By Carl Brown, President, GettingGreatRates.com

Get Payback With Adequate And Fair Rates

Payback is getting more from an investment than what you invested. Everyone intuitively makes payback estimations before investing money, time, a career or anything else. Some people do some actual math. That is seldom required for most decisions. Whether we use math or just intuition, we all seek positive paybacks, meaning we want more out of our investments than what we put in.

Along with payback calculations, we must consider risk, too. Risk is the likelihood that we will not get back what we hope to get. It even includes the possibility that we will lose our original investment, too. While risk cannot be eliminated, it can be managed.

People can learn these principles and the math behind them and then apply them to any investment. But for now, let's focus on the water utility and the management decisions that boards/councils and staffs must make to turn the water utility into a star performer.

To get the payback of excellent customer service from a water utility, the city council or RWD board members and the staff members of those systems and their ratepayers must collectively invest money, time, expertise and more. What investment vehicle will give the utility the best payback?

No math is required to determine that investments made in sanitary conditions and practices will yield a valuable payback to customers; nobody will die. The customers of water systems want … check that – … the CUSTOMERS demand that water system governing bodies puts their money into these kinds of investments.

Further down the priority list is investments aimed at assuring continuous, uninterrupted service. For individuals, this is mainly a convenience issue. For businesses dependent on water and sewer service, this is a life-blood. Cut off the water and the customer likely has to close for the day. That is a day that customer cannot generate revenue and that's a day that customer cannot make money. It's likely that the customer will even lose money because he/she incurs some costs even when the business is shut down. Allow too many outages for too long and that customer is going to be unforgiving. Or, in worse cases, the water system won't hear from the customer because he/she will have moved away.

Further down the priority list is water that tastes or smells bad but that is otherwise perfectly healthy to drink. This is not an issue at all for a car wash. But it is for restaurants

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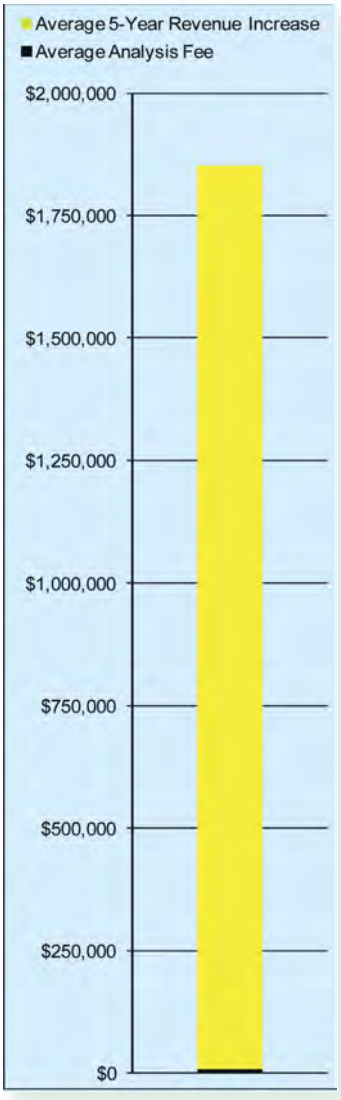

and individuals. The poorer the water tastes or smells, the less the system's customers will support the utility. That can make raising the money needed to achieve even the higher priorities difficult to accomplish.

All of these are great investment opportunities, but they are peanuts compared to… rate analysis. That's right, rate analysis.

While the payback period – the time it takes to get the original investment back – is measured in years for most good investments, the payback period for rate analysis is measured in days, sometimes hours.

- Most systems serving 200 connections will recover their $4,500 or so original investment in rate analyst fees back in a couple of weeks or so of the extra rate and fee revenues the analysis enables them to collect.
- For systems serving 2,000 connections, they will get their $5,500 or so original investment back in a couple of days or so.
- For systems serving 20,000 connections, they will get their $8,500 or so original investment back in perhaps a couple of hours, a day on the long side.

While this sounds like a commercial for the author's firm, another firm that could deliver results, even if its fees were ten times higher, would still be a good investment.

The adjacent bar chart shows the five-year increase in revenues ($1,843,375) enjoyed by the last 11 clients (owning 19 utilities) of the author's firm (not including some legal clients and some large cities that skew the return bar off the top of the page). The thin black line at the bottom of the yellow bar is the average investment ($7,396) that these clients had to make to get this extra revenue. In simple terms, they invested $7,396 and will get back $1,843,375 over the next five years, most of it during the first year.

The resulting average return on investment rate of 24,924 percent is, frankly, somewhat unbelievable. But the math does not lie: $1,843,375 / $7,396 = 24,924 percent.

Granted, if you are good at math and can deftly sort out rate setting issues, you might get half of this increase "for free," disregarding the costs of your time and risks, of course. But it's not the first 50 percent of the extra revenues, or even the first 80 percent that make a utility financially strong. Almost all water utilities are getting that, yet most are not sustainable. It's the last 20 percent that makes a superstar. That is the piece that almost all systems are missing right now. And that is the piece that outside expertise can provide. Strong revenues are wonderful. But it is equally important that rates be collected using a fair rate structure. Without doing some difficult math, you simply can't arrive at such rates. And calculating such rates is not enough. Your ratepayers want proof that they are fair.

Find opportunities to make the water utility strong. Invest first in those that will provide the best return on investment. Then, go right down the list until returns tail off. The ratepayers won't thank the governing body or staff for higher rates. But ratepayers will surely be thankful for the great service those rates enable the system to deliver.

There is a famous negative saying about payback. But this positive one is the one you can really enjoy, "Payback is sweet." Enjoy some payback.

Not a believer in using outside rate setting expertise? Perhaps the 25 percent discount the Kansas RATES Program delivers will convince you. To learn more about the program visit krwa.net/ratereviews/ratereviews.shtml or call KRWA at (785) 336-3760.

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