



# **Drip Drop Drought Rates**

## ***It's Coming, Be Financially Prepared***

By Alex Handlers 02/21/14



**BARTLE WELLS ASSOCIATES**  
Independent Public Finance Advisors

# Overview

- 💧 **Financial Impacts of a Drought**
- 💧 **What You Can Do**
- 💧 **Drought Rates**
- 💧 **Legal Issues**





# FINANCIAL IMPACTS OF DROUGHT



# Financial Impacts of Drought

## REVENUE IMPACTS

Revenues



- Reduced water sales = reduced revenues
- More cutback at higher rate tiers = more revenue loss
  - Contrary to expectations, lower tiers may have higher % cutback
- To encourage conservation, many agencies have rate structures that disproportionately recover costs from variable rates
  - Double-edged sword
    - The rate structure encourages conservation, particularly for high use
    - Also leaves agency vulnerable to disproportionately large revenue losses

# Financial Impacts of Drought

## EXPENSE IMPACTS

Expenses



- **Higher costs of water supply**
  - Wholesale rate increases (due to reduced deliveries)
  - Potential wholesale penalties or surcharges (e.g. SFPUC drought rates up to 10x base rate in prior drought)
  - Ag districts more reliant on more-expensive groundwater
- **Expenses mitigated by reduced volume of water purchases**
- **Increased conservation program expenses**

# Impact on Rates

- 💧 Reduced revenues + potentially increased expenses = need for rate increases
  - Support financial stability
  - Reduce water demand
- 💧 Develop a financial model to evaluate impacts & rates
- 💧 Customers who conserve may face higher rates, but not necessarily higher bills

$$\text{Rates} \uparrow + \text{Use} \downarrow = \text{Water Bill} \rightarrow$$

# What Can You Do

- 💧 **Build & maintain fund reserves to provide financial buffer**
- 💧 **Develop drought response plan in advance**
  - Communications & outreach
  - Customer support & rebates/incentives
  - Water use restrictions
  - Water supply offset program for new development (if applicable)
  - Drought rate response (*rates are only one of many tools*)
- 💧 **Reduce potable demand prior to drought**
  - Ongoing conservation program & rates
  - Recycled water; offset potable demand
- 💧 **Supplemental water supply & water banking**



# DROUGHT RATES





# Drought Rate Possibilities

- 💧 Increase volumetric rates
  - E.g. Higher increases for higher tiers
- 💧 Reduce tier breakpoints
  - Less water use billed in each tier
  - Customers hit higher tiers sooner
- 💧 Increase fixed charges
  - More revenue stability

# Drought Rate Possibilities

- 💧 **Water budgets (financial rationing)**
  - Form of inclining tiers with tier breakpoints customized to characteristics of each account, for example:
    - Tier 1 based on indoor use & number of people
    - Tier 2 based on lot size, area of irrigation (evapotrans)
    - Tiers 3 + for excess use
  - Can result in different bills for neighbors using same amount of water
  - No need to make it overly complex
  - Use per tier can be reduced or rates increased in drought

# Drought Rate Possibilities

- 💧 **Surcharges based on historical use**
  - E.g. Surcharge for use over 80% of historical use
  - Customers who previously conserved shouldn't be penalized
- 💧 **Excess use penalties (not subject to Prop. 218)**
- 💧 **Different approaches may be more appropriate for different customer classes**
- 💧 **No single correct answer**
- 💧 **Balance of competing objectives**

# Implementation

- 💧 Adopt drought rates via Prop. 218 process when adopting regular rate increases
  - Provides flexibility to implement when needed
  - *Automatic wholesale rate pass-through (AB3030)*
- 💧 Penalties not subject to Prop. 218
- 💧 Phase in rate response as a drought develops
  - E.g. Coinciding with UWMP drought stages
- 💧 Phase out as water use gradually returns to normal



# LEGAL ISSUES



# Constitutional Mandates

- 💧 **Article X, Section 2 of the California Constitution**
  - **Requires public agencies to maximize the beneficial use of water, prevent waste, and encourage conservation**
  - **Tiered rates historically justified as consistent with Article X**

# Constitutional Mandates

## 💧 Article XIID, Section 6 (Prop. 218)

- Revenues cannot exceed cost of providing service
- Revenues can only be used for the purpose collected
- Charge shall not exceed the proportional cost of the service attributable to the parcel
- Charge can only be imposed if service is used by, or is immediately available, to the property
- No charge may be imposed for general governmental services available to the public at large (police/fire etc.)

# **Evolving Interpretations of 218**

- 💧 **Appellate court decision in 2011 (Palmdale)**
  - Rates were not equitable between customer classes
  - Agencies must demonstrate, satisfactory to a court's independent judgment, that rates meet the proportionality requirement of Section 6
- 💧 **Superior court decision in 2013 (San Juan Capistrano)**
  - Tiered rates must reflect cost basis (no administrative record supported a cost-nexus for each tier)
  - Potable water rates cannot fund recycled water system costs
  - Under appeal, not currently a precedent



# Prop. 218 Immunization

- 💧 Important to develop administrative record supporting rates
  - Show how rates are developed & costs are allocated
  - Reasonable equity between customer classes
- 💧 Tiered rates can be supported by a cost allocation to each tier
  - Higher water supply costs (if multiple sources)
  - Conservation program costs
  - Capital costs associated with peak demands
  - Cost for supplemental supply and reliability projects



**“By failing to prepare, you are preparing to fail.”**

**- Benjamin Franklin**

