well-thought out approach
- ◆ Should an outside consultant be used?
 - ❖ Advantages: “disinterested expert”, lends legitimacy and credibility to project, staff may not have time
 - ❖ Disadvantages: some ratepayers don’ t like paying for consultants

Guidelines for Implementing Rate Adjustments



Tip #3 – Make full use of accepted rate design options

- ◆ That phrase again – ratemaking is an art, not a science!
- ◆ Consider special Lifeline rates for lowest income ratepayers
- ◆ Try not to disproportionately impact any customer class
 - ❖ Will lead to perception of unfairness; customers WILL complain!
- ◆ Consider “capacity fees” and other non-rate revenue supplements

Guidelines for Implementing Rate Adjustments



Tip #4 – Consider implementing conservation-based Inverted Block Rates

- ◆ Inverted Block – ratepayers who use higher volumes of water pay higher rates
- ◆ Minimizes rate adjustments on low volume, low income users
- ◆ Promotes conservation of a precious, diminishing natural resource
- ◆ Becoming increasingly popular all over the world

| INVERTED BLOCK RATE EXAMPLE | | |
|-----------------------------|----|-------|
| Base Charge | \$ | 10.00 |
| Per 1,000 Gallons | | |
| 0 -- 10,000 | \$ | 1.00 |
| 10,001 -- 20,000 | \$ | 1.50 |
| 20,001 -- Above | \$ | 2.00 |

Guidelines for Implementing Rate Adjustments



Tip #5 – Implement limited annual adjustments rather than a single major adjustment

- ◆ Small annual increases are generally more acceptable
- ◆ Allows ratepayers time to adjust household budgets to incorporate new rate structure
- ◆ Requires a long-term (5-10) financial plan and fiscal discipline
- ◆ Certain financial strategies can make this doable (i.e. interest-only bonds)

Guidelines for Implementing Rate Adjustments



Tip #6 – Reach out to the public

- ◆ You have compelling reasons for requiring rate adjustments – make sure the public knows them
- ◆ Public involvement reinforces the fact that you care about the impact of rate adjustments on your ratepayers and you are listening to them
- ◆ But try not to let public hearings degenerate into “gripe sessions” about the utility

ARS 9-511 Implementation Guidelines



- ◆ Complete “rate study” and make it publicly available
- ◆ Council must adopt a “Notice of Intent” to adjust rates
- ◆ 60 days after NOI, public hearing on rate plan must be held
- ◆ Council can adopt proposed or revised rate plan after public hearing
- ◆ Rate plan goes into effect 30 days after adoption

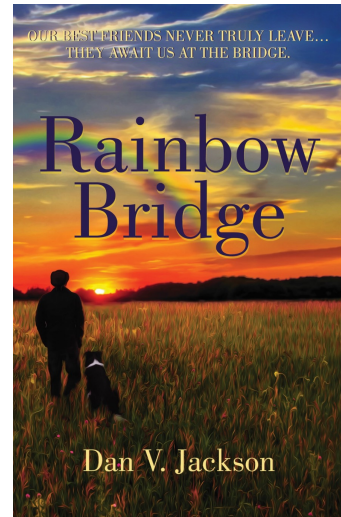


Summary



- ◆ It is inevitable that utilities will have higher costs in the 21st century
- ◆ Prudent utilities must plan for periodic rate adjustments to cover these increased costs
- ◆ How rate adjustments are structured and presented is the key to whether they will be accepted by the public
- ◆ Following the guidelines outlined in this presentation may lead to more acceptance and less controversy in the implementation of rate adjustments





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Questions?