

The Rate Setting RESULTS Are In!

Utilities need adequate and fair rates. Stating the need is easy. Satisfying the need is hard. Ask yourself these questions:

- ◆ How are adequate and fair rates calculated?
- ◆ Who should do the calculating – me? Someone else?
- ◆ Do I want to take the time to learn what assumptions to make, the process of analysis and how to do the calculations? Do I want to catch flack for recommending rates? If not,

- ◆ How much will it cost to have a specialist do it for me? The nagging worry...
- ◆ Will they take me for a ride? And, the elephant in the room...
- ◆ How much extra revenue will a rate analysis help my utility generate?

“Back in the day” when utility service was cheap, rates were... cheap. Being cheap, rate structure fairness was no big deal. Surprise: it’s 2017! Utilities are not cheap anymore. Now, rate structure matters.

The Kansas Rural Water Association understands this change. They provide rate setting help. But, it’s mostly of the basic kind. Rate analysis is time consuming and KRWA staff have a lot of systems and projects they are actively involved in.

Rate analysis is also a narrow specialization. It takes a long time to learn the principles and how to “do the math.” Unless you do a lot of rate analysis, it’s just not worth the time it takes to learn this discipline.



Success in Ellsworth



Success – we all want it. If you are responsible for a utility, you can measure its success by how well it serves customers: Excellent service + reasonable cost = success. Simple formula.

Over the long-haul, your utility can’t be successful if the rates are too low. And, while customers might not know their rates are not fairly-structured, unfair rates serve them poorly.

Following is a utility rate setting success story. While every utility has negatives in its history, negatives are only used here as a frame of reference. Our best performance is limited by what we have to work with at the time. I don’t judge them. You shouldn’t either.

Now we have the technology and understanding needed to design fairly-structured and adequate rates and do it at low cost. That is what we set out to do here, and it worked.

We all need to accept and maybe commiserate together on the fact that, “public” service does not mean that everything you do is visible to, understood by or appreciated by the public. But, as a public servant, if you do the right thing, at the very least, you’ve done the right thing. If folks appreciate it, just consider that a bonus. Doing the right thing is good governance. So is appropriate rate setting.

Let’s go behind the statistic. The Ellsworth water and wastewater utilities started in a, shall we say, “sub-optimal” place, but they are turning their rates around. Hopefully you have made a similar turn-around. Or if you haven’t, you will see that you can.

Ellsworth is close to the center of Kansas and it’s a bit off the beaten path. And, it is home to some wonderful folks, right next to the Smoky Hill River.

Ellsworth’s situation is like so many small towns in America: Slow growth, if any; slow customer income growth, if any; big system improvement needs; and rates that have not kept up with needs.

Ellsworth came to us in 2014. We analyzed water and sewer rates, recommending big increases for the water rates back then. However, because it was thought at the time there was

“I found working with Carl Brown and the rate analysis process extremely helpful for our city. This process helped guide the City Council in making their decision; I am glad we had the expertise to evaluate all our options with us!”
– Scott Moore, City Manager, Ellsworth, Kan.

Enter, the “RATES Program”

In 2012, the Kansas and Wyoming associations were the first to initiate RATES Programs. North Dakota, New Mexico and Virginia came along the next year. In early 2017, Colorado became the most recent association to join in.

A few years into the program, some of the RATES Programs now have results to show. This article discusses those results.

Table 1 shows some of the over-arching results of the RATES Programs. For example, the average fee for rate analysis of one utility works out to \$6,123. Since the average client has had 1.75 utilities analyzed (usually water and sewer) and included a visit to present results and

Table 1: Over-arching Results of RATES Programs	
\$109,067,878	Projected 5-year Revenue Increase, All Utilities Combined
\$2,225,875	Average Revenue Increase per Utility Analyzed
\$6,123	Average Fee per Utility Analyzed
1.75	Average Number of Utilities Analyzed for Each Client
\$10,715	Average Fee per Client for All Utilities Analyzed
36,353%	Average Five-year Return on Rate Analysis Fee Investment
5.0	Average Days to Payback of the Analyst's Fees

recommendations to their board or council, the total fee came in at \$10,715.

On average, utilities end up raising their overall rates by enough that they recover the fees out of the revenue increase in five days. For the next five years or so, minus five days, the

increased revenues are available to pay for needed improvements and such.

All this averaging might make it seem like fees are not nailed down. They are. We scope each project and charge fees on a lump-sum basis: \$XX for a water rate analysis, \$YY for sewer and \$ZZ for an on-site visit.

little need to improve the sewer system, the analysis model showed the sewer rates could be reduced. (I've seen that phenomenon perhaps a dozen times in 20 years of rate analysis and I never wanted to believe it any of those times. I shouldn't have believed it this time.) Because the city council was already going to hit customers with a big water rate increase, the council opted for a sewer rate decrease to reduce some of the sting.

Surprise! The sewer system needed big improvements in 2014. That became clear in 2016. That brings us to early 2017. Under the direction of a new city administrator who calls it like he sees it, the city re-engaged us to update their rate analyses (sewer was the critical one) with the newly identified capital improvement needs.

The water system may need a new water storage tank. Or, maybe not. It depends on whether the city enters into a supply agreement with a large water district next door. To find the best water supply way forward, the city needed to know what a new tank would cost, on a rates basis.

With the tank, water rates would need to rise by 14.4 percent. Without the tank, they still would need to go up by 9.9 percent. Thus, the tank cost would increase rates by 5.5 percent. Now the city can compare what would happen to rates if it began buying district water. And, the city is now in a good position to bargain with the district on rates because it has the 5.5 percent alternative in its pocket. Knowing this makes for a nice “apples to apples” comparison. That improves decision-making and makes it easier to “sell” decisions to ratepayers.

Sewer rate increase needs are in a whole different ballpark. To cover the costs of a slate of system improvement options, the city organized those improvements into “tiers.” The most critical improvements were placed into Tier 1 and less critical

improvements went into Tiers 2 and 3. Then, rates were calculated to cover each of the tiers of new costs.

If the city does all three tiers of projects, and distributes the initial sewer rate increase of 94 percent over the first three years, and after the third year the city drops back to “only” a ten percent annual increase for another two years, the revenue increase will be as shown in the sidebar table.

That is going to be a tough-sell, but if anyone can do it, I think the new city administrator can. And if they can't get it all in one big project, they can drop back to doing Tier 1 projects and work their way through the priority list as they get the rates, and perhaps grants, to fund more.

It would have been nice not to have given up ground on the sewer rates three years ago, but that is revenue down the drain now. That's OK. Rate setting is not a jet airplane ride and then you get off at great rates. Rather, it is a slow road trip. Ellsworth is taking the scenic route, but they are getting there.



Going in, clients know exactly what their project will cost. The uncommon situation where we charge by the hour is when attorneys are involved (lawsuits).

The five-year average return on investment rate is 36,353 percent! That's right, not single or double digits of percent, but thousands of percent. Beat that, Wall Street!

Table 2 shows electric utilities saw the greatest average rate revenue increases. Electric is often considered the "cash cow" of utilities, but those rates still needed to go up.

Those who represent or work for water systems might be gratified that water rates needed to go up the least. On average, the water utilities were only \$334,000 per year short of the revenues they should have been collecting. But, a third of one-million-dollars per year is a lot to be short!

In Table 3 notice that we analyzed 49 utilities but only had 29 clients many cities and a few districts have us analyze multiple utilities. And, we didn't have 29 different clients. Eight of our clients so far have been repeats. They had us analyze something. After

Table 2: Returns by Utility Type			
Utility Type	Number	Revenue Increase	
		Total	Average
Water	24	\$40,059,063	\$1,669,128
Sewer	19	\$49,447,795	\$2,602,516
Electric	3	\$13,307,281	\$4,435,760
Trash	3	\$6,253,739	\$2,084,580

that experience, they came back and had us analyze again. Sometimes that was to update a previous analysis. Sometimes it was to analyze a different utility.

There are two big picture results we crow about. The hidden one is the improvement in rate structure fairness that rate analysis enabled

Table 3: Basic RATES Program Client Data	
2,839	Average Number of Connections of Each Client
49	Utilities Analyzed
29	Clients (Cities, Water Districts)
8	Repeat Clients
6	Analyses Where a Return on Investment (lawsuits, rate disputes, etc.) Calculation is Not Relevant
4	Analyses Underway as of 9-1-17

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these utilities to achieve. You can't show rate structure fairness in a return on investment calculation. However, it yields an important, if immeasurable, return. It's called "goodwill". Every public servant and utility needs goodwill.

The in-your-face satisfying result is the increase in revenues - \$109 million. That will buy these systems a lot of improvements, equipment repair and replacement, you name it. That enables a lot of good service. Good service buys goodwill. We're double-dipping on the goodwill return.

There are many articles in this issue of *The Kansas Lifeline*, and all the editions that came before it, about a problem and its fix. At the heart of almost every utility problem is (the lack of) money. Money may not make the world "go-round," but it does make

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utilities go-round. By setting up the RATES Program, your Association cut straight to the problem - getting enough money and doing it fairly.

But, they didn't set up the RATES Program and then walk away. They monitor the communications, work, results and fees of the rate analyst (me). If I mess up, they fire me. After 269 rate analyses, to-date, that has yet to happen and my intent is for it to never happen.

Within the next five years your utility will probably need rate analysis. It probably needs a lot more revenue

right now. And, your ratepayers deserve fairly-structured rates. Rate analysis is the best first step to fixing those problems.

So, do this. Talk to KRWA. Tell them your situation. Ask them if they think you need rate analysis. If so, KRWA will put us in contact. We will be glad to get you into great rates and add your "stats" to those above.

But don't worry. To us, you will never be just a set of statistics.

Carl Brown is President of GettingGreatRates.com, which specializes in water, sewer and other utility rate analysis. The firm also serves as the RATES Program rate analyst for the Colorado, Kansas, New Mexico, North Dakota, Virginia and Wyoming rural water associations. Contact: (573) 619-3411; carl1@gettinggreatrates.com



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