Washington State Department of HEALTH

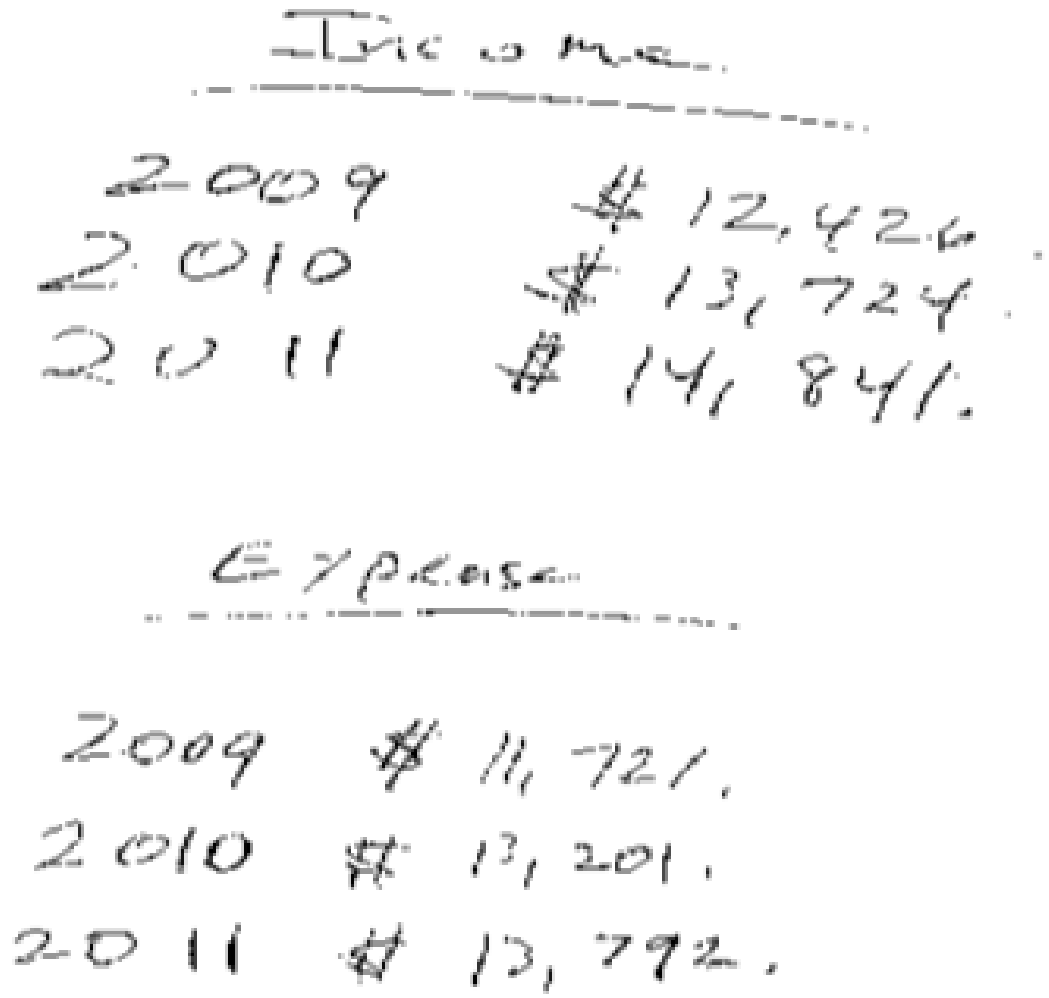
CHALLENGES OF ESTABLISHING ADEQUATE WATER SYSTEM RATES

Office of Drinking Water

Discussion Points

- Historical financial statements used for budgeting.
- Repayment source; G.O. vs revenue debt. What is the source for future loan repayments (informational)
- Types of acceptable statements for budgeting purposes and loan approvals
- Budgets are based on past performance
- Budget examples
- Collateral?
- The bottom line

Financial Statements



GO or Revenue Certification

DRINKING WATER STATE REVOLVING FUND (DWSRF)

Loan Security for Local Governments Only

The LOCAL GOVERNMENT must select **one** of the following options for securing repayment of the loan. **Please initial the appropriate option**.

1. _____ **General Obligation:**

This loan is a general obligation of the LOCAL GOVERNMENT.

OR

2. _____ **Revenue Obligation:**

This Contract is a revenue obligation of the CONTRACTOR payable solely from the net revenue of the WATER system. Payments shall be made from the net revenue of the utility after the payment of the principal and interest on any revenue bonds, notes, warrants or other obligations of the utility having a lien on that net revenue. As used here, "net revenue" means gross revenue minus expenses of maintenance and operations. This option may be used only if the entire project is a domestic water, sanitary sewer, storm sewer or solid waste utility project.

GO Debt (Municipal)

- **General obligation (GO) debt** is secured by property tax revenue. The municipality pledges its tax revenues unconditionally to pay the interest and principal on the debt as it matures. If the debt is in the form of a bond, the bond owners have a legal claim on all the general income of the jurisdiction if a default occurs. The limitations on general obligation indebtedness are provided for in chapter 39.36 RCW. (2.5%)

Revenue Debt (Operating income)

- **Revenue debt** is different from GO debt in its method of repayment.
  - Unlike GO debt, which relies on taxation, revenue debt is repaid from cash flow by the specific water revenues minus expenses generated by the applicant.

Acceptable Financials

- BARS Reporting (municipal)
- S.A.O. Reports
- Tax Returns (non-municipal, HOA's) Form 990 postcard, 990 EZ, 990 standard
- CPA prepared or audited statements (non-municipal)
- Internally prepared QuickBooks statements on a case-by-case basis (ask questions)

Budgeting Based on Past Performance

- Three to five years financial statements
- Looking for trends in analysis
- Historic increases/decreases in operating revenue/expense
- Current water rates vs potential future rate increases

Example One statements

	Connec-tions	Revenue	Expense	Outstanding Debt	Liquidity	Total Assets
2024	150	$833,372	$722,864	$948,255	$212,466	$5,262,498
2024	*Interim 9-month	*$141,776	$59,372	$948,255	$92.840	$4,452,717
2023		$259,952	$312,304		$145,192	$3,736,981
2022		$200,938	$264,137		$208,391	$3,283,692
2021		$210,115	$222,518		$220,194	$3,070,595

*Interim statement

Example Two statements

	Connec-tions	Revenue	Expense	Outstanding Debt	Liquidity	Total Assets
2023	59	$41,906	$60,141	$38,411	$10,872	$10,872
2022		$39,782	$47,284	$0.0	$21,423	$21,423
2021		$38,886	$44,953	$0.0	$28,364	$28,364
2020		N/A	N/A	N/A	N/A	N/A

ERU total/Rate Increase: 59 existing connections that pay a current average monthly billing of 72.67. This loan adds an additional $124.91 cost to the users per month

Example Three statements

	Connec-tions	Revenue	Expense	Outstanding Debt	Liquidity	Total Assets
2023	34,166	$34,366,858	$20,195,832	$20,097107	$3,911,558	$12,717,556
2022		$29,357,681	$17,880,867	$21,245,575	$2,128,430	$12,661,678
2021		$25,066,412	$16,002,397	$21,577,041	$1,343,265	$12,194,701
2020	N/A	N/A	N/A	N/A	N/A	N/A

Collateral

- UCC Filing statement on Inventory, Equipment and A/R.
- Deeds of Trust
- Water Rights (?)
- Why take collateral?
- “We don’t want to be in the water business”

The Bottom Line

- GENERAL RULE: If the financial analysis indicates marginal or negative cash flows for any of the years submitted in the application, staff will meet with the applicant to discuss appropriate measures to resolve financial risks including providing a resolution to increase revenues or providing a deed of trust on property or other forms of loan collateral. If these financial risks cannot be mitigated or reduced, or the applicant has multiple consecutive years of net operating losses, the DWSRF will recommend bypassing the loan based on managerial and financial capacity deficits.

Questions?

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What do Rates Have to do With it?

- Water systems MUST generate sufficient revenue for
  - O+M of the system
  - Replacement of capital assets as they wear out and the acquisition of new assets to meet changes in regulatory requirements and customer demand
  - Financial security of the water system during emergencies and unexpected changes in revenue

Impact of Rates on Revenue and Budget

- How are rates and associated assessments being considered in developing capital plan and associated budget?
- Are rate revenues steady or is the system having difficulty collecting rates?
- Has the system clearly split out water system revenue and expenditures from other revenue sources and expenditures.
- Maintenance of good financial records is vital

Rate Setting

- Best practice
  - Analyze and understand future capital needs
  - Minimize costs and identify efficiencies
  - Develop multiple rate alternatives to determine the design that best fits the community
- Incremental adjustments tied to annual budget may not capture current and future system expenses and does not adequately capture efficiencies that can be achieved in operations over time.

Rates 101

- Rates reflect the fixed costs of operating a water or wastewater system
- Fixed Expenses
  - Long term debt
  - Reserve funding
  - Administrative
  - Operator salaries
  - Others
- Variable Expenses (directly related to production of water)
  - Chemicals and equipment
  - Utility charges
  - Contracted repairs
  - Others

Types of Rates

- Uniform Flat Rate
- Single Block Rate
- Decreasing Block Rate
- Increasing Block Rate
- Conservation Pricing

NOTE: All involve the utilization of base rates

- Base Rate: a charge per billing period that occurs regardless of usage
  - Can also be coordinated with connection or meter fees to pay for the base capacity development and operation of the system

Uniform Flat Rate

- Customers pay a flat rate regardless of amount of water used
  - Often found in unmetered systems and HOAs
  - EX: $30 month for unlimited use
- Advantages
  - No meter expense
  - Easy to calculate
  - Easy to bill
- Disadvantages
  - No accuracy of billing tied to actual use
  - Rewards high consumption
  - Can hamper leak detection and repair
  - Does not promote conservation

Single Block Rate

- Customers pay a constant flow rate ($ per gal) regardless of amount used
  - Often coupled with a base rate
- Advantages
  - Easy to calculate
  - Easy to bill and roughly direct to amount used
  - Potential to promote conservation if priced appropriately
- Disadvantages
  - If priced inappropriately, no disincentive to high usage

Decreasing Block Rate

- Flow rate declines as usage increases
  - Each successive block is less expensive
- Advantages
  - Attractive to large volume users (commercial businesses or agriculture)
- Disadvantages
  - At higher blocks, rate may be less than cost of production
  - Low volume users often subsidize high volume
  - Does not promote conservation

Increasing Block Rate

- Flow rate increases as amount used increases
  - Each successive block is more expensive
- Advantages
  - Promotes water conservation
  - Provides water for essential use at a reasonable cost while charging a premium for discretionary uses
- Disadvantages
  - Often requires different structures for industrial or commercial users v. residential
  - Requires more precise metering
  - Larger households can pay more even if their per capita use is lower

Conservation Pricing

- Price water to reflect actual scarcity and environmental costs, rather than just utility costs
  - Tiered pricing
  - Allows conservation gains to be "sold back" through rebates
- Advantages
  - Allows for more accurate reflection of fixed costs
  - Provides incentives for regional solutions
  - Reflects scarcity value
- Disadvantages
  - High costs in areas of scarcity
  - How to reflect residential v. industrial use