

Ratesetting for the Future

Carl Brown
Carl Brown Consulting, LLC

SCRWA Fall Conference
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Where are our rates now?
Where do we want them to be?
How do we get them there?

Note: access this presentation at
<http://carlbrownconsulting.com/SCRWA.pdf>

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The State of the Rates

Soda pop/household -
\$58.92/month for a few gallons

Residential water and sewer -
\$39.50/month for about 5,000 gallons

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The State of the Rates

Residential water and sewer need to go up 50-
100% to \$60-\$80/month for (5,000 gallons),

but

5,000 gallons of bottled water costs about
\$7,000

Our rates have room to grow

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The State of Your Rates

Who has the oldest rates?

- How do your ratepayers feel about that?

Who has the lowest rates?

- How do your ratepayers feel about that?

Which system is going to fail first?

- How will your ratepayers feel about that?

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How do we do Ratesetting now?

1. Lots of procrastination
2. Lots of haggling, arguing, politicking
3. Maybe ask the clerk or accountant what it cost last year to provide service
4. Set rates at that or a little higher or lower, all the while
5. Pay little if any attention to future needs

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Our Systems Should:

Be run like a business - must cash-flow properly

Be self-sustaining and success must be nearly guaranteed by:

- Maintaining strong reserves
- Good staff
- Good equipment
- Good practices

Our Rates Should:

Enable good business practices to happen

Ratesetting Two-step

1. Comprehensive rate analysis and adjustment
2. Each following year do inflationary rate adjustments (this is do-it-yourself step)

Eventually start over with comprehensive rate analysis

Definition

User Charge Analysis: A thorough examination of a system's current rates, current financial position and future financial prospects that informs decision-makers on how and when to adjust rates.

Step 1. Comprehensive Analysis

Analyze operations, CIP needs, expenses, growth, everything

Improve operations/cut expenses

Analyze rates

Build support for new rates/propose adjustments

Adjust rates, probably big-time

Track results

If you Want to do Your own Analysis

- Big Chief tablet, pencil, calculator
- EPA guide "Setting Small Drinking Water System Rates for a Sustainable Future" - visit tools page to access
- Some associations, agencies, etc. have rate setting tools

If you Want to do Your own Analysis

- Missouri DNR Rate Assist program
<http://www.dnr.mo.gov/env/wpp/srf/cw-ucs-methodology.xls>
- "Show-me Ratemaker" available from National Drinking Water Clearinghouse - to access visit
<http://carlbrownconsulting.com/Show-me%20Ratemaker.htm>

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If you Want to do Your own Analysis

- GettingGreatRatesNow (coming in 2008) -e-mail me, ask to be put on notification list when it's ready
- Getting Great Rates Guide (coming in 2008) -e-mail me

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If you Want to Hire it Done

Get:

- "How to get Great Rates Guide"
<http://carlbrownconsulting.com/HowtogetGreatRatesGuide.pdf>
- "How to Get a Rate Study Guide"
<http://carlbrownconsulting.com/HowtogetaRateStudy.htm>

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Step 2. Financial Examinations and Adjustments Between Comprehensive Analyses

Calculate financial performance indicators (operating and coverage ratios) and compare with those predicted in analysis

Adjust rates every year on an inflationary basis to track with the analysis

Get financial statement template at
<http://carlbrownconsulting.com/GettingGreatRatesLater.xls>

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Learn to set Rates Properly

Watch for SCRWA rate setting workshop
Probably next March in Columbia

ATTEND!

Tell your management and board/council to
ATTEND!

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Act Swiftly but Effectively

Get:

A model RFQ
<http://carlbrownconsulting.com/RFQModel.doc>

Other guides and resources
<http://carlbrownconsulting.com/>

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Operating Ratio

$$\frac{\text{Total Operating Income}}{\text{Total Operating Expenses*}}$$

*Not including debt

Operating Ratio

$$\frac{\$150,000 \text{ (Operating Income)}}{\$100,000 \text{ (Operating Expenses)}} = 1.50 \text{ Operating Ratio}$$

Coverage Ratio

$$\frac{\text{Income Available for Debt Service*}}{\text{Annual Debt Service Expenses}}$$

*Annual income minus operating costs and minus funds that are dedicated to a specific use.

Coverage Ratio

$$\frac{\$12,500 \text{ Available for Debt}}{\$10,000 \text{ Annual Debt Payment}} = 1.25 \text{ Coverage Ratio}$$

Model financial statement
calculates these ratios and
current position

[http://carlbrownconsulting.com/
GettingGreatRatesLater.xls](http://carlbrownconsulting.com/GettingGreatRatesLater.xls)

Summary

Utilities are businesses - need to cash-flow right
Water and sewer are sorely under-funded now
but can change

Need to reset rates in two steps

1. Initial comprehensive analysis
2. Inflationary increases

Do these things and it will all turn out fine...
probably

Questions?

Carl Brown Consulting, LLC
(573) 619-3411

carlbrown@mchsi.com

<http://carlbrownconsulting.com/>

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Postscript

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What User Charge Analysis Does

Shows you current and projected fund balances

Helps you develop new rates

Helps in grant and loan applications

Helps schedule funds needed for system repair and replacement (R & R)

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What User Charge Analysis Does

Shows you current and future financial indicators:

- affordability index, operating ratio, coverage ratio

Demonstrates the financial effects of:

- fixed and variable costs, R & R and capital improvement costs, interest and inflation rates, adjusting user charge rates, so on

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What User Charge Analysis Does

Estimates water loss or I&I costs

Gives you "pictures" for management decisions and to "sell" your ratepayers

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Rate Setting and Asset Management Resources

<http://carlbrownconsulting.com/Tools.htm>

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Common Mistakes in Getting a Rate Analyst

1. Not buying, and not adjusting rates at all
2. Thinking you can do comprehensive study cheaper (and better) than specialist (like investing in stocks without doing research or hiring investment advisor)
3. Not talking to people - this is relationship game

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Common Mistakes in Getting a Rate Analyst

4. Procrastinating, taking too much time
5. Over-specifying or over-controlling the analyst
6. Using engineering RFPQ methods
7. Not requiring money-back, full satisfaction guarantee
8. Not checking references

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Affordability Index

The percentage of annual median household income (AMHI) needed to pay for a utility service (water, sewer, etc.)

For water or sewer, it is based on 5,000 gallons/month.

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Affordability Index

Average Monthly 5,000 Gallon Residential Water or Sewer Bill

Monthly Median Household Income

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Affordability Index

$\frac{\$20/\text{month water bill}}{\$2,000/\text{month MHI}} = 1.0\% \text{ AI}$

\$2,000/month MHI

National average is about 1%
CDBG and USDA looking for user fees >1.5 % of the average AMHI before they will give grants

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Situation:

End of year, paid out \$100,000 in operating costs. How much should be left in operating account?

At least \$25,000 (25%)
Maybe \$50,000 (50%) or more
Depends

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Operating Ratio

1.0 is "break-even"

Less and you're operating in the red

Responsible ORs:

- >1.15 -- for larger systems (1,000+ connections)
- >1.30 -- for smaller systems (<1,000 connections)
- >1.35 -- why?

Easier way to judge

Figure your "operating ratio"
(A measure of your ability to
pay operating costs)

Situation:

End of year, paid out \$10,000
in loan payments. How much
should be left in debt service
account?

Whatever your loan agreement says,
or
\$2,500 (25%) or more, whichever is
greater

Coverage Ratio

Less than 1.0, you can't pay your debt

> 1.25 is a common target

Strong OR almost always gives you strong
CR

Lenders insist on strong coverage ratio
(They're soooo inflexible about getting
paid back)

Easier way to judge

Figure your "debt coverage ratio"
(A measure of your ability to pay
debt costs)