Drip Drop Drought Rates

It’s Coming, Be Financially Prepared

By Alex Handlers  02/21/14
Overview

- Financial Impacts of a Drought
- What You Can Do
- Drought Rates
- Legal Issues
FINANCIAL IMPACTS OF DROUGHT
Financial Impacts of Drought

REVENUE IMPACTS

- 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 disproportionally 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

- 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

Rates $\uparrow$ + Use $\downarrow$ = Water Bill
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 XIIIId, 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