





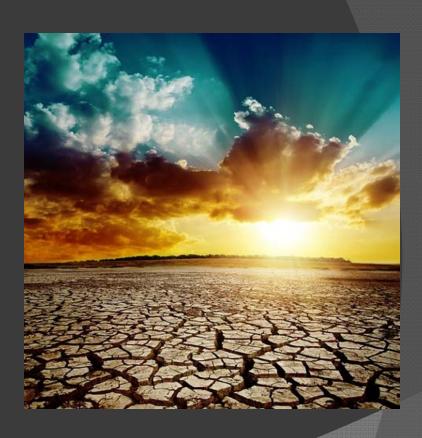
Drip Drop Drought Rates It's Coming, Be Financially Prepared

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

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 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

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



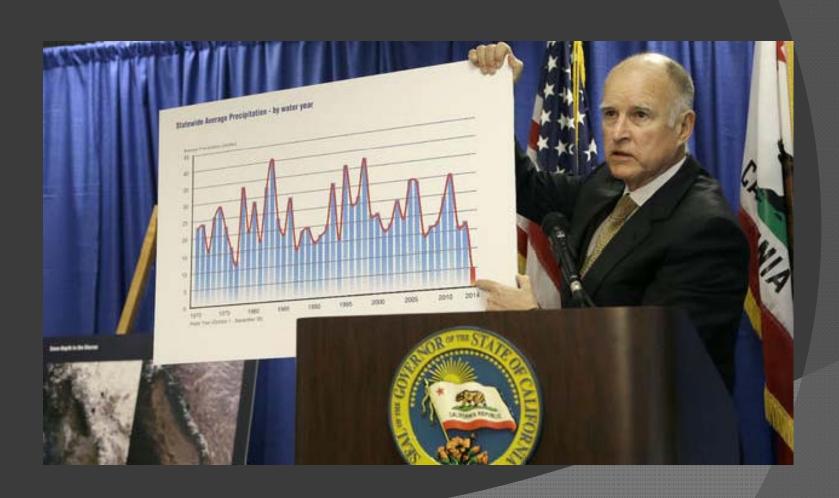
Impact on Rates

- 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

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 XIIID, 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

